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Key Differences Between ASC 605-35 (Formerly SOP 81-1) and ASC 606

The Bottom Line

- In May 2014, the FASB and the International Accounting Standards Board (IASB®) issued their final standard on revenue from contracts with customers. The standard, issued as ASU 2014-09[1] (and codified in ASC 606) by the FASB and as IFRS 15[2] by the IASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes ASC 605-35[3] (formerly SOP 81-1[4]) and most other current revenue recognition guidance (including other industry-specific guidance).
- This *Aerospace & Defense Spotlight*, which updates Deloitte's September 2014 *Aerospace & Defense Spotlight*, highlights key accounting issues and potential challenges for aerospace and defense (A&D) entities related to the transition to ASC 606.

[1] FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*.
[2] IFRS 15, *Revenue From Contracts With Customers*.
[3] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."
[4] AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*.

Beyond the Bottom Line

The table below summarizes key differences between ASC 605-35 and ASC 606 regarding long-term contracts in the A&D industry. It does not address all possible fact patterns and should be read in conjunction with ASU 2014-09.

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Scope		
This guidance generally applies to contracts for which the customer provides specifications regarding "the construction of facilities or the production of goods or the provision of related services." Such products do not include goods manufactured in a standard manufacturing operation. The guidance may also apply to other arrangements, such as federal government contracts (subject to ASC 912) or certain software arrangements (as specified in ASC 605-985[5]). (SOP 81-1, ¶ 11)	This guidance applies to contracts with customers. Arrangements subject to other guidance, such as leases, insurance contracts, certain financial instruments, guarantees, and certain nonmonetary exchanges, are outside the ASU's scope. (ASC 606-10-15-1 through 15-5) An entity is precluded from recognizing revenue unless the arrangement meets the ASU's definition of a "contract." For example, a contract does not exist if it is not probable that the entity will collect the consideration to which it expects to be entitled. When the ASU's definition of a contract is not met and the entity receives consideration from the customer, the entity will recognize the consideration received as revenue only when either (1) the entity has no remaining obligations to transfer goods or services to the customer and substantially all of the consideration has been received by the entity and is nonrefundable or (2) the contract has been terminated and the consideration received is nonrefundable. (ASC 606-10-25-1 through 25-8)	Contracts previously accounted for under SOP 81-1, including federal government service contracts, are within the ASU's scope. Further, entities will need to use the ASU's criteria to ensure that a contract exists before recognizing any revenue under the contract. (This may be different from the entity's current practice under U.S. GAAP.)
Determining the Profit Center/Unit of Account		
The basic presumption is that the contract is the profit center (unit of account) for income measurement. (SOP 81-1, ¶ 17 and 34; AICPA Audit and Accounting Guide *Construction Contractors* (AAG), ¶ 2.09)	To identify the "contract" for accounting purposes, an entity may have to combine an individual contract with other contract(s) on the basis of specific criteria, including the timing and interrelation of negotiations, the interrelation of pricing, and whether the promised goods or services are considered "distinct." (ASC 606-10-25-9) An entity analyzes the identified contract to assess the goods or services and identify the entity's performance obligations.[6] (ASC 606-10-25-14)	Entities can no longer assume that the entire contract is an acceptable unit of account. An entity must analyze contracts to determine whether the combination of multiple contracts or the identification of multiple performance obligations (units of account) within a contract is required. This analysis may result in more or fewer units of account than under ASC 605.

