Centri's Focus On: FASB

ASC 606, Revenue from Contracts with Customers

Details

The Financial Accounting Standards Board ("FASB") issued ASC 606, *Revenues from Contracts with Customers*, and ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers*, and the International Accounting Standards Boards ("IASB") issued IFRS 15, *Revenue from Contracts with Customer*s in May 2014. It generally converged both revenue standards eliminating most differences between U.S. GAAP and IFRS in accounting for revenue from contracts with customers. It takes effect in 2018 for annual reporting periods beginning after December 15, 2017 for public entities and annual reporting periods beginning after December 15, 2018 for nonpublic entities, and addresses virtually all industries in U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. For many entities, the timing, pattern of revenue recognition and capitalization of certain costs will change. In some areas, the changes will be very significant and will require careful planning.

The new standard also introduces significantly enhanced disclosure requirements. In practice, even if the timing and pattern of revenue recognition does not change, it is certain that new and modified processes will be needed in order to comply with the disclosure requirements.

Background

The FASB's joint project with the IASB to develop a new accounting standard for revenue recognition dates back over a decade. The U.S. and international standard setters had noted inconsistencies and weaknesses in each of their respective accounting standards. In IFRS, there was significant diversity in practice because existing standards contained limited guidance for a range of significant topics, such as accounting for contracts with multiple elements; Under U.S. GAAP, concepts for revenue recognition had been supplemented with a broad range of industry specific guidance, which had resulted in economically similar transactions being accounted for differently.

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In addition, both the FASB and the IASB noted that existing disclosure requirements were inadequate. The previous requirements often resulted in insufficient information for users of financial statements to understand the sources of revenue, and the key judgments and estimates that had been made in its recognition. This often led to the information being disclosed as 'boilerplate' and uninformative.

The new revenue standards establish a single, comprehensive framework, which sets out how much revenue is to be recognized, and when. The core principle is that revenue is recognized as a result of an entity transferring promised goods or services to customers.

Recent Updates

Subsequent to issuing new accounting standards for revenue recognition, the FASB and IASB (the "Boards") formed the Joint Transition Resource Group for Revenue Recognition ("TRG"). The goals of the TRG are to inform the Boards about potential implementation issues and to assist stakeholders in understanding specific aspects of the new guidance. As a result of TRG deliberations, the FASB has made the following updates to ASC 606:

- ASU 2015-14, *Deferral of the Effective Date*
- ASU 2016-08, *Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*
- ASU 2016-10, *Identifying Performance Obligations and Licensing*
- ASU 2016-12, *Narrow Scope Improvements and Practical Expedients*
- ASU 2016-20, *Technical Corrections and Improvements to ASC 606, Revenue from Contracts with Customers*

Scope

Applies to all contracts with customers, except for contracts that are within the scope of other standards:

- Lease contracts (ASC 840)
- Insurance contracts (ASC 944)
- Financial instruments and other contractual rights or obligations (ASC 310, 320, 323, 325, 405, 470, 815, 825, and 860)
- Certain non-monetary exchanges

Effective Date

Public entities

- First interim period within annual reporting periods beginning after December 15, 2017.

Nonpublic entities

- Annual reporting periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019.

Early adoption

- Permitted for all entities but no earlier than periods beginning after December 15, 2016.

Transition

ASC 606 is required to be applied using one of the following methods:

(i) Retrospective application to each reporting period presented in accordance with ASC 250, *Accounting Changes and Error Corrections* or IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*

(ii) Modified retrospective by means of recognizing a cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings in the period of adoption. The following practical expedients can also be elected:

- Need not restate contracts that begin and are completed with the same annual reporting period
- For completed contracts that have variable consideration, may use transaction price at the date the contract was completed
- For reporting period prior to the date of initial application, need not disclose the amount of transaction price allocated to the remaining performance obligations and related explanation
- Need not restate modified contracts that were modified before the beginning of the earliest reporting period presented

Definitions

Contract:

An agreement between two or more parties that creates enforceable rights and obligations.

Customer:

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Revenue:

US GAAP - Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

IFRS – Revenue as income arising in the course of an entity's ordinary activities.

