



# Revenue Recognition in the Manufacturing Industry

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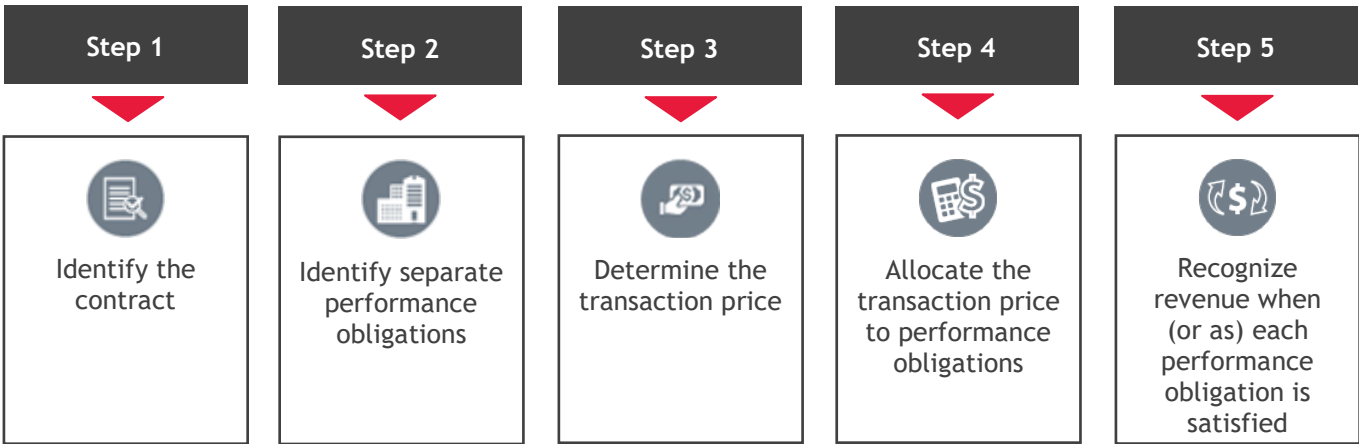
# TABLE OF CONTENTS

|                                                                              |    |
|------------------------------------------------------------------------------|----|
| Revenue Recognition in the Manufacturing Industry                            | 3  |
| Introduction                                                                 | 3  |
| Step 1: Identify the Contract with a Customer                                | 4  |
| Step 2: Identify the Performance Obligations in the Contract                 | 12 |
| Step 3: Determine the Transaction Price                                      | 24 |
| Step 4: Allocate the Transaction Price to the Performance Obligations        | 47 |
| Step 5: Recognize Revenue When or as the Performance Obligation is Satisfied | 51 |
| Contract Costs                                                               | 78 |
| Appendix A – BDO Blueprints                                                  | 81 |
| Contacts                                                                     | 82 |

# REVENUE RECOGNITION IN THE MANUFACTURING INDUSTRY

## INTRODUCTION

A manufacturing entity applies ASC 606, *Revenue from Contracts with Customers*, to recognize revenue from a contract with a customer. ASC 606 includes a detailed five-step revenue recognition model, which requires a manufacturer to identify its performance obligations in a contract with a customer and recognize revenue when or as its performance obligations are satisfied.



Manufacturing entities face unique challenges in applying certain aspects of the guidance because of the judgments inherent in applying the guidance and the unique nature of manufacturing arrangements.

### About This Publication

This publication discusses certain significant considerations specific to the manufacturing industry in applying the five-step revenue recognition model. We encourage you to read the interpretations and examples in this publication with BDO’s Blueprint, [Revenue Recognition Under ASC 606](#), which includes a detailed discussion of the five-step revenue recognition model and certain other key concepts included in ASC 606.

Revenue recognition for contracts with customers varies based on the specific facts and circumstances of each contract and, therefore, may differ from the examples and insights in this publication or in BDO’s Blueprint, [Revenue Recognition Under ASC 606](#).