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

6 A performance obligation is a promise in a contract with a customer (whether explicit or implicit) to transfer to the customer either a distinct good or service (or bundle) or "a series of distinct goods or services that are substantially the same and have the same pattern of transfer" to the customer.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Combination of Contracts With a Single Customer and Combination of Production Contracts		
Combination of contracts with a single customer — Multiple contracts with a single customer may be combined for accounting purposes depending on certain criteria, including how the contracts were negotiated and the extent to which the activities are interrelated. (SOP 81-1, ¶ 37) *Combination of production contracts* — Production contracts using the units-of-delivery basis of the percentage-of completion method of accounting may be combined if production is concurrent or sequential for identical products (and may be for multiple customers). (SOP 81-1, ¶ 38)	The ASU provides specific criteria that must be met for an entity to conclude that a contract with a customer exists. (ASC 606-10-25-1) Two or more contracts **must** be combined to form a single contract if the contracts are entered into around the same time and with the same customer (or related parties) and if any of the following criteria are met: • "The contracts are negotiated as a package with a single commercial objective." • "The amount of consideration . . . in one contract depends on the price or performance of the other contract." • All (or some) of the goods or services promised in the contracts are a single performance obligation (i.e., they are not "distinct," as that term is defined in the ASU). (ASC 606-10-25-9)	Contract combination may be more frequent and will not be optional. Note that contracts with multiple customers (that are not related parties) will not meet the criteria for contract combination.
Segmentation		
In general, a contract may be segmented if either of the following criteria is met: • The segments were separately proposed (in addition to the entire contract) and the aggregate amount of the segment proposals approximated the amount of the total contract proposal. • The segments are clearly indicated in the contract and the seller has a significant history of selling the segments individually (with a consistent pricing strategy and gross profit rates differing from the entire project's gross profit rate). The "excess of the sum of the [segment] prices" over the entire contract price "is clearly attributable to cost savings incident to combined performance." (SOP 81-1, ¶ 40–41) The company must evaluate the circumstances, contract terms, and management intent in determining contracts that may be accounted for by utilizing a combination or segmentation approach. "The criteria for segmenting" and combining contracts "should be applied consistently to contracts with similar characteristics and in similar circumstances." (SOP 81-1, ¶ 37 and 39)	At contract inception, an entity must analyze the goods or services promised in the contract to identify each performance obligation. A performance obligation is a promise in a contract with a customer (whether explicit or implicit) to transfer to the customer either a distinct good or service (or bundle) or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. (ASC 606-10-25-14) A good or service is distinct if the following criteria are met: • "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 (that is, the good or service is capable of being distinct)." • "The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract." (ASC 606-10-25-19)	The ASU's requirements will likely result in an increase in the number of units of account. In a production contract, units that meet the criteria for being distinct must be accounted for separately to the extent that they are delivered in different accounting periods (unless they represent a series of distinct goods or services that are the same and have the same pattern of transfer (as defined in ASC 606-10-25-15)). Contracts that combine development and production may include separate units of account if the goods or services are distinct.

(Table continued)

<table>
<tr><th>ASC 605-35 (Formerly SOP 81-1)</th><th>ASC 606</th><th>Impact</th></tr>
<tr><td colspan="3">Production Contracts</td></tr>
<tr><td>For a production contract under which the units-of-delivery method is employed, segments may be assigned to production lots or releases so that estimated average unit cost may be used. Production lots or releases may span multiple periods or years. (SOP 81-1, ¶ 42)</td><td>The ASU provides specific indicators for evaluating whether a promised good or service is distinct in the context of the contract (the second criterion above). For example, the good or service would not be separable if (1) it significantly modifies or customizes the other good or service in the contract, (2) the entity provides a significant service of integrating goods or services in the contract, or (3) the good or service is highly dependent on or highly interrelated with any other goods or services. (ASC 606-10-25-21)</td><td>To the extent that individual units are considered distinct and are delivered in different accounting periods, units currently accounted for as part of production lots or releases may be treated as separate units of account under the ASU.</td></tr>
<tr><td colspan="3">Nonrecurring Engineering Activities</td></tr>
<tr><td>Under legacy U.S. GAAP, the accounting for costs associated with nonrecurring engineering (NRE) activities (and associated consideration received from the potential customer) may vary across industries and within the same industry.</td><td>Some diversity in practice for the accounting for costs associated with NRE activities and related reimbursements may be acceptable depending on the facts and circumstances and an entity’s historical conclusions about scope.