Distinct:

A good or service that is promised to a customer that meets both the following criteria:

(i) 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.
(ii) The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Standalone selling price:

The price at which an entity would sell a promised good or service separately to a customer.

Performance obligation:

A promise to transfer to the customer either:

(i) A <u>distinct</u> (bundle of) good(s) or service(s)
(ii) A series of substantially the same <u>distinct</u> goods or services that have the same pattern of transfer to the customer, and the pattern of transfer is both over time and represents the progress towards complete satisfaction of the performance obligation.

THE 'FIVE STEP' MODEL

Revenue from contracts with customers is recognized based on the application of a principle-based 'five step' model:

IDENTIFY, DETERMINE, ALLOCATE, RECOGNIZE

- **Step 1: IDENTIFY the contract**
- **Step 2: IDENTIFY the performance obligation(s)**
- **Step 3: DETERMINE the transaction price**
- **Step 4: ALLOCATE the transaction price to each performance obligation**
- **Step 5: RECOGNIZE revenue as each performance obligation is satisfied**

Step 1: Identify the Contract

Features of a 'contract' under ASC 606

Contracts, and approval of contracts, can be written, oral or implied by an entity's customary business practices.

ASC 606 requires contracts to have **all** of the following attributes:

- The contract has been approved and the parties are committed to perform their respective obligations
- The rights and payment terms regarding goods and services to be transferred can be identified
- The contract has commercial substance
- It is probable substantially all of the consideration that the vendor is entitled to will be collected (considering only the customer's ability and intention to pay)

If each party to the contract has a unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties), no contract exists under ASC 606.

Combining multiple contracts

Contracts are combined if they are entered into at (or near) the same time, with the same customer, if any of the following criteria are met:

- The contracts are negotiated as a package with a single commercial objective;
- The consideration to be paid in one contract depends on the price or performance of another; or
- The overall goods or services of the contracts represent a single performance obligation.

Contract modifications

A change in enforceable rights and obligations (i.e. scope and/or price) is only accounted for as a contract modification if it has been approved, and creates new or changes existing enforceable rights and obligations.

Contract modifications are accounted for as a separate contract if, and only if:

- The contract scope changes due to the addition of <u>distinct</u> goods and services, and
- The change in contract price reflects the standalone selling price of the <u>distinct</u> good or service.

Contract modifications that are not accounted for as a separate contract are accounted for as either:

(i) Replacement of the original contract with a new contract (if the remaining goods and services under the original contract are distinct from those already transferred to the customer).

(ii) Continuation of the original contract (if the remaining goods and services under the original contract are distinct from those already transferred to the customer, and the performance obligation is partially satisfied at modification date).

Step 2: Identify the Performance Obligation

What is a performance obligation?

A performance obligation is the contractual promise by an entity, to transfer to a customer, distinct goods or services, either individually, in a bundle, or as a series over time.

Activities of the entity that do not result in a transfer of goods or services to the customer (e.g. certain internal administrative 'set-up' activities) are **not** performance obligations in the contract with the customer and do not give rise to revenue.

Definition of 'Distinct' (two criteria to be met)

(i) The customer can 'benefit' from the good or service

Benefit from the good or service can be through either:

- Use, consumption, or sale (but not as scrap), or
- Held in a way to generate economic benefits.

Benefit from the good or service can be either:

- On its own, or
- Together with other readily available resources (i.e. those which can be acquired by the customer from the entity or other parties).

(ii) The promise to transfer a good or service is separable from other promises in the contract

The assessment requires judgment, and consideration of all relevant facts and circumstances. A good or service may **not be separable** from other promised goods or services in the contract, if:

- There are significant integration services with other promised goods or services;
- It modifies/customizes other promised goods or services; and
- It is highly dependent/interrelated with other promised goods or services.

Step 3: Determine the Transaction Price

What is the transaction price?

The transaction price is the amount of consideration an entity expects to be entitled to in exchange for transferring the promised goods or services. The transaction price is allocated to previously identified performance obligation(s) and ultimately is the amount of revenue recognized as those identified performance obligations are satisfied. An accounting policy election is available to exclude amounts collected from customers for all sales (and other similar) taxes from the transaction price. Otherwise, an entity must determine whether such amounts should be included or not.