## STEP 1: IDENTIFY THE CONTRACT WITH A CUSTOMER

The first step in applying the five-step revenue recognition model is to identify the contract with a customer. The definitions of the terms “contract” and “customer” establish the scope of ASC 606.

### Definition of Customer

A customer is 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.”

While the term “ordinary activities” is not defined, it refers to the notion of a manufacturing entity’s “ongoing major or central operations.”

### BDO INSIGHT 1: DETERMINING WHETHER INCOME IS FROM ORDINARY ACTIVITIES

Judgment may be required to determine whether an income-generating activity is an ordinary activity under ASC 606. For example, a manufacturing entity that starts selling new products would need to determine whether and when the new offering becomes its ordinary activity or part of its ongoing major or central operations. Conversely, selling excess manufacturing equipment is likely not part of an entity’s ongoing major or central operations and thus would likely be outside the scope of ASC 606. (See Appendix A of BDO’s Blueprint, [Revenue Recognition Under ASC 606](#), for a discussion of accounting for transfers of non-financial assets.) Reaching a conclusion about whether an income generating activity is an ordinary activity requires the application of professional judgment based on the facts and circumstances.

### EXAMPLE 1: SALE TO A COUNTERPARTY THAT IS NOT A CUSTOMER

#### FACTS

- ▶ A manufacturing entity generates revenue by manufacturing and selling containers.
- ▶ The manufacturing entity enters a contract to transfer one of the machines from its manufacturing facility to a counterparty in exchange for \$10,000.
- ▶ The manufacturing entity does not ordinarily generate revenue by selling machines; instead, it uses the machine (a fixed asset) to manufacture containers.

#### CONCLUSION

The sale of the machine is not an ordinary activity and therefore is not presented as revenue.

#### ANALYSIS

- ▶ The manufacturing entity considers whether the sale of the machine is within the scope of ASC 606.
- ▶ It observes that it does not ordinarily generate revenue by selling machines; rather, it uses the machine (a fixed asset) in its facility to manufacture containers for sale. The manufacturing entity concludes that the sale of the machine is not an output of its ordinary activities, so the counterparty in the contract for the sale of machine is not a customer. Accordingly, ASC 606 does not apply to the transaction. In other words, the manufacturing entity does not recognize or present the \$10,000 it receives from the sale of the machine as revenue.
- ▶ The manufacturing entity considers the guidance in ASC 610-20, *Other Income –Gains and Losses from the Derecognition of Nonfinancial Assets*, to determine the appropriate accounting and presentation of the sale of the machine (see Appendix A of BDO’s Blueprint, [Revenue Recognition Under ASC 606](#)).

## Definition of a Contract

A contract is an “*agreement between two or more parties that creates enforceable rights and obligations.*”

To determine whether enforceable rights and obligations exist in an arrangement with a customer, a manufacturing entity evaluates the five contract existence criteria shown below. Contract inception is the date on which all five contract existence criteria are met. ASC 606 is applied to contracts with customers only when **all** five criteria are met.

### Contract Existence Criteria

The contract has been approved and the parties are committed to performing their obligations.

Each party’s rights regarding the goods or services to be transferred can be identified.

The payment terms for the goods or services to be transferred can be identified.

The contract has commercial substance.

Collectibility of substantially all the consideration is considered probable.

In some instances, multiple legal agreements may need to be considered in combination in order to meet the definition of a contract, as illustrated in the following example:

#### EXAMPLE 2: MASTER SUPPLY AGREEMENT AND PURCHASE ORDERS

##### FACTS

- ▶ A manufacturing entity enters a master supply agreement (MSA) with a customer to supply a product according to the MSA’s terms and conditions (for example, duration of the MSA, pricing information, payment terms, return rights).
- ▶ The MSA states that the customer will place a purchase order (PO) for the quantity of products needed throughout the term of the MSA, and that each PO will be subject to the MSA’s terms and conditions.
- ▶ The MSA itself does not obligate the manufacturing entity to transfer a specific number of products to the customer or the customer to purchase and pay for a specific number of products.
- ▶ One month after the execution of the MSA, the customer submits a PO specifying the number of products it wants to purchase.
- ▶ The customer has the intent and ability to pay amounts due under the PO.