Specific considerations entities should take into account include the following:
• Entities that historically concluded that NRE costs were within the scope of ASC 340-10 will continue to apply such guidance upon adoption of the ASU.
• Entities that applied ASC 340-10 by analogy should evaluate their NRE costs under the fulfillment cost guidance in ASC 340-40 upon adoption of the ASU.
• Diversity in practice will continue to be acceptable in accounting for reimbursements for NRE activities. If the entity historically accounted for reimbursements as revenue under ASC 605, it would be acceptable upon adoption of the ASU to continue to account for the reimbursements as revenue. Similarly, if the entity accounted for the reimbursements as an offset to the related cost (i.e., not revenue), this practice would continue to be acceptable upon adoption of the ASU. The resulting policy should be consistent with the principles of ASC 606 and related discussion of the FASB’s Transition Resource Group (TRG) in November 2015 (see TRG Agenda Paper 46).
• If an entity would like to change its accounting policy for reimbursements received for NRE activities, further analysis may be required. A supplier should consider consulting with its accounting advisers if it believes that a change in its accounting policy for reimbursements for preproduction activities (i.e., a change from revenue to cost reimbursement or a change from cost reimbursement to revenue) is warranted under ASC 606.</td><td>Entities may need to assess whether the ASU’s guidance is applicable to customer reimbursements and consider whether the NRE activities are a distinct performance obligation when they are determining the appropriate accounting under ASC 606.</td></tr>
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(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Nonrecurring Engineering Activities (continued)		
	For additional information about accounting for NRE activities under ASC 606, see Deloitte's September 2017 *Automotive Spotlight* (updated November 2017).	
Warranty		
A warranty may be segmented (i.e., revenues are allocated to and separately recognized as warranty revenue) if it meets the criteria for segmentation. (SOP 81-1, ¶ 40–41)	The ASU retains the current cost accrual model related to the accounting for warranty obligations. However, a warranty must be treated as a separate performance obligation "if a customer has the option to purchase a warranty separately" or if the warranty (or part of the warranty) "provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications." (ASC 606-10-55-30 through 55-35)	Entities may need to analyze their warranties to determine whether they, in full or in part, provide a customer with a service in addition to the assurance that the product complies with the agreed-upon specifications of the good or service. To the extent that a warranty, in full or in part, meets these criteria, the service would be accounted for as a separate performance obligation under the ASU rather than as a warranty obligation under ASC 460. This could result in an acceleration of revenue for assurance-type warranties previously segmented under legacy U.S. GAAP, since assurance-type warranties do not affect the recognition of revenue under the ASU (i.e., they are outside the scope of the ASU).
Customer Options for Additional Goods or Services		
Entities may not currently treat customer options for additional goods or services as separate deliverables before the options are executed.	Options for additional goods and services are not accounted for as part of the contract unless the option provides the customer with a "material right." An option in a contract gives rise to a performance obligation if it provides the customer with a material right that it would not have received without entering into the contract. An estimate of the stand-alone selling price for the option should include adjustments for (1) "[a]ny discount that the customer could receive without exercising the option" and (2) the "likelihood that the option will be exercised." (ASC 606-10-55-41 through 55-45)	Options that do not contain a material right are not accounted for as part of a contract until exercised. Options providing the customer with a material right must be treated as a performance obligation (separate unit of account). This may result in additional units of account.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Contract Modification (Change Orders, Executed Options, and Additions)		
An addition to an existing contract (e.g., a change order) is treated as a separate contract if the related good or service is significantly different from the good or service under the original contract, is priced at a significantly different margin, or was negotiated without regard to the original contract. (SOP 81-1, ¶ 64)	A contract modification is treated as a separate contract if it results in both of the following: • The addition of a distinct performance obligation (or obligations). • A change in consideration that reflects the stand-alone selling price of that performance obligation.[7] If the contract is not determined to be a separate contract, the ASU provides guidance on determining whether to account for the modification either (1) as a termination of the original contract and the creation of a new contract (i.e., the amount of consideration not yet recognized is allocated to the remaining performance obligations) or (2) as if it were part of the original contract (i.e., by updating the transaction price, measuring progress toward complete satisfaction of the performance obligation, and recording a cumulative catch-up adjustment to revenue). (ASC 606-10-25-10 through 25-13)	An entity will need to evaluate contract modifications to determine how they should be treated under the ASU's definition of a contract (which may differ from how entities currently evaluate such modifications). A contract modification may be treated as a (1) separate contract, (2) termination of an existing contract and creation of a new contract, or (3) modification of an existing contract: • *Separate contract* — The entity will treat the contract modification as a separate contract with no impact on the previous contract. The additional transaction price will be allocated to the added performance obligations on the basis of the stand-alone selling price. • *Termination of an existing contract and creation of a new contract* — The entity needs to evaluate the total transaction price not already recognized as revenue and allocate, on a prospective basis, the remaining transaction price to the remaining performance obligations. • *Modification of an existing contract* — The entity needs to recalculate the transaction price and update the measure of progress to date toward satisfying the performance obligation(s) in the modified contract (which generally should be consistent with current practice).