The transaction price may be effected by the nature, timing, and amount of consideration, and includes consideration of significant financing components, variable components, amounts payable to the customer (e.g. refunds and rebates), and non-cash amounts.

Accounting for variable consideration

Examples of variable consideration include discounts, rebates, refunds, credits, concessions, incentives, performance bonuses, penalties, and contingent payments. Variable consideration must be estimated using either:

(i) **Expected value method:** based on the sum of probability-weighted amounts within a range of possible consideration amounts (i.e. for large number of similar contracts).

(ii) **Most likely amount**: the single most likely amount within a range of possible consideration amounts (i.e. where there are few outcomes to consider).

Constraining (limiting) the estimate of variable consideration

- Variable consideration is only recognized if it is probable that a subsequent change in the estimate would not result in a significant revenue reversal (i.e. a significant reduction in cumulative revenue recognized).

Accounting for a significant financing component

Required if the timing of payments provides either the customer or the entity with a significant benefit of financing the transfer of goods or services. The transaction price is adjusted to reflect the cash selling price at the point in time control of the goods or services is transferred.

A significant financing component can either be explicit or implicit. Factors to consider include:

- Difference between the consideration and cash selling price
- Combined effect of interest rates and length of time between transfer of control of the goods and services and payment

A significant financing component does not exist when:

- Timing of the transfer of control of the goods or services is at the customer's discretion
- The consideration is variable with the amount or timing based on factors outside of the control of the parties
- The difference between the consideration and cash selling price arises for other non- financing reasons (i.e. performance protection)

Discount rate to be used

- Must reflect credit characteristics of the party receiving the financing and any collateral/security provided

Practical expedient – period between transfer and payment is 12 months or less

- Do not account for any significant financing component.

Accounting for consideration payable to the customer

Includes cash paid (or expected to be paid) to the customer (or the customer's customers) as well as credits or other items such as coupons and vouchers. Accounted for as a reduction in the transaction price, unless payment is in exchange for a distinct good or service received from the customer in which case no adjustment is made – except where:

- The consideration paid exceeds the fair value of the goods or services received (the difference is set against the transaction price)
- The fair value of the goods or services cannot be reliably determined (full amount taken against the transaction price)

Accounting for non-cash consideration

Includes receipt of goods, services, or equity instruments from a customer. Usually measured at fair value at contract inception.

Step 4: Allocate the Transaction Price to Each Performance Obligation

The transaction price (Step 3) is allocated to each performance obligation (Step 2) based on the *stand-alone selling price* of each performance obligation. If the *stand-alone selling price(s)* is/are not observable, it is estimated, maximizing the use of observable inputs.

Approaches to estimate may include:

(i) **Adjusted market assessment approach**
(ii) **Expected cost plus a margin approach**
(iii) **Residual approach** (i.e. residual after observable stand-alone selling prices of other performance obligations have been deducted)

Note that restrictive criteria must be met for approach (iii) to be applied.

Allocating variable consideration

Variable consideration is allocated entirely to a performance obligation (or a distinct good or service within a performance obligation), if both:

- The terms of the variable consideration relate specifically to satisfying the performance obligation (or transferring the distinct good or service within the performance obligation); and
- The allocation of the variable consideration is consistent with the principle that the transaction price is allocated based on what the entity expects to receive for satisfying the performance obligation (or transferring the distinct good or service within the performance obligation).

Allocating a 'discount'

A discount exists where the sum of the stand-alone selling prices of all performance obligations exceeds the consideration payable. Discounts are allocated on a proportionate basis, unless there is observable evidence that the discount relates to one or more specific performance obligation(s) after meeting all of the following criteria:

- The goods or services (or bundle thereof) in the performance obligation are regularly sold on a stand-alone basis, and at a discount; and
- The discount is substantially the same in amount to the discount that would be given on a stand-alone basis.

