

## Technology Spotlight

# The Future of Revenue Recognition

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## The Bottom Line

- On May 28, 2014, the FASB and IASB issued their final standard on revenue from contracts with customers. The standard, issued as [ASU 2014-09](#)<sup>1</sup> by the FASB and as IFRS 15<sup>2</sup> by the IASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance.<sup>3</sup>
- Under the ASU, goods or services in a contract that are “highly dependent on, or highly interrelated with, other goods or services promised in the contract” or that “significantly modify or customize” each other are not considered distinct performance obligations. Applying these criteria may require significant judgment.
- Revenue recognition in software arrangements will no longer be deferred if vendor-specific objective evidence (VSOE) of fair value is not established for undelivered goods or services, since revenue is allocated to all performance obligations on the basis of an estimated stand-alone selling price.
- When contract consideration is variable, revenue should be recognized only to the extent that it is probable that a significant revenue reversal will not occur. In arrangements involving sales- or usage-based licenses of intellectual property, revenue is recognized only when it is determinable (i.e., when the sale or usage has occurred).
- Entities that license software to customers may need to determine whether they provide a “right to use the entity’s intellectual property as it exists at a point in time” (a “static” license for which control is transferred at a point in time) or “access to the entity’s intellectual property as it exists throughout the license period” (a “dynamic” license for which control is transferred over time).
- Since the new standard requires significantly more extensive disclosures, technology entities may need to modify their systems and processes to gather information about contracts with customers that is not otherwise readily available.

The new revenue standard supersedes most current revenue recognition guidance, including industry-specific guidance.

<sup>1</sup> FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*.

<sup>2</sup> IFRS 15, *Revenue From Contracts With Customers*.

<sup>3</sup> The SEC has indicated that it plans to review and update the revenue recognition guidance in SEC Staff Accounting Bulletin (SAB) Topic 13, “Revenue Recognition,” when the ASU is issued. The extent to which the ASU’s guidance will affect a public entity will depend on whether the SEC removes or amends the guidance in SAB Topic 13 to be consistent with the new revenue standard.

# Beyond the Bottom Line

This *Technology Spotlight* discusses the new revenue model and highlights key accounting issues and potential challenges for technology entities that account for revenue under U.S. GAAP. For additional information about the new standard, see Deloitte's May 28, 2014, [Heads Up](#).

## Background

The goals of the ASU are to clarify and converge the revenue recognition principles under U.S. GAAP and IFRSs while (1) streamlining, and removing inconsistencies from, revenue recognition requirements; (2) providing "a more robust framework for addressing revenue issues"; (3) making revenue recognition practices more comparable; and (4) increasing the usefulness of disclosures. The ASU states that the core principle for revenue recognition is that an "entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."

The ASU indicates that an entity should perform the following five steps in recognizing revenue:

- "Identify the contract(s) with a customer" (step 1).
- "Identify the performance obligations in the contract" (step 2).
- "Determine the transaction price" (step 3).
- "Allocate the transaction price to the performance obligations in the contract" (step 4).
- "Recognize revenue when (or as) the entity satisfies a performance obligation" (step 5).

As a result of the ASU, entities will need to comprehensively reassess their current revenue accounting and determine whether changes are necessary.

### Thinking It Through

As a result of the ASU, entities will need to comprehensively reassess their current revenue accounting and determine whether changes are necessary. In addition, the ASU requires significantly expanded disclosures about revenue recognition, including both quantitative and qualitative information about (1) the amount, timing, and uncertainty of revenue (and related cash flows) from contracts with customers; (2) the judgment, and changes in judgment, used in applying the revenue model; and (3) the assets recognized from costs to obtain or fulfill a contract with a customer.

## Key Accounting Issues

### Identifying the Contract With the Customer (Step 1)

A contract can be written, verbal, or implied; however, the ASU applies to a contract only if all of the following criteria are met:

- "The parties to the contract have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their respective obligations."
- "The entity can identify each party's rights regarding the goods or services to be transferred."
- "The entity can identify the payment terms for the goods or services to be transferred."
- "The contract has commercial substance (that is, the risk, timing, or amount of the entity's future cash flows is expected to change as a result of the contract)."

- “It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.”<sup>4</sup>

If a contract does not meet these criteria at contract inception, an entity must continue to reassess the criteria to determine whether they are subsequently met.

### Thinking It Through

Although technology entities may currently consider certain of these criteria when determining whether persuasive evidence of an arrangement exists under ASC 985-605-25<sup>5</sup> or SAB Topic 13.A (codified in ASC 605-10-599-1), entities that currently account for contracts under ASC 985-605 or ASC 605 may be precluded from applying the remaining steps of the ASU unless all of the requirements mentioned above are met.

### Collectibility

The ASU establishes a collectibility threshold under which an entity must determine whether “[i]t is probable that the entity will collect the consideration to which it will be entitled.” If the threshold is not met, the entity is precluded from applying the remaining steps in the ASU and recognizing revenue until it is probable<sup>6</sup> that the consideration will be collected. Any amounts received before collectibility is considered probable would be recorded as revenue only if the consideration received is nonrefundable and either (1) all performance obligations in the contract have been satisfied and substantially all of the promised consideration has been received or (2) the contract has been terminated or canceled. If those conditions are not met, any consideration received would be recognized as a liability.

For contracts that have a variable sales price (including price concessions), entities would first estimate the consideration due under the contract (see [Determining the Transaction Price \(Step 3\)](#) below) and would then apply the collectibility threshold to the estimated transaction price.

### Thinking It Through

While the probability threshold is unchanged from current U.S. GAAP, this requirement may change current practice. Technology entities typically assess collectibility under SAB Topic 13.A or ASC 985-605 and defer revenue recognition until cash is received. The new standard could potentially require further deferral even when nonrefundable cash has been received.

In addition, technology entities often offer extended payment terms (see [Significant Financing Component](#) below for additional information). In certain cases (e.g., when the contract is with a financially stressed customer), entities may be unable to assert that the collectibility of the total estimated transaction price is probable. In such situations, the contract would not be accounted for under the ASU’s remaining steps until collectibility is probable. As mentioned above, any amounts that are received before the probability threshold is met would usually be recorded as a liability unless the amount is nonrefundable and either (1) all performance obligations under the contract have been satisfied and substantially all of the consideration has been received or (2) the contract has been canceled, in which case the amount would be recognized as revenue.