[7] The price may be adjusted to reflect the particular circumstances of the contract. Such circumstances may include a discount that the customer receives because it is not necessary for the entity to incur selling-related costs that it would incur when selling a similar good or service to a new customer, but would not reflect volume or other discounts related to the original contract.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Revenue Elements		
Total revenue is based on the contract price. Estimated revenues may be limited or excluded for certain items, including award fees and other performance incentives, unpriced change orders, and claims (e.g., award fees would be included only to the extent a reasonably dependable estimate can be made). Revenue is allocated among segments on the basis of the relative value of each segment. (SOP 81-1, ¶ 39, 62, and 65–66; AAG, ¶ 2.12) Estimated incentives, award fees, and other performance incentives are included in estimate-at-complete (EAC)[8] revenue and therefore affect current results. Award fees and other performance incentives are included in EAC revenue to the extent that a reasonably dependable estimate can be made. (AAG, ¶ 2.12)	Total revenue is based on the contract terms and the entity's customary business practices (e.g., a history of providing price concessions for similar contracts). The transaction price to be allocated to the various performance obligations in the contract is the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to a customer, excluding amounts collected on behalf of third parties (e.g., some sales taxes). It may include fixed amounts, variable amounts, or both. It may also include cash consideration, noncash consideration, consideration payable to a customer, all three, or a combination thereof. It is not adjusted for the effects of the customer's credit risk. Estimated revenues are included in the transaction price only to the extent that the entity concludes it is probable that a subsequent change in the estimate would not result in a significant revenue reversal (e.g., an entity would most likely not include an estimate of the consideration to be received for an unpriced modification or a modification whose scope is not approved unless it is able to determine that it would have a legally enforceable right to receive the additional consideration). In general, the transaction price (and changes therein) is allocated to performance obligations on the basis of their relative stand-alone selling prices (which may be estimated if necessary). See Allocation of Revenue below for further discussion about allocating the transaction price. (ASC 606-10-32-2 and 32-3, ASC 606-10-32-11, and ASC 606-10-32-31 through 32-33)	The estimates of the total transaction price may be different to the extent that award fees or performance incentives were included or excluded under current U.S. GAAP (because of the inability to develop a reasonably dependable estimate). The total transaction price (EAC revenue) may be lower to the extent that unpriced change orders and claims were included under current U.S. GAAP and potentially excluded under the ASU. Revenue recognition may be accelerated or delayed if there are any differences in the total transaction price. See discussion of differences between allocation methods under Allocation of Revenue below.

[8] This represents the total estimated amount for the unit of account.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Unpriced Change Orders		
Unpriced change orders are included in contract costs as incurred. Revenue is adjusted on the basis of the likelihood of cost recovery through an increase in price: • If cost recovery is probable, "revenue should be recognized to the extent of the costs incurred."[9] • Revenue may be recognized in excess of costs incurred if the amount can be reasonably estimated and assured beyond a reasonable doubt. If cost recovery is not probable, revenue is not adjusted. (SOP 81-1, ¶ 62)	An entity must use significant judgment to determine whether a contract modification exists when the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price. Specifically, an entity is required to assess whether it can identify the payment terms associated with the modification. An entity would include an estimate for unpriced change orders in the transaction price if it determines, on the basis of the underlying contractual terms, that it has enforceable rights to payment for its performance. The entity would include its estimate in the transaction price to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. (ASC 606-10-25-11 and ASC 606-10-32-11)	Revenue recognition related to unpriced change orders may be delayed to the extent that an entity does not possess sufficient evidence that the change order will be approved or the price is variable (and therefore is unable to assert that the estimate of such revenue is not subject to a significant revenue reversal). The ASU does not provide specific guidance on determining when this criterion has been met; however, an entity should consider the factors in ASC 606-10-32-12 and paragraphs 3.1.10 through 3.1.16 of Chapter 3 of the AICPA Audit and Accounting Guide *Revenue Recognition* when making this determination.
Claims[10]		
Claims-related contract revenues may be adjusted up to the amount of costs incurred if such amounts are probable and can be reliably estimated in accordance with specific criteria, including legal basis, ability to identify costs, and quality of evidence.[11] (SOP 81-1, ¶ 65–66)	An entity must use significant judgment to determine whether a contract modification exists when the parties to a contract have a dispute about the scope or price (or both) of the modification. Specifically, an entity is required to determine whether a contract exists and, if so, estimate the variable consideration that it will be entitled to by using either the most-likely-value approach or the expected-value approach and subject its estimate to the constraint. (ASC 606-10-25-11, ASC 606-10-32-11, and ASC 606-10-55-134 and 55-135)	Revenue recognition related to claims may be accelerated if an entity is able to determine that it has a legally enforceable right to consideration related to a claim in excess of its costs.