Step 5: Recognize Revenue as Each Performance Obligation is Satisfied

The transaction price allocated to each performance obligation (Step 4) is recognized as/when the performance obligation is satisfied, either:

- **(i)** Over time, or
- **(ii)** At a point in time.

Satisfaction occurs when control of the promised good or service is transferred to the customer:

- Ability to direct the use of the asset
- Ability to obtain substantially all the remaining benefits from the asset

Factors to consider when assessing transfer of control:

- Entity has present right to payment for the asset
- Entity has physically transferred the asset
- Legal title of the asset
- Risks and rewards of ownership
- Acceptance of the asset by the customer

(i) Recognizing Revenue <u>Over Time</u> (applies if any of the following three criteria are met)

1. **Customer simultaneously receives and consumes all of the benefits**
   E.g. many recurring service contracts (such as cleaning services). If another entity would not need to substantially re-perform the work already performed by the entity in order to satisfy the performance obligation, the customer is considered to be simultaneously receiving and consuming benefits.

2. **The entity's work creates or enhances an asset controlled by the customer**
   The asset being created or enhanced (e.g. a work in progress asset) could be tangible or intangible.

3. **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.**
   a. *<u>Alternate use</u>*
      Assessment requires judgment and consideration of all facts and circumstances. An asset does not have an alternate use if the entity cannot *practically* or *contractually* redirect the asset to another customer:
      - Significant economic loss, i.e. through rework, or reduced sale price (*practical*)
      - Enforceable rights held by the customer to prohibit redirection of the asset (*contractual*)

      Whether or not the asset is largely interchangeable with other assets produced by the entity should also be considered in determining whether practical or contractual limitations occur.

   b. *<u>Enforceable right to payment</u>*
      Consider both the specific contractual terms and any applicable laws or regulations. Ultimately, other than due to its own failure to perform as promised, an entity must be entitled to compensation that approximates the selling price of the goods or services transferred to date. The profit margin does not need to equal the profit margin expected if the contract was fulfilled as promised. For example, it could be a proportion of the expected profit margin that reflects performance to date.

Revenue that is recognized over time is recognized in a way that depicts the entity's performance in transferring control of goods or services to customers. Methods include:

- Output methods: (e.g. Surveys of performance completed to date, appraisals of results achieved, milestones reached, units produced/delivered, etc.).
- Input methods: (e.g. Resources consumed, labor hours, costs incurred, time lapsed, machine hours, etc.), excluding costs that do not represent the seller's performance.

(ii) Recognizing Revenue at a Point in Time

Revenue is recognized at a point in time if the criteria for recognizing revenue over time are not met. Revenue is recognized at the point in time at which the entity transfers control of the asset to the customer (see adjacent box).

Application Guidance with ASC 606

ASC 606 contains application guidance for:

- **Contract costs**
- Sale with a right of return
- **Warranties**
- Principal versus agent considerations
- Customer options for additional goods or services
- Customers' unexercised rights
- **Licensing**
- **Non-refundable upfront fees (and some related costs)**
- Repurchase agreements
- Consignment arrangements
- Bill-and-hold arrangements
- Customer acceptance

A summary is set out below for the items in bold.

Contract costs (Subtopic 340-40)

Costs of obtaining a contract that are incremental and expected to be recovered are recognized as an asset. If costs to fulfill a contract are within the scope of other Topics (e.g. ASC 330, 350, 360, etc.) apply those Topics. If not, a contract asset is recognized under Subtopic 340-40 if, and only if, the costs:

- Are specifically identifiable and directly relate to the contract (e.g. direct labor, materials, overhead allocations, other unavoidable costs (e.g. sub- contractors));
- Create (or enhance) resources of the entity that will be used to satisfy performance obligation(s) in the future; and
- Are expected to be recovered.

Costs that are recognized as an expense as incurred

- General and administrative expenses
- Wastage, scrap, and other (unanticipated) costs not incorporated into pricing the contract
- Costs related to (or can't be distinguished from) past performance obligations

Amortization and impairment of contract assets

- **Amortization** is based on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates.
- **Impairment** exists where the contract carrying amount is greater than the remaining consideration receivable, less directly related costs to be incurred.