The ASU establishes a collectibility threshold under which an entity must determine whether “[i]t is probable that the entity will collect the consideration to which it will be entitled.”

<sup>4</sup> In assessing whether it is probable that the entity will collect the consideration, an entity would consider only the customer’s ability and intention to pay that amount of consideration when it is due. The amount of consideration evaluated may be less than the price stated in the contract if the consideration is variable because the entity may offer price concessions (see step 3 on determining the transaction price).

<sup>5</sup> For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte’s “[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#).”

<sup>6</sup> Under U.S. GAAP, “probable” refers to a “future event or events [that] are likely to occur.” This threshold is considered higher than “probable” as used in IFRSs, under which the term means “more likely than not.”

If the probability threshold is subsequently met, all remaining revenue related to satisfied performance obligations, including revenue that had been deferred, would be recognized. This treatment may differ from that of current U.S. GAAP, under which extended payment terms often result in revenue recognition only when each payment becomes due in the absence of historical experience indicating that the entity typically collects all amounts without providing any concessions.

### **Contract Combination**

Although entities would most likely apply the ASU to a single contract, in certain circumstances they may be required to combine a group of contracts and evaluate them as if they were a single contract. Under the ASU, an entity must combine contracts entered into at or near the same time with the same customer (or related parties of the customer) if one or more of the following criteria are met:

- “The contracts are negotiated as a package with a single commercial objective.”
- “The amount of consideration to be paid in one contract depends on the price or performance of the other contract.”
- “The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation [as defined].”

Although entities would most likely apply the ASU to a single contract, in certain circumstances they may be required to combine a group of contracts and evaluate them as if they were a single contract.

### **Thinking It Through**

Since technology entities commonly enter into multiple agreements with the same customer within a short period, they need to consider whether certain contracts should be combined for revenue recognition purposes. Although the contract combination requirements mentioned above are similar to certain aspects of existing guidance (such as the factors listed in ASC 985-605-55-4 for software arrangements), entities may need to reevaluate their conclusions under the ASU to determine whether changes in contract combinations may be necessary.

### **Contract Modifications**

The ASU also provides guidance on accounting for “approved” modifications to contracts with customers. The approval of a contract modification can be in writing, by oral agreement, or implied by customary business practices, and a contract modification is considered approved when it creates new or changes existing enforceable rights or obligations. A contract modification must be accounted for as a separate contract when (1) it results in a change in contract scope because of additional promised “distinct” goods or services (see [Identifying the Performance Obligations \(Step 2\)](#) below) and (2) the additional consideration reflects the entity’s stand-alone selling price of those additional promised goods or services (including any appropriate adjustments to reflect the circumstances of the contract). If an entity determines that the modification is not a separate contract, the entity would, depending on the specific facts and circumstances of the modified contract, apply one of the following methods:

- *Treatment as a new contract (prospective method)* — If the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification, the remaining transaction price<sup>7</sup> and any additional consideration promised as a result of the modification are allocated to the remaining performance obligations in the modified contract.

<sup>7</sup> Under the revenue model, the transaction price available for allocation would include the “consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and that had not been recognized as revenue.”

- *Cumulative catch-up adjustment (retrospective method)* — If the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied as of the date of the contract modification, the performance obligation’s measure of progress toward completion is updated, which may result in a cumulative catch-up of revenue.
- A combination of these two methods (if both of the above conditions exist).

### Thinking It Through

Technology entities often enter into agreements that may amend, terminate, or otherwise change the provisions of the master or original agreement (e.g., side agreements). These entities may need to use judgment in determining whether such agreements represent approved modifications and whether each modification should be accounted for as a separate contract or dealt with under the prospective or retrospective method outlined above. The accounting for such modifications under the ASU may differ from that under current U.S. GAAP.

## Identifying the Performance Obligations (Step 2)

The ASU provides guidance on evaluating the promised “goods or services”<sup>8</sup> in a contract to determine each performance obligation (i.e., the unit of account). A performance obligation is each promise to transfer either of the following to a customer:

- “A good or service (or a bundle of goods or services) that is distinct.”
- “A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.”<sup>9</sup>

A promised good or service is distinct (and therefore a performance obligation) if both of the following criteria are met:

- *Capable of being distinct* — “The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.”
- *Distinct within the context of the contract* — “The entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.” The ASU provides the following indicators for evaluating whether a promised good or service is separable from other promises in a contract:
  - “The entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract . . . . In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.”
  - “The good or service does not significantly modify or customize another good or service promised in the contract.”
  - “The good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, . . . a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services.”

The ASU provides guidance on evaluating the promised “goods or services” in a contract to determine each performance obligation (i.e., the unit of account).

<sup>8</sup> Although the ASU does not define goods or services, it includes several examples, such as goods produced (purchased) for sale (resale), granting a license, and performing contractually agreed-upon tasks.

<sup>9</sup> A series of distinct goods or services has the same pattern of transfer if both of the following criteria are met: (1) each distinct good or service in the series would meet the criteria for recognition over time and (2) the same measure of progress would be used to depict performance in the contract.

The assessment of whether goods or services in a contract are highly dependent on, or highly interrelated with, one another may be particularly challenging for entities with technology arrangements that are currently accounted for under ASC 605-25.

## Elimination of ASC 605-25

Currently, multiple-element software arrangements that are not within the scope of ASC 985-605 or ASC 605-35<sup>10</sup> (e.g., certain types of hosted software and data arrangements) are typically accounted for under ASC 605-25. Under ASC 605-25-25-5, deliverables in multiple-element arrangements are treated as separate units of account if the delivered items have value to the customer on a stand-alone basis (a determination that involves an assessment of whether the deliverables are sold separately by any vendor or the customer could resell the delivered items on a stand-alone basis). Under the ASU, in evaluating whether a good or service is a separate performance obligation, entities need to consider whether the good or service is *capable of being distinct* and *distinct within the context of the contract*, as described above.