9 Alternatively, costs may be deferred (excluded from contract costs), with no adjustment to revenue.

10 Claims are amounts in excess of (or not included in) the agreed-upon contract price that the seller seeks to collect from the customer or others for customer-caused delays, errors in specifications and designs, contract terminations, change orders in dispute or unapproved regarding both scope and price, or other causes of unanticipated additional costs.

11 A seller may adopt an accounting policy of adjusting claim revenues only when the revenues are received.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Time Value of Money		
Generally, the time value of money is not considered.	The time value of money should be reflected in the promised consideration when the contract includes a significant financing component. The interest rate used should reflect a hypothetical financing-only transaction between the entity and the customer on the date of contract inception. This calculation is not required if, at contract inception, the expected time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services will be one year or less. (ASC 606-10-32-15 through 32-20)	Companies will need to assess whether a contract includes a significant financing component and may need to adjust total revenue and recognize interest income or expense.
Allocation of Revenue		
Revenue is allocated among segments on the basis of the relative value of each segment. In general, significant estimation of value is not required because segmentation is allowed only when the segments have been separately proposed or when the entity has a significant history of selling the segments separately. (SOP 81-1, ¶ 39)	The transaction price (and changes therein) is allocated to performance obligations on the basis of their relative stand-alone selling prices (which may be estimated if necessary).[12] In certain circumstances, exceptions may apply to the following: • Discounts. • Variable consideration. • Changes in the transaction price. (ASC 606-10-32-28 and 32-29 and ASC 606-10-32-32 and 32-33)	For a contract with differing fee types (e.g., cost-reimbursable and fixed-price performance obligations), an entity will need to assess the stand-alone selling prices on a comparable (fixed-price) basis. This could result in a different-margin application to cost-reimbursable work at contract inception. In certain circumstances, the method for allocating the transaction price may yield results that are not considered representative of the underlying economics, including: • Contracts containing performance obligations of mixed fee types. • Discounts and contingent consideration that are related to specific performance obligations but that do not meet the criteria for allocation to those obligations.