Warranties (fall into either one of two categories):

(i) Assurance type (apply Subtopic 460-10):

- An assurance to the customer that the good or service will function as specified
- The customer cannot purchase this warranty separately from the entity

(ii) Service type (accounted for separately in accordance with ASC 606):

- A service is provided in addition to an assurance to the customer that the good or service will function as specified
- This applies regardless of whether the customer is able to purchase this warranty separately from the entity

In determining the classification (or part thereof) of a warranty, an entity considers:

- Legal requirements: (warranties required by law are usually assurance type)
- Length: (longer the length of coverage, more likely additional services are being provided)
- Nature of tasks: (do they provide a service or are they related to assurance? (e.g. return shipping for defective goods))

Licensing (of an entity's intellectual property (IP)

(i) *If the license is not distinct from other goods or services*

- It is accounted for together with other promised goods and services as a single performance obligation
- A license is not distinct if either:
  - o It is an integral component to the functionality of a tangible good; or
  - o The customer can only benefit from the license in conjunction with a related service.

(ii) *If the license is distinct from other goods or services*

- It is accounted for as a single performance obligation.
- Revenue is recognized either at a point in time, or over time, depending on whether the nature of the vendor's promise in transferring the license to the customer is to provide customer with either:
  - o A right to access the vendor's IP throughout the license period (i.e., the vendor continues to be involved with its IP); or
  - o A right to use the vendor's IP as it exists at the point in time the license is granted.

To determine whether the promise represents a right to access the vendor's IP or a right to use the vendor's IP, consider the nature of the IP by categorizing the underlying license as either functional or symbolic.

- A functional license has significant standalone functionality because it can be used as is for performing a specific task, or be aired or played.
- A symbolic license does not have significant standalone functionality. It represents a promise to both (a) grant the customer rights to use and benefit from the intellectual property and (b) support or maintain the intellectual property during the license period (or over the remaining economic life, if shorter).

Non-refundable upfront fees

Includes additional fees charged at (or near) the inception of the contract (e.g. joining fees, activation fees, set-up fees etc.). Treatment dependents on whether the fee relates to the transfer of goods or services to the customer (i.e. a performance obligation under the contract):

- **Yes**: Recognize revenue in accordance with ASC 606 (as or when goods or services transferred)
- **No**: Treated as an advance payment for the performance obligations to be fulfilled

(*Note*: Revenue recognition period may in some cases be longer than the contractual period if the customer has a right to, and is reasonably expected to, extend/renew the contract).

Disclosure

Overall objective: to disclose sufficient information to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

Contracts with customers (information regarding):
- Disaggregation of revenue
- Contract assets and contract liabilities
- Performance obligations (including remaining)

Use of practical expedients (related to):
- Significant financing component (greater than 12-months)
- Contract costs (amortization period greater than 12-months)

Significant judgments:
- Performance obligation satisfaction
- Transaction price (including allocation)
- Determining contract costs capitalized

Contract costs capitalized:
- Method of amortization
- Closing balances by asset type
- Amortization and impairment

Presentation

Statement of financial position
- Contract assets and contract liabilities from customers are presented separately
- Unconditional rights to consideration are presented separately as receivables

Statement of profit or loss and comprehensive income
- Line items (revenue and impairment) are presented separately in accordance with the requirements of Topic 205, *Presentation of Financial Statements.*

Appendix 1 – Frequently Asked Questions – SEC Registrants

Q1: ***Can an SEC registrant early adopt ASC 606?***
A1: In limited circumstances. For a public business entity, the amendments in the update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The U.S. standard allows early adoption as of the original effective date, which was for periods beginning after December 15, 2016. Adoption prior to that date is not permitted under U.S. GAAP. However, foreign private issuers (FPIs) that report under IFRS as issued by the IASB are allowed to early adopt. Otherwise, IFRS 15 applies to annual reporting periods beginning on or after January 1, 2018.