### Thinking It Through

The ASU's guidance on determining whether a customer can benefit from a good or service on its own, or with other readily available resources, is generally consistent with the current guidance in ASC 605-25 on determining whether a good or service has stand-alone value. The ASU states that "the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service."

The requirement that the promise to transfer a good or service be "separately identifiable from other promises in the contract" is a new concept under which entities must further evaluate a good or service for separability. Entities may need to use significant judgment when determining whether the goods or services in a contract are "highly dependent on, or highly interrelated with, other goods or services promised in the contract" or whether they "significantly modify or customize" each other. In such circumstances, entities may need to account for a bundle of goods or services, which may qualify for separate accounting under current U.S. GAAP, as a single performance obligation (unit of account).

Example 11<sup>11</sup> of the ASU presents two cases that illustrate how technology entities would determine whether goods or services in a software arrangement are distinct. Each case depicts a typical software arrangement involving a license, an installation service, software updates, and technical support. In Case A, the installation service does not significantly modify or customize the software; in Case B, however, the installation service significantly modifies and customizes it. The ASU concludes that the license and installation service would be considered distinct from each other in Case A but not in Case B. Entities with software arrangements similar to the one in Case A should refer to that illustration and reasonably reach the same conclusion.

The assessment of whether goods or services in a contract are highly dependent on, or highly interrelated with, one another may be particularly challenging for entities with technology arrangements that are currently accounted for under ASC 605-25. For example, software-as-a-service (SaaS) arrangements are often bundled together with additional products or services, such as implementation or consulting services, in a single arrangement (see [SaaS Arrangements](#) below for more information). Entities may find it difficult to determine whether the hosted software and other products or services offered are separately identifiable, depending on the nature of each item and how the items interact. However, if certain products or services offered under an arrangement have the same pattern of transfer, entities could effectively measure and recognize them as a single performance obligation under the ASU. This guidance may simplify the identification of all distinct performance obligations under certain contracts.

<sup>10</sup> Formerly AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*.

<sup>11</sup> ASC 606-10-55-141 through 55-150.



## ***Elimination of the Requirement for VSOE of Fair Value in Software Arrangements***

Currently, ASC 985-605 provides industry-specific guidance on accounting for multiple-element software arrangements. Under this guidance, to separate a software arrangement that includes multiple elements, a vendor must establish VSOE of fair value for each identified element. Whether VSOE of fair value can be established for an element may dramatically affect how revenue is recognized in a multiple-element software arrangement. Variations in pricing from customer to customer, the unique and customer-specific nature of many software elements, and the lack of historical sales information about new software products or specified upgrade rights can often make it difficult or impossible to establish VSOE of fair value. When there is no VSOE of fair value for certain goods or services in a multiple-element arrangement, entities often must defer recognizing revenue related to delivered elements in an arrangement until the remaining goods or services are delivered or VSOE of fair value is established.

The ASU eliminates the VSOE requirement for software arrangements. As a result, a technology entity's accounting for each element of a multiple-element software arrangement may change, since the entity will now be required to determine whether each deliverable in the arrangement constitutes a "distinct" performance obligation.

Accounting for each element of a multiple-element software arrangement may change since technology entities will no longer be required to establish VSOE of fair value but will have to determine whether each deliverable constitutes a "distinct" performance obligation.

### **Thinking It Through**

Elimination of the VSOE requirement could have a significant impact on software transactions. For example, many software companies develop roadmaps to articulate both short-term and long-term goals for the future development of software sold or licensed to a customer. Roadmaps can include upgrades or enhancements to the functionality of software to be delivered at a specific time in the future. Because such upgrades or enhancements typically have not been developed or sold separately at contract inception, there is often no VSOE of fair value for such elements. Under current guidance, if a roadmap implies or explicitly promises the delivery of specified upgrades and there is no VSOE of fair value for the upgrade rights, entities often must defer recognizing revenue related to other elements in the arrangement until delivery of the upgrades commences or VSOE of fair value is established. Such deferral limits software companies' ability to include desired content in their product roadmaps because it may result in adverse revenue recognition consequences.

By replacing the requirement to determine VSOE of fair value with the concept of "distinct" goods or services, the ASU may give software companies more flexibility to include specified upgrade rights in their product roadmaps (i.e., the ability to separately allocate and recognize revenue for upgrade rights may accelerate revenue recognition under the ASU). However, to separately allocate and recognize revenue for specified upgrade rights, entities would need to conclude that an upgrade right is a distinct performance obligation under the ASU.

As mentioned above, software entities may encounter several challenges in asserting that specified upgrades or other services (e.g., customization, installation, or hosting) are not "highly dependent on, or highly interrelated with," or do not "significantly modify or customize," any of the goods or services provided under a software arrangement. Technology entities will need to consider the ASU's guidance, as well as the illustrations in Example 11 (see [Elimination of ASC 605-25](#) above), in determining whether the various performance obligations in their software arrangements are distinct.

### ***Renewal Options***

Under the ASU, an option given to a customer to acquire additional goods or services represents a performance obligation if it provides a "material right" to the customer that it otherwise would not have received without entering into the contract. If an option is deemed a performance obligation, an entity must allocate a portion of the transaction price to the option and recognize revenue when control of the goods or services underlying the option is transferred to the customer or when the option expires.

Under the ASU, if the renewal option provides the customer with a material right that it would not have received had it not entered into the contract, the option should be treated as a separate performance obligation.

### Thinking It Through

Contracts in the technology industry often offer customers the option to renew their contract with the entity at potentially favorable rates once the initial contract term expires or without incurring any additional up-front fees. For example, SaaS vendors may offer customers various incentives to entice them to renew their contract. Under the ASU, if the renewal option provides the customer with a material right that it would not have received had it not entered into the contract, the option should be treated as a separate performance obligation. A material right may be represented by (1) a discounted renewal rate that is incremental to the range of discounts offered to a customer in a given geographical area or market or (2) a waiver of an up-front fee that would have been paid by the customer for a new contract. In these cases, a portion of the original contract consideration would need to be allocated to the renewal option.