[12] The stand-alone selling price is the price at which an entity would sell a promised good or service separately. If estimation is required, an entity should maximize the use of observable inputs.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Timing of Revenue/Cost Recognition		
In general, revenues and costs are recognized on the basis of the percentage of the contract that is complete. Revenues and costs are typically calculated under one of two alternative methods: ***Alternative A***[13] • Incurred-to-date (ITD) revenue = EAC revenue × % complete. • Cost of earned revenue = EAC cost × % complete. ***Alternative B*** • ITD margin = EAC margin × % complete. • Cost of earned revenue = Actual costs incurred.[14] Other calculations are required when reasonably dependable estimates cannot be made or when a loss is expected. (SOP 81-1, ¶ 25 and 79–81; AAG, ¶ 2.04–.06 and 2.27)	Revenue and costs are recognized upon satisfaction of performance obligations (i.e., when the customer obtains control of the promised goods or services).[15] When control is transferred at a point in time, indicators of the transfer of control include (but are not limited to) the present right to payment, transfer of legal title, physical possession, significant risks and rewards of ownership, and customer acceptance. Revenue recognition on an incomplete good or service (like percentage-of-completion accounting) is appropriate only when control is transferred over time, as defined in the ASU (see Requirements for Percentage-of-Completion Accounting below). Other calculations are required when a reasonable measure of progress cannot be made and may be required when a loss is expected on the entire contract. (ASC 606-10-25-23 through 25-37)	An entity must analyze performance obligations to determine when control is transferred (and therefore when revenue can be recognized). Certain contracts may no longer qualify for revenue recognition during the construction period. For contracts for which a cost-to-cost model is currently used and for which the entity has determined that revenue recognition over time is appropriate under ASC 606, the timing of revenue recognition may not differ significantly. Further, for production contracts for which the units-of-delivery method is currently used and for which the entity has determined that such method is appropriate under the ASU, the timing of revenue recognition may not differ significantly. However, costs may need to be expensed as incurred, which could cause a difference in the timing of margin recognized. For other contracts, the timing of revenue recognition may be significantly later to the extent that the transfer of control is not over time.[16]
Requirements for Percentage-of-Completion Accounting		
To use percentage-of-completion accounting, the seller must be able to make reasonably dependable estimates. Estimates of total contract revenue and costs are considered reasonably dependable if minimum total revenue and maximum total cost can be estimated with enough confidence to justify the seller's bid. (SOP 81-1, ¶ 23 and 27)	Satisfaction of an obligation over time is required if any one of the following three criteria is met: • The customer simultaneously receives and consumes the benefit 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 [e.g., inability to transfer to another customer without substantial rework] and the entity has an enforceable right to payment for performance completed to date"[17] and expects to fulfill the contract as promised. (ASC 606-10-25-27)	Certain contracts/performance obligations may no longer qualify for revenue recognition during the performance or construction period. But an entity may now be required by other contracts that historically have resulted in recognition of revenue when units are delivered to recognize revenue over time as units are produced.

13 A modification of this method allows for revenue and cost to be recorded on the basis of stated unit prices, actual unit cost, or both, if the units-of-delivery method is used. Under the units-of-delivery method, percentage complete is calculated on the basis of the number of units delivered compared with the total units to be delivered.

14 Costs incurred are adjusted to exclude materials that are not unique to the contract and subcontractor costs for work yet to be performed.

15 Control refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Benefits are the potential direct or indirect cash flows (i.e., inflows or savings in outflows) that may be obtained from using the asset (e.g., to produce goods or provide services, enhance the value of other assets, settle liabilities or reduce expenses, make a sale or exchange, pledge as security for a loan).

16 Under any scenario, the amount of revenue to be recognized in any period may be different depending on the impact of the segmentation criteria discussed above.

17 Compensation for performance completed to date includes payment that approximates the selling price of the goods or services transferred to date (e.g., cost plus a reasonable profit margin), rather than compensation only for loss of profit.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Methods of Measuring Progress		
The percentage complete may be measured in terms of input or output measures (i.e., amounts expended or completed compared with total estimated input or output). Various methods are allowed, provided that the measure is reasonably related to actual progress toward completion. (SOP 81-1, ¶ 44–51)	Progress should be measured by using a method that depicts the transfer of control of goods or services. Input or output measures may be used.[18] The ASU states that output methods may often result in the most faithful depiction of an entity's performance. If an entity is not able to reasonably measure the outcome of a performance obligation (e.g., in the early stages of a contract) but expects to recover its costs, the entity should recognize revenue to the extent of costs incurred until it can reasonably measure the outcome of the performance obligation. (ASC 606-10-25-31 through 25-37 and BC164 of ASU 2014-09)	Entities may need to reevaluate the manner in which they measure progress toward completion.
Adjustments to Input and Output Measures		
When using a cost-incurred input measure, an entity should disregard certain costs that are unrelated to performance (e.g., significant uninstalled materials). (SOP 81-1, ¶ 50)	Percentage-of-completion calculations exclude the following: • "[G]oods or services for which the entity does not transfer control to a customer." • For input measures, (1) wasted materials, labor, or other resources not reflected in the price of the contract (i.e., the unexpected amounts) and (2) significant material procurement in advance of the related efforts (in certain instances, these costs may need to be recognized at a zero margin). (ASC 606-10-25-34 and ASC 606-10-55-21)	Cost-to-cost and other input methods must be modified to exclude the effects of cost overruns/underruns that do not result in the transfer of additional/reduced assets to the customer. Output methods (e.g., milestones) may need to be adjusted to exclude goods or services that are not transferred to the customer. In some instances, significant material procurement, in advance of related efforts, will be recorded at a zero margin (as opposed to being excluded from the percentage-of-completion calculation).
Provision for Anticipated Losses		
When estimated costs exceed estimated revenues, a provision for the entire loss is immediately recognized. The amount should include all elements of contract costs and is recorded as additional contract cost. (SOP 81-1, ¶ 85–88)	An entity would need to assess in each reporting period whether it expects to incur a loss on the basis of its current estimates of (1) the amount of consideration that it expects to be entitled to in exchange for transferring promised goods or services to the customer and (2) contract cost. If an entity estimates that a loss will be incurred, a provision for the loss on the contract is required. Companies can elect to determine provisions for losses at either the contract level (including contracts that are combined) or the performance obligation level (ASC 605-35-25-47).	Because entities may now have multiple performance obligations within a contract, they may be required to perform their loss contract assessment at a more granular level.