Q2: ***Is there any accommodation in the transition rules if a company's status changes from "private" to "public" in 2018? For example, what happens if a private company conducts an IPO, is acquired by an SEC registrant under Regulation S-X 3-05 Financial statements of businesses acquired or to be acquired, or becomes a significant equity method investee of a public company in 2018 under Regulation S-X 3-09 or 4-08(g)?***
A2: No. Currently, in each of the situations noted above, a "private" company would meet the definition of a public business entity for purposes of an SEC filing that includes its financial statements. The FASB's definition of a public business entity (PBE) includes entities whose financial information or financial statements are included in a filing with the SEC. Consequently, entities that are otherwise privately-held may be considered PBEs solely because their financial information/statements appear in an SEC filing (e.g., financial statements of an acquired business under Rule 3-05 or an equity method investee under Rule 3-09, and financial information of equity method investees under Rule 4-08(g)). As such, the "private" company would be considered public and required to adopt the standard one year earlier than entities that are not public. However, the staff discussed the application of the PBE definition to an insignificant equity method investee whose financial information is not included in the filing, but is used only for purposes of recording the registrant's share of the investee's earnings or losses. The staff indicated that this type of equity method investee would not be considered a PBE and therefore, would not be required to adopt the new accounting standards using the PBE adoption dates.

Q3: ***Are any disclosures required prior to adoption of the new revenue standard?***
A3: Yes. SEC registrants should continue to make disclosures under Staff Accounting Bulletin No. 74 (codified in SAB Topic 11-M) in their interim and annual filings. SAB 74 addresses disclosure of the impact that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period. The SEC staff has indicated that it expects these disclosures to evolve over time as companies begin to better understand how the standard will impact their financial statements. At the September 22, 2016 EITF meeting, the SEC staff made an announcement regarding its views about SAB 74 disclosures related to ASU 2014-09, among others. The staff expects registrants that are not yet in a position to disclose the effects of the standard on their financial statements will make additional qualitative disclosures including:

- The effect of the accounting policies that the registrant expects to apply (if determined) and a comparison to the registrant's current accounting policies and
- The status of its process to implement the new standards and the significant implementation matters yet to be addressed.

Registrants should also consider making any additional qualitative disclosures necessary to help financial statement users understand the impact of the new standard. As encouraged by SAB 74, this may include disclosure of the potential impact of other significant matters that may result from the adoption of the standard (e.g., technical violations of debt covenants or planned changes in business practices). The method of transition should also be disclosed as soon as one is elected, which will likely vary across entities.

Q4: ***Must SEC registrants recast all periods reflected in the 5-year Summary of Selected Financial Data in accordance with the new revenue standard?***
A4: No. The Division of Corporation Finance Financial Reporting Manual states that registrants that select a full retrospective approach are not required to apply the new revenue standard when reporting selected financial data to periods prior to those presented in its retroactively-adjusted financial statements. That is, a company would be required to reflect the accounting change in selected financial data only for the three years for which it presents full financial statements elsewhere in the filing. Companies will be required to provide the disclosures required by Instruction 2 to S-K Item 301 regarding comparability of the data presented.

Q5: ***Will an entity's accounting for breakage change as a result of the new revenue standard?***
A5: Maybe. The SEC staff currently accepts three approaches for recognizing breakage: (1) upon vendor's legal release from its obligations, for example, at expiration, (2) at the point redemption becomes remote, or (3) in proportion to redemption activity. The selection of a breakage model is an accounting policy election.

The new revenue standard does not permit the first approach based on legal release. Further, an accounting policy election between the two remaining approaches is not available. Rather, if an entity expects to be entitled to breakage, then it is required to recognize the breakage as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, breakage is recognized as revenue when the likelihood of the customer exercising its remaining rights becomes remote. Further, when assessing breakage, entities are required to apply the guidance on constraining variable consideration, which ensures that the entity's obligation to stand ready to provide future goods and services is not understated. As such, entities may or may not (1) be required to change the way they account for breakage and/or (2) experience a change in the timing of when breakage is recognized.

However, companies must continue to comply with any applicable escheatment laws. Amounts subject to escheatment laws must be remitted to the government and should not be recognized as revenue under the breakage guidance in the new standard.