### Determining the Transaction Price (Step 3)

The ASU requires an entity to determine the transaction price, which is the amount of consideration to which it expects to be entitled in exchange for the promised goods or services in the contract. The transaction price can be a fixed amount or can vary because of “discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, or other similar items.”

#### *Variable Consideration*

When the transaction price includes a variable amount, an entity is required to estimate the variable consideration by using either an “expected value” (probability-weighted) approach or a “most likely amount” approach, whichever is more predictive of the amount to which the entity will be entitled.

Some or all of an estimate of variable consideration is only included in the transaction price to the extent that it is probable<sup>12</sup> that subsequent changes in the estimate would not result in a “significant reversal” of revenue (this concept is commonly referred to as the “constraint”). The ASU requires entities to perform a qualitative assessment that takes into account both the likelihood and magnitude of a potential revenue reversal and provides factors that could indicate that an estimate of variable consideration is subject to significant reversal (e.g., susceptibility to factors outside the entity’s influence, long period before uncertainty is resolved, limited experience with similar types of contracts, practices of providing concessions, or a broad range of possible consideration amounts). This estimate would be updated in each reporting period to reflect changes in facts and circumstances.

#### *Sales-Based or Usage-Based Royalties*

The constraint does not apply to sales- or usage-based royalties derived from the licensing of intellectual property; rather, consideration from such royalties is only recognized as revenue at the later of when the performance obligation is satisfied or when the uncertainty is resolved (e.g., when subsequent sales or usage occurs). Usage- or sales-based fee structures are common in the technology industry, particularly for software licenses.

<sup>12</sup> Like the term “probable” in step 1 regarding the collectibility threshold, “probable” in this context has the same meaning as in ASC 450-20-20: the “future event or events are likely to occur.” In IFRS 15, the IASB uses the term “highly probable,” which has the same meaning as the FASB’s “probable.”



Entities offering price concessions or other incentives that result in variable consideration may need to establish a robust set of controls and procedures for incorporating the impact of variable terms in estimating the transaction price and determining the probability of any future revenue reversals.

### Thinking It Through

Under current U.S. GAAP, the amount of revenue recognized by most technology entities is generally limited to the amount that is not contingent on a future event (i.e., the price is no longer variable). Under the ASU, an entity must include some or all of an estimate of variable (or contingent) consideration in the transaction price (which is the amount to be allocated to each unit of account and recognized as revenue) when the entity concludes that it is probable that changes in its estimate of such consideration will not result in significant reversals of revenue in subsequent periods. It is likely that this less restrictive guidance will result in earlier recognition of revenue under the ASU than under current U.S. GAAP.

Price concessions are common in the technology industry and are often provided to customers as an incentive to renew or upgrade arrangements such as software licenses. Under current U.S. GAAP, such price concessions often lead to a deferral of revenue recognition; under the ASU, however, price concessions would be treated as variable consideration in the manner described above. Entities offering price concessions or other incentives that result in variable consideration may need to establish a robust set of controls and procedures for incorporating the impact of variable terms in estimating the transaction price and determining the probability of any future revenue reversals. These controls and procedures would also need to take into account the requirement to update these estimates as of each reporting period.

When determining the probability of a significant revenue reversal in the future, an entity may need to consider the price concessions it has historically offered to customers and the possibility that it will offer a concession larger than initially expected. This assessment may be particularly challenging when there are large volumes of contracts and a broad range of price concessions has been offered historically or is expected to be granted.

### Significant Financing Component

Adjustments for the time value of money are required if the contract includes a “significant financing component” (as defined in the ASU). Generally, no adjustment is necessary if payment is expected to be received within one year of the transfer of goods or services to the customer. However, if an entity concludes, on the basis of the payment terms, that there is a significant financing component, it should adjust the sales price when recording revenue to present the amount that would have been attained had the buyer paid cash for the goods or services on the date of sale.

### Thinking It Through

Payment terms in the technology industry often include up-front fees or extended payment terms, particularly for software entities that have longer-term license contracts with customers. Under current guidance, arrangements that offer extended payment terms often result in the deferral of revenue recognition since the fees are typically not considered fixed or determinable unless the entity has a history of collecting fees under such payment terms without providing any concessions. In the absence of such a history, revenue is recognized when payments become due or when cash is received from the customer, whichever is earlier.

The ASU does not have identical requirements for the deferral of contingent revenue but does require entities to apply the constraint when recognizing revenue allocated to performance obligations.

Under the ASU, if the financing term extends beyond one year and a significant financing component is identified, the entity would need to initially estimate the transaction price by incorporating the impact of any potential price concessions (see [Variable Consideration](#) above) and then adjust this amount to account for the time value of money. The amount would then be recognized as revenue when the entity transfers control of the good or service to the customer. When the entity is providing financing, interest income would be recognized as the discount on the receivable unwinds over the payment period. However, when the entity receives an up-front fee, the entity is deemed to be receiving financing from the customer, and interest expense is recognized with a corresponding increase to revenue recognized. This recognition pattern may differ significantly from the pattern under current U.S. GAAP, as described above.

### ***Elimination of Existing Guidance on Contingent Revenue***

Technology entities may need to reconsider arrangements that permit refunds of payment received in the event that a vendor fails to deliver future deliverables. Similarly, entities may need to determine whether they have entered into multiple-element arrangements in which the realization of the revenue allocated to a specific deliverable depends on the future delivery of another good or service. In both cases, under current U.S. GAAP, a portion of revenue may need to be deferred as contingent consideration until the future deliverables have been delivered. The ASU does not have identical requirements for the deferral of contingent revenue but does require entities to apply the constraint when recognizing revenue allocated to performance obligations. This requirement may change revenue recognition for certain contracts.

### **Allocating the Transaction Price (Step 4)**

Under current U.S. GAAP, in a multiple-element software arrangement accounted for under ASC 985-605, entities allocate the fixed and determinable transaction price to each element by using VSOE of fair value for each element. Entities that account for multiple-element arrangements under ASC 605-25 allocate consideration to all deliverables that qualify for separation on the basis of each deliverable's "selling price," which is determined on the basis of a hierarchy of evidence. Entities are currently prohibited from using the residual approach to allocate consideration in multiple-element arrangements that are within the scope of ASC 605-25; however, they can apply the residual method when allocating consideration to delivered (though not to undelivered) elements in software arrangements that are within the scope of ASC 985-605.