[18] One method is chosen per performance obligation and must be applied consistently in similar circumstances.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Recognition Constraint on Variable Consideration, Including Award Fees and Incentives		
The amount of revenue recognized to date (ITD revenue) is constrained only to the extent that it does not qualify for inclusion in the contract EAC. (SOP 81-1, ¶ 79–81)	If the consideration an entity expects to be entitled to under a contract includes a variable amount, the entity should estimate the amount it expects to be entitled to by using whichever of the following methods better predicts that amount: • *"Expected value" approach* — Typically used if the entity has a contract with a large number of outcomes within a narrow range. • *"Most likely amount" approach* — Typically used if a contract has only two possible outcomes (e.g., an entity receives a performance bonus or does not). However, the entity's estimate of variable consideration should be included in the transaction price only to the extent that the entity concludes that it is probable that a subsequent change in the estimate of the amount of variable consideration would not result in a significant revenue reversal. The entity must reperform this assessment as of each reporting date. Factors that indicate that including an estimate of variable consideration in the transaction price could result in a significant revenue reversal include: • "The amount of consideration is highly susceptible to factors outside the entity's influence" (e.g., judgment of third parties, weather conditions). • "The uncertainty . . . is not expected to be resolved for a long period of time." • The extent of "experience (or other evidence) . . . is limited." • The entity has a practice of offering a broad range of price concessions or changing the payment terms and conditions of similar contracts. • Existence of a large number and broad range of possible outcomes. (ASC 606-10-32-8 and ASC 606-10-32-11 and 32-12)	An entity will continue to be required to use significant judgment to estimate the amount of variable consideration in a contract that is not subject to significant revenue reversal as of each reporting date. A significant portion of revenue recognized under contracts for which consideration is based on the price of a commodity or currency on a future date may be delayed until the uncertainty regarding the amount of variable consideration is resolved.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Cost Elements, Precontract Costs, and Learning Costs		
Cost elements — Contract costs include all direct costs (e.g., materials, labor) and allocable indirect costs (e.g., insurance, depreciation). Other types of allowable costs[19] may be included in contract costs for government contractors. (SOP 81-1, ¶ 39 and 72; AAG, ¶ 2.18–2.20) *Precontract costs* — Precontract start-up costs are typically expensed as incurred. Other precontract costs may be capitalized[20] in the following instances: • Costs are incurred for assets, such as materials, equipment, or creation of inventory, and "their recovery from future contract revenue or from other dispositions of the assets is probable." • Costs are incurred for a specific anticipated contract (and will result in no future benefits unless the contract is obtained) and their recoverability from that contract is probable. (SOP 81-1, ¶ 75) *Learning costs* — Learning or start-up costs related to existing contracts "and in anticipation of follow-on or future contracts for the same goods or services should be charged to existing contracts." (SOP 81-1, ¶ 75)	Costs to fulfill a contract are capitalized (included in contract costs) if they meet the requirements in other standards (e.g., inventory). Other costs to fulfill a contract must be capitalized if they (1) are directly related to a current or specific anticipated contract, (2) generate or enhance resources of the entity that will be used in satisfying (or continuing to satisfy) performance obligations in the future, and (3) are expected to be recovered. The following costs must be expensed as incurred: • General and administrative (G&A) costs that are not explicitly chargeable to the customer. • "Costs of wasted materials, labor, or other resources . . . that were not reflected in the price of the contract." • "Costs that relate to satisfied performance obligations (or partially satisfied performance obligations)." • Costs related to remaining performance obligations but that the entity cannot distinguish from costs related to satisfied performance obligations. (ASC 340-40-25-5 through 25-8)	For existing production contracts accounted for as production lots or releases (or units of delivery with average cost), a lower margin may be recognized in early periods (and a higher margin in later periods) depending on the nature of learning curve costs, whether units are considered distinct (i.e., the number of identified performance obligations), and whether the contract terms specifically allow an entity to charge costs to its customer.
Costs of Obtaining a Contract		
Selling costs are expensed as incurred, "unless they meet the criteria for precontract costs." (SOP 81-1, ¶ 72)	Incremental costs of obtaining a contract, which are defined as costs that the entity "would not have incurred if the contract had not been obtained" (e.g., sales commissions), are capitalized if the entity expects to recover the costs. Otherwise, such costs are expensed as incurred unless they are explicitly chargeable to the customer, regardless of whether the contract is obtained. Capitalized costs are then "amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates." As a practical expedient, costs of obtaining a contract can be expensed as incurred if the amortization period is one year or less. (ASC 340-40-25-1 through 25-4 and ASC 340-40-35-1)	Certain costs of obtaining a contract may need to be capitalized and amortized.