In addition, ASU 2016-04, *Recognition of Breakage for Certain Prepaid Stored-Value Products* provides guidance on accounting for the derecognition of financial liabilities related to unused prepaid gift cards and other stored-value products. Although these liabilities are not within the scope of the new revenue recognition guidance, ASU 2016-04 requires breakage on prepaid stored-value products to be recognized consistent with the breakage model in the new revenue recognition guidance.

Q6: ***Is the accounting for bill-and-hold arrangements expected to change under the new standard compared to the SEC staff's current guidance?***
A6: Generally, no. The SEC staff may revise or rescind its bill-and-hold criteria when it reconsiders SAB 104 (see below). Although the new standard's bill-and-hold guidance is slightly less prescriptive than the current SEC staff guidance, the concepts are similar. However, if this SEC staff guidance is rescinded, the accounting for bill-and-hold arrangements may change in certain circumstances. For example, there might be rare situations where revenue is recognized earlier compared to current U.S. GAAP for bill-and-hold arrangements because there is no longer a requirement for the vendor to have a fixed delivery schedule from the customer in order to recognize revenue, nor is the customer required to have been the party that initiated the bill and hold arrangement.

However, in all cases, entities must apply the basic five-step model for recognizing revenue in addition to meeting the specific criteria for bill and hold arrangements. Further, agreements that lack a fixed delivery schedule or that the customer did not initiate, may in fact lack a substantive business purposes. If the arrangement lacks substance, revenue recognition on a bill and hold basis would be precluded.

Q7: ***Will the SEC staff rescind SAB No. 104?***
A7: This is still uncertain. The SEC staff recently reiterated that the guidance in SAB 104 will continue to be applicable prior to the adoption of the new revenue standard, and thus will remain relevant until all registrants have completed their transition. However, the staff also indicated that they are reviewing all ASC 606 implementation-related consultations through consideration of the new standard rather than SAB 104.

Q8: ***Does the new revenue standard change the SEC's rule to separately present items of revenue that represent 10% or more of total income, e.g., different types of product and service revenue?***
A8: No. There is no indication that Rule 5-03, *Income Statements* of Regulation S-X will be amended as a result of the new standard.

Q9: ***Are there any internal control implications related to adopting and implementing the new revenue standard?***
A9: Yes. The SEC staff has indicated that public companies should ensure they have the appropriate controls in place with respect to implementing new accounting standards, including the new revenue recognition standard. This is prior and in addition to any internal control changes related to revenue recognition after adoption.

Q10: ***If a registrant elects to adopt the new revenue standard on a full retrospective basis and files a new or amended registration statement on Form S-3 in the year of adoption, will it be required to retrospectively revise its financial statements earlier than would otherwise be required if it did not file a new or amended registration statement?***
A10: Yes. Item 11(b) of Form S-3 requires a registrant to recast its annual financial statements in a new or amended registration statement after retrospective adoption of a new accounting principle, if the change is material. Consequently, a registrant that elects to adopt the new revenue standard on a full retrospective basis may be required to recast its financial statements for an additional year if it files a new or amended registration statement in 2018. For example, a registrant with a calendar year end that adopts the revenue standard on a full retrospective basis on January 1, 2018 and does not file a registration statement in 2018 would be required to recast its 2017 and 2016 financial statements for purposes of its 2018 Form 10-K. However, if the registrant files a registration statement on Form S-3 in 2018 after it has filed its first quarter Form 10-Q, it would be required to restate its 2017, 2016 and 2015 financial statements. However, the staff communicated that registrants may consider the impracticability exception included in ASC 250-10-45-9 if, for example, a company is unable to apply the requirement to recast all periods presented in its financial statements after making every reasonable effort to do so. While not required, the staff has indicated that a registrant may wish to consult with the Office of the Chief Accountant if it has concluded it would be impracticable to present one or more comparative periods.

With respect to shelf takedowns (i.e., offers made using an already effective registration statement) in 2018, the staff indicated that it would not expect registrants to conclude that the adoption of a new accounting standard qualifies as a "fundamental change," which would trigger the need to file a post-effective amendment to the registration statement and the recasting of the financial statements for the additional year as described above.