Under the ASU, when a contract contains more than one performance obligation, an entity would generally allocate the transaction price to each performance obligation on a relative stand-alone selling price basis. The ASU states that the "best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers." If the good or service is not sold separately, an entity must estimate it by using an approach that maximizes the use of observable inputs. Acceptable estimation methods include, but are not limited to, adjusted market assessment, expected cost plus a margin, and a residual approach (when it is not directly observable and either highly variable or uncertain).

For multiple-element arrangements accounted for under ASC 605-25, the elimination of the selling-price hierarchy and the ability to use the residual method in limited circumstances to determine the stand-alone selling price of certain goods or services may make it easier to allocate revenue to all performance obligations.

### Thinking It Through

Revenue from certain software contracts accounted for under ASC 985-605 may no longer be deferred if VSOE of fair value is not established for some of the goods or services in the contract, since entities will now be required to allocate revenue to all performance obligations on the basis of an estimated stand-alone selling price and not VSOE of fair value. However, although the ASU effectively eliminates the need to determine VSOE of fair value for certain performance obligations and may make it necessary for entities to implement revised processes to determine the stand-alone selling price of each performance obligation, the factors currently used to determine VSOE of fair value for such obligations (e.g., the stated renewal rate) may still be relevant to entities' estimation of each obligation's stand-alone selling price.

For multiple-element arrangements accounted for under ASC 605-25, the elimination of the selling-price hierarchy and the ability to use the residual method in limited circumstances to determine the stand-alone selling price of certain goods or services may make it easier to allocate revenue to all performance obligations. However, entities that have historically applied ASC 605-25 and have established stand-alone selling prices for goods or services (through either separate sales or estimations) may not meet the ASU's criteria for using a residual approach.

In addition, the ASU allows entities to apply the residual method to determine the stand-alone selling price of delivered or undelivered elements in an arrangement provided that the price of the elements under consideration is highly variable or uncertain. The use of this method to determine the stand-alone selling price of undelivered elements is known as the reverse residual method. The reverse residual method may benefit entities that account for multiple-element arrangements under ASC 605-25 as well as those that account for software arrangements under ASU 985-605, both of which are currently prohibited from applying this method when allocating the transaction price. However, when applying the residual or reverse residual method, entities still need to consider the ASU's overall allocation principle<sup>13</sup> to ensure that unrealistic amounts are not allocated to performance obligations (see the ASU's Example 34, Case C<sup>14</sup>).

### Recognizing Revenue When (or as) Performance Obligations Are Satisfied (Step 5)

Under the ASU, a performance obligation is satisfied (and the related revenue recognized) when "control" of the underlying goods or services (the "assets") related to the performance obligation is transferred to the customer. The ASU defines "control" as "the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset." An entity must first determine whether control of a good or service is transferred over time. If so, the related revenue is recognized over time as the good or service is transferred to the customer. If not, control of the good or service is transferred at a point in time.

#### *Recognizing Revenue Over Time*

Control of a good or service (and therefore satisfaction of the related performance obligation) is transferred over time when at least one of the following criteria is met:

- "The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs."
- "The entity's performance creates or enhances an asset . . . that the customer controls as the asset is created or enhanced."
- "The entity's performance does not create an asset with an alternative use to the entity . . . and the entity has an enforceable right to payment for performance completed to date."

<sup>13</sup> Under this principle, the amount allocated to a performance obligation represents the amount to which the entity expects to be entitled for satisfying the obligation.

<sup>14</sup> ASC 606-10-55-269.

If a performance obligation is satisfied over time, an entity recognizes revenue by measuring progress toward satisfying the performance obligation in a manner that best depicts the transfer of goods or services to the customer. The ASU provides specific guidance on measuring progress toward completion, including the use and application of output and input methods.

### Thinking It Through

Software companies often enter into arrangements in which significant production, modification, or customization of software is required. Many of these entities currently account for such arrangements under ASC 605-35 by using the percentage-of-completion or completed-contract method. Under the ASU, it may be appropriate for entities to recognize revenue related to software development over time when (1) the developer's performance creates or enhances an asset that the customer controls as it is created (e.g., development of software in a customer's technology environment) or (2) the developer's performance does not create an asset with an alternative use to the developer and the developer has an enforceable right to payment for performance to date (e.g., the software developed is specific to a customer's needs and therefore has no alternative use to the developer).

Revenue from arrangements that satisfy these criteria may be recognized in a manner similar to how it is currently recognized by entities that use the percentage-of-completion method. Revenue from arrangements that fail to meet the requirements above should be recognized at a point in time instead of over time (i.e., in a manner similar to how revenue is currently recognized by entities that apply the completed-contract method).

If the ASU's "right to access" criteria are met, the consideration allocated to the license is recognized as revenue over time; if such criteria are not met, the consideration allocated to the license is recognized at a point in time.

## Other Accounting Issues

### Accounting for Licenses

A technology entity may transfer to its customer a license granting a right to the entity's intellectual property (e.g., software, patents, trademarks, or copyrights). The ASU requires entities to determine whether the license is distinct (as defined in the ASU) from other promised goods or services in the contract (see [Identifying Performance Obligations \(Step 2\)](#) above). An entity must determine whether a distinct license gives the customer the "right to use the entity's intellectual property as it exists at the point in time at which the license is granted" (a "static" license for which control is transferred at a point in time) or a "right to access the entity's intellectual property as it exists throughout the license period" (a "dynamic" license for which control is transferred over time).

For a distinct license to represent a right to access the entity's intellectual property, all of the following criteria must be met:

- The contract requires (or the customer reasonably expects) the entity to undertake activities that significantly affect the intellectual property.
- The rights granted by the license directly expose the customer to any positive or negative effects of the activities.
- Those activities do not result in the transfer of a good or service to the customer.

If such criteria are met, the consideration allocated to the license is recognized as revenue over time. If such criteria are not met, the license is deemed a right to use and the consideration allocated to it is recognized at a point in time.