[19] As defined by federal procurement regulations.

[20] Noninventory costs are classified outside of the inventory or contract cost classification until the contract is received. Costs previously expensed are not reinstated upon receipt of the contract.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
G&A Expenses		
Generally, G&A costs are expensed as incurred and are not included in contract costs, except: • To the extent they are considered allowable costs for government contracts. • To the extent they are reimbursable under cost-type government contracts. • As allowed for contracts accounted for under the completed-contract method. If included in contract costs, G&A expenses may be expensed as incurred or included in inventory. (SOP 81-1, ¶ 69–72; AAG, 3.04–3.07 and 3.61–3.62)	In general, an entity should recognize G&A costs as expenses when incurred "(unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with paragraph 340-40-25-7)." (ASC 340-40-25-8) "Costs that relate directly to a contract (or a specific anticipated contract) include any of the following: . . . d. Costs that are explicitly chargeable to the customer under the contract." (ASC 340-40-25-7) "[C]osts incurred in fulfilling a contract with a customer" may be "within the scope of another Topic." If so, "an entity shall account for those costs in accordance with those other Topics or Subtopics." Therefore, these costs may be capitalized on the balance sheet. (ASC 340-40-25-6)	Current guidance provides for diversity in practice with regard to G&A costs. If such costs are determined to be capitalizable, an entity would then apply the criteria in ASC 340-40-25-5 to determine whether it is appropriate to record an asset for these costs. If the entity historically has been including G&A expenses as inventoriable costs, it should continue to do so when it is determining the provision for forward loss under ASC 606.

(Table continued)

ASC 605-35 (Formerly SOP 81-1)	ASC 606	Impact
Contract Assets and Liabilities		
"Amounts representing progress payments [and advance payments] billed but not yet received by the contractor are not shown in the balance sheet because it would be improper to show uncollected progress payments as an offset to the accumulated cost of contracts in progress." (ASC 912-310-25-8)	"When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable. "If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (that is, a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer. "If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for impairment in accordance with Topic 310 on receivables. An impairment of a contract asset shall be measured, presented, and disclosed in accordance with Topic 310 (see also paragraph 606-10-50-4(b))." (ASC 606-10-45-1 through 45-3)	As noted to the left, new guidance may result in different classification within the balance sheet for contract assets and liabilities.

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