The ASU precludes an entity from recognizing revenue related to a good physically transferred to a third party on consignment until control of that good is transferred to the third party.

### Thinking It Through

Technology entities often license software to a customer in an arrangement that includes other services or specified upgrade rights. To apply the license guidance outlined above, an entity will initially need to determine whether the license is distinct from the other promised goods or services. As discussed in [Identifying the Performance Obligations \(Step 2\)](#) above, it may be challenging to assess the level of dependency and interrelationship between promises in a given technology arrangement and conclude whether the license is distinct. However, for typical software arrangements involving a license and postcontract customer support (PCS), it is likely that an entity will often conclude that the license is distinct on the basis of Example 11, Case A, assuming that the PCS does not significantly modify the software.

If the technology entity concludes that a license is distinct from other promises in the same contract, it may need to use judgment in determining which activities it is required (or can be reasonably expected) to perform as well as whether those activities “significantly affect” licensed intellectual property, such as software. Such activities would not include items such as upgrades or other PCS that are considered distinct performance obligations since those items result in the transfer of an additional good or service to the customer.

Entities may need to use significant judgment in determining whether the activities they are required or expected to perform during the license period will significantly affect the software and expose the licensee to the positive and negative effects of such activities. If the software largely functions as intended, PCS is identified as a separate performance obligation, and the entity is generally not required to undertake additional activities that will significantly affect the software, the license would generally be considered static and revenue would accordingly be recognized when the license is transferred to the customer. However, this may not be the case for all software licenses, and entities may need to use significant judgment in determining whether the activities they are required or expected to perform during the license period will significantly affect the software and expose the licensee to the positive and negative effects of such activities.

As noted in [Sales-Based or Usage-Based Royalties](#) above, revenue from software licenses that have sales- or usage-based fee structures will only be recognized as the subsequent sales or usage occurs.

### *Sell-Through Arrangements*

Technology entities often enter into arrangements with intermediaries (such as a dealer or distributor) for the sale of their products. Under existing guidance, revenue is often deferred until the intermediary has subsequently sold the goods to an end customer, typically because one or both of the following are true:

- The sales price may only be fixed or determinable at that point.
- Transfer of the risks and rewards of ownership of the goods (i.e., delivery) only occurs upon final sale.

The ASU precludes an entity from recognizing revenue related to a good physically transferred to a third party on consignment until control of that good is transferred to the third party. However, if the arrangement does not involve consignment, an analysis of the control indicators for determining at what point control is transferred is critical to determining when revenue may be recognized.

When control is deemed to pass to an intermediary, revenue may be recognized earlier than under current practice.

### Thinking It Through

Entities will need to evaluate arrangements in which goods are sold through an intermediary to determine when control passes (i.e., the point in time at which control is transferred). In making this determination, they will have to assess all facts and circumstances by considering the indicators in the ASU (i.e., right to payment, title, physical possession, rights and rewards, and customer acceptance). Their assessment may require significant judgment and could result in a different revenue recognition pattern.

When control is deemed to pass to the intermediary, revenue may be recognized earlier than under current practice. In such situations, the sales price could be variable as a result of the arrangement with the intermediary. Accordingly, entities are required to estimate the transaction price to which they expect to be entitled and must consider the constraint guidance, specifically the probability of future revenue reversals (see [Determining the Transaction Price \(Step 3\)](#) above), before recognizing revenue.

In addition, when goods or services provided to an intermediary are transferred subject to a return provision, entities should assess whether to apply the ASU's guidance on rights of return. The ASU specifically requires entities that sell goods with a right of return to recognize (1) revenue in the amount to which they expect to be entitled (considering any refund provisions), (2) a liability for any refunds or credits to be provided, and (3) an asset for any right to recover the product from the customer. However, when an entity anticipates significant levels of returns, it should consider how those expected returns could affect its decisions about whether control of the goods has passed to a customer.

### *Sale of Virtual Goods*

Traditionally, online gaming companies have charged customers a monthly subscription fee or a fee for premium services to gain access to online content for a specified period. Recently, the "freemium" business model has become more popular in the online industry. Under the freemium model, gamers are given access to a gaming entity's online game free of charge (or for a nominal fee) and revenue is largely generated through "microtransactions" involving the sale of virtual goods and services ("virtual goods"). Virtual goods are nonphysical objects that enhance the gamer's playing experience or ability to make progress in the game and may take various forms (e.g., items such as clothing, equipment, weapons, speed, power, or health).

### Thinking It Through

Technology entities that sell virtual goods will need to (1) assess whether each virtual good represents a distinct performance obligation (step 2) and (2) recognize revenue when such a performance obligation is satisfied (step 5). Some virtual goods are consumed by customers immediately or shortly after they gain access to them, and others are consumed over time. In an online gaming setting, entities typically recognize revenue for virtual goods on the basis of their best estimate of the life of (1) the virtual good, (2) the gamer (i.e., the period during which the gamer is expected to play the game), or (3) the game. Under the ASU, entities will need to revisit their policies regarding the pattern of revenue recognition for virtual goods.

Given the typical volume of transactions involving virtual goods, entities may find it challenging to individually account for each sale. While the ASU's guidance applies to "individual" contracts with customers, entities can use a portfolio approach to account for contracts with similar characteristics if management "reasonably expects" that the financial effects of applying the ASU to a portfolio of contracts would not materially differ from those of applying the guidance to individual contracts.



In applying the ASU, SaaS vendors would be required to recognize up-front fees over a period extending beyond the initial contract period only if the customer has the option to renew the SaaS contract and the renewal option provides the customer with a material right.

## ***SaaS Arrangements***

The ASU will change several aspects of accounting for hosting arrangements, including SaaS arrangements that offer customers the use of cloud-based application software. Access to hosted SaaS arrangements is frequently offered together with a bundle of additional services, such as implementation or customization and configuration services. Because the requirements for determining the stand-alone value of each element have been eliminated (see [Elimination of ASC 605-25](#) above), SaaS vendors will need to determine instead whether each promised good or service is distinct under the ASU.

### **Thinking It Through**

The elimination of the stand-alone value requirements is not the only change that may affect SaaS arrangements. For example, the ASU does not carry forward the existing guidance on deferring the recognition of contingent revenue in certain instances (see [Elimination of Existing Guidance on Contingent Revenue](#) above). Currently, this guidance applies to SaaS arrangements in which the realization of the revenue allocated to services provided in addition to a hosted software application depends on the future delivery of the hosted software application. Although the ASU eliminates this guidance, it does require entities to apply the constraint to the transaction price and thus may change the recognition of revenue for certain contracts.

Many SaaS arrangements also involve set-up or “activation” fees, which typically are charged in addition to the subscription fee for the related hosting service. Activation fees generally do not involve the provision of a service other than simply “activating,” or permitting a customer to access the hosted software application. Other set-up services may require incremental work before a customer can access the software application. However, vendors need to consider whether the set-up services involved are essential to the functionality of the hosted software application under current U.S. GAAP. Frequently, customers are unable to access or use the software until the set-up services have been completed. As a result, activation or set-up services are generally not considered to have stand-alone value under ASC 605-25. These services are generally expected to benefit customers for the period they use the services (including potential renewal periods); as a result, the revenue allocated to the services is recognized over the initial contract period or over the estimated customer relationship period if longer.

The ASU provides guidance on nonrefundable up-front fees that is generally consistent with current U.S. GAAP. Under this guidance, entities must assess whether a “fee relates to the transfer of a promised good or service.” In applying the ASU, SaaS vendors would be required to recognize up-front fees over a period extending beyond the initial contract period only if the customer has the option to renew the SaaS contract and the renewal option provides the customer with a material right. The ASU’s requirement to incorporate only renewal options that represent material rights into their estimation of a customer relationship period may not always be consistent with current U.S. GAAP, which may take into account renewal options that are not necessarily considered material rights. As noted in [Renewal Options](#) above, material rights would need to be accounted for as separate performance obligations under the ASU.

Further, revenue from SaaS arrangements that include a license of intellectual property and have usage-based fee structures are likely to be recognized only when subsequent usage occurs (see [Sales-Based or Usage-Based Royalties](#) above for more information).

## ***Warranties***

Technology companies often provide a range of warranties for their various products. The ASU allows entities to continue to use a cost accrual model to account for warranty obligations (in accordance with ASC 460), but only for warranties ensuring that the good or service complies with agreed-upon specifications. To the extent that a warranty provides a service beyond ensuring that the good or service complies with agreed-upon

Technology companies may need to reconsider their policies when accounting for costs such as sales commissions, which are often significant.

specifications, it would be accounted for as a performance obligation (consideration would be allocated to this obligation and recognized as it is satisfied). Further, if the customer has the option to purchase the warranty separately, it would also be accounted for as a performance obligation.

Product liabilities, such as compensation paid by an entity for harm or damage caused by its product, do not represent a performance obligation in the contract and would continue to be accounted for in accordance with the existing literature on loss contingencies in ASC 450-20.

### Thinking It Through

Although the ASU is unlikely to significantly change how technology entities account for most of their warranties, entities will need to verify that the warranties they offer do not provide services beyond ensuring that the good or service complies with agreed-upon specifications. Further, although this guidance applies to hardware manufacturers, it may also be relevant to software entities.

### Contract Costs

The ASU contains criteria for determining when to capitalize costs associated with obtaining and fulfilling a contract. Specifically, entities are required to recognize an asset for incremental costs of obtaining a contract (e.g., sales commissions) when those costs are expected to be recovered (the ASU provides a practical expedient allowing entities to “expense these costs when incurred if the amortization period is one year or less”). Costs of fulfilling a contract (that are not within the scope of other standards, such as the guidance in ASC 985-20 on the costs of software sold, leased, or marketed, or the guidance in ASC 350-40 on internal-use software) would be capitalized only when they (1) are directly related to a contract, (2) generate or enhance resources that will be used to satisfy performance obligations, and (3) are expected to be recovered. The ASU also requires entities to expense certain costs, such as those related to satisfied (or partially satisfied) performance obligations. Capitalized costs would be amortized in a manner consistent with the pattern of transfer of the goods or services to which the asset is related (which may extend beyond the original contract term in certain circumstances).

### Thinking It Through

Technology companies may need to consider the impact of this guidance on their current policies for capitalizing the costs of obtaining a contract. Under current U.S. GAAP, there is limited guidance on the capitalization of such costs, and entities generally make an accounting policy election to expense these costs or, in certain cases, to capitalize them by analogy to the guidance in ASC 310 on deferred loan origination costs. The ASU may require entities to change their policy when they have previously expensed these costs or amortized them in a manner inconsistent with the ASU’s requirements. In particular, technology companies may need to reconsider their policies when accounting for costs such as sales commissions, which are often significant.

### Disclosures

The ASU requires entities to disclose both quantitative and qualitative information that enables “users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.” The ASU’s disclosure requirements, which are significantly more comprehensive than those in existing revenue standards, include the following (with certain exceptions for nonpublic entities):

- Presentation or disclosure of revenue and any impairment losses recognized separately from other sources of revenue or impairment losses from other contracts.

For public entities, the ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016.

- A disaggregation of revenue to “depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors” (the ASU also provides implementation guidance).
- Information about (1) contract assets and liabilities (including changes in those balances), (2) the amount of revenue recognized in the current period that was previously recognized as a contract liability, and (3) the amount of revenue recognized in the current period that is related to performance obligations satisfied in prior periods.
- Information about performance obligations (e.g., types of goods or services, significant payment terms, typical timing of satisfying obligations, and other provisions).
- Information about an entity’s transaction price allocated to the remaining performance obligations, including (in certain circumstances) the “aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied)” and when the entity expects to recognize that amount as revenue.
- A description of the significant judgments, and changes in those judgments, that affect the amount and timing of revenue recognition (including information about the timing of satisfaction of performance obligations, the determination of the transaction price, and the allocation of the transaction price to performance obligations).
- Information about an entity’s accounting for costs to obtain or fulfill a contract (including account balances and amortization methods).
- Information about the policy decisions (i.e., whether the entity used the practical expedients for significant financing components and contract costs allowed by the ASU).

The ASU requires entities, on an interim basis, to disclose information required under ASC 270 as well as to provide the disclosures (described above) about (1) the disaggregation of revenue, (2) contract asset and liability balances and significant changes in those balances since the previous period-end, and (3) the transaction price allocated to the remaining performance obligations.

The ASU allows nonpublic entities to use certain practical expedients to avoid providing some of the disclosures required of public entities. For additional information about the disclosure relief provided, see Appendix C of Deloitte’s May 28, 2014, *Heads Up*.

### ***Effective Date and Transition***

For public entities, the ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016. Early application is not permitted (however, early adoption is optional for entities reporting under IFRSs).

The effective date for nonpublic entities is annual reporting periods beginning after December 15, 2017, and interim reporting periods within annual reporting periods beginning after December 15, 2018. Nonpublic entities may also elect to apply the ASU as of any of the following:

- The same effective date as that for public entities (annual reporting periods beginning after December 15, 2016, including interim periods).
- Annual periods beginning after December 15, 2016 (excluding interim reporting periods).
- Annual periods beginning after December 15, 2017 (including interim reporting periods).

Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in the ASU.

Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in the ASU:

- *Full retrospective application* — Retrospective application would take into account the requirements in ASC 250 (with certain practical expedients).
- *Modified retrospective application* — Under the modified approach, an entity recognizes “the cumulative effect of initially applying [the ASU] as an adjustment to the opening balance of retained earnings . . . of the annual reporting period that includes the date of initial application” (revenue in periods presented in the financial statements before that date is reported under guidance in effect before the change). Under the modified approach, the guidance in the ASU is only applied to existing contracts (those for which the entity has remaining performance obligations) as of, and new contracts after, the date of initial application. The ASU is not applied to contracts that were completed before the effective date (i.e., an entity has no remaining performance obligations to fulfill). Entities that elect the modified approach must disclose an explanation of the impact of adopting the ASU, including (1) the financial statement line items and respective amounts directly affected by the standard’s application and (2) an “explanation of the reasons for significant changes.” The following chart illustrates the application of the ASU and legacy GAAP under the modified approach for a public entity with a calendar year-end:

January 1, 2017	2017	2016	2015
Initial Application Year	Current Year	Prior Year 1	Prior Year 2
New contracts	New ASU		
Existing contracts	New ASU + cumulative catch-up	Legacy GAAP	Legacy GAAP
Completed contracts		Legacy GAAP	Legacy GAAP

### Thinking It Through

The modified transition approach provides entities relief from having to restate and present comparable prior-year financial statement information; however, entities will still need to evaluate existing contracts as of the date of initial adoption under the ASU to determine whether a cumulative adjustment is necessary. Therefore, entities may want to begin considering the typical nature and duration of their contracts to understand the impact of applying the ASU and to determine the transition approach that is practical to apply and most beneficial to financial statement users.

## Considerations and Challenges for Technology Entities

### Income Taxes

Federal income tax law provides both general and specific rules for recognizing revenue on certain types of transactions (e.g., long-term contracts and arrangements that include advance payments for goods and services). These rules are often similar to the method a taxpayer uses for financial reporting purposes and, if so, the taxpayer uses the revenue recognition method it applies in maintaining its books and records (e.g., cash basis, U.S. GAAP, IFRSs). Although the Internal Revenue Code (IRC) does not require entities to use any particular underlying financial accounting method to determine their taxable income (such as U.S. GAAP), entities must make appropriate adjustments (on Schedule M) to their financial accounting pretax income to determine taxable income under the IRC.

The ASU may change the timing of revenue recognition and, in some cases, the amount of revenue recognized for entities that maintain their books and records under U.S. GAAP or IFRSs. These changes may also affect taxable income. Thus, it will be important for tax professionals to understand the detailed financial reporting implications of the standard so that they can analyze the tax ramifications and facilitate the selection of any alternative tax accounting methods that may be available.

To comply with the ASU's new accounting and disclosure requirements, technology entities will have to gather and track information that they may not have previously monitored.

If a change in a tax accounting method is advantageous or expedient (including circumstances in which the book method has historically been used), the taxpayer will most likely be required to obtain approval from the relevant tax authorities to use the method. Similar requirements may arise in foreign jurisdictions that maintain statutory accounting records under U.S. GAAP or IFRSs. Additional record keeping will also be required when entities are not permitted to use the ASU's revenue recognition method for tax purposes.

## Accounting Processes and Internal Controls

To comply with the ASU's new accounting and disclosure requirements, technology entities will have to gather and track information that they may not have previously monitored. The systems and processes associated with such information may need to be modified to support the capture of additional data elements that may not currently be supported by legacy systems. Further, to ensure the effectiveness of internal controls over financial reporting, management will want to assess whether it should revise existing, and implement additional, controls. In assessing the effect of applying the ASU on systems, processes, and internal controls, technology entities may need to critically analyze all of the effects of implementing the ASU's requirements by considering questions such as the following:

- What processes should entities implement to identify all goods and services in a contract with a customer?
- How will entities estimate the stand-alone selling price for contracts involving multiple goods or services?
- How will entities ensure consistency of judgments in identifying performance obligations, estimating stand-alone selling prices, and measuring progress toward completion?
- What systems, processes, and controls are necessary to reliably estimate variable consideration and determine whether it is probable that a significant reversal of revenue will not occur?
- Will entities need new processes and controls to identify and capitalize contract costs that would be considered incremental?
- Will entities need to implement new processes and controls to periodically review contract costs and to test capitalized amounts for recoverability or impairment?
- When should new policies and procedures be designed and implemented?

## Increased Use of Judgment

Management will need to exercise significant judgment in applying certain aspects of the ASU's requirements, including those related to the identification of performance obligations and allocation of revenue to each performance obligation. It is important for technology entities to consider how the standard specifically applies to them so that they can prepare for any changes in revenue recognition patterns.

## Thinking Ahead

Although the ASU is not effective until annual reporting periods beginning after December 15, 2016 (with a maximum deferral of one year for nonpublic entities that apply U.S. GAAP), technology entities should start carefully examining the ASU and assessing the impact it may have on their current accounting policies, procedures, systems, and processes.

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