##### CONCLUSION

The MSA and PO together meet the definition of a contract.

##### ANALYSIS

- ▶ The combination of the MSA and PO (rather than the MSA alone) creates enforceable rights and obligations that require the manufacturing entity to transfer the products under the PO to the customer and the customer to purchase those products and pay according to the pricing information and payment terms in the MSA. Therefore, the first four contract existence criteria are met.
- ▶ The customer has the intent and ability to pay amounts due under the PO, therefore collectibility of substantially all the consideration is considered probable.
- ▶ Since all five contract existence criteria are met, the MSA and PO together meet the definition of a contract.

**COLLECTIBILITY IS ASSESSED FOR EACH CONTRACT**

To meet the definition of a contract, the entity must expect to collect the consideration in the contract. This criterion is assessed separately for each contract. When an entity has a practice of executing MSAs and POs with its customers, such that each PO is a separate contract, it must assess collectibility for each contract, i.e., for each PO. Entities must establish policies and procedures for monitoring creditworthiness related to their customers on an on-going basis to support its conclusions that each PO meets the definition of a contract.

In other instances, an MSA may meet the definition of a contract on its own, as illustrated in the following examples:

**EXAMPLE 3: MSA WITH MINIMUM VOLUME GUARANTEE****FACTS**

- ▶ A manufacturing entity enters an MSA with a customer to supply a product according to the MSA's terms and conditions (for example, duration of the MSA, pricing information, payment terms, return rights).
- ▶ The MSA provides that the customer will place POs for the quantity of products needed throughout the term of the MSA, and that each PO will be subject to the MSA's terms and conditions.
- ▶ The MSA includes a minimum volume guarantee under which:
  - The manufacturing entity guarantees the supply of the product.
  - The customer agrees to purchase a minimum volume of the product during the contract term.
- ▶ If the customer fails to purchase the minimum volume required, the manufacturing entity has the right to charge a penalty equal to the price of the shortfall.
- ▶ Collectibility of substantially all the consideration (including the shortfall penalty) is considered probable.

**CONCLUSION**

The MSA itself meets the definition of a contract.

**ANALYSIS**

- ▶ The MSA obligates the manufacturing entity to transfer a (minimum) specific number of products to the customer and the customer to purchase and pay for a (minimum) specific number of products. These mutual commitments create enforceable rights and obligations under the MSA regardless of whether POs have been received.
- ▶ Specifically, the MSA creates enforceable rights and obligations for the manufacturing entity to transfer the minimum volume of the product to the customer and the customer to purchase the minimum volume of the product according to the MSA's pricing information and payment terms.
- ▶ Collectibility of substantially all the consideration (including the shortfall penalty) is considered probable; therefore, all five contract existence criteria are met.
- ▶ Therefore, the MSA itself meets the definition of the contract regardless of whether POs have been received.

#### EXAMPLE 4: MSA WITH MINIMUM VOLUME GUARANTEE THAT HAS NOT BEEN ENFORCED IN THE PAST FACTS

Assume the same facts in Example 3, except that:

- ▶ The manufacturing entity's past practice indicates that if the customer does not purchase the specified minimum volume in the MSA, the manufacturing entity does not enforce the shortfall penalty.

#### CONCLUSION

The MSA itself does not meet the definition of a contract. Rather, the MSA and PO together meet the definition of a contract.

#### ANALYSIS

- ▶ Even though the MSA includes a minimum volume guarantee, the past practice of not enforcing the minimum purchase requirement indicates that the manufacturing entity and the customer are not committed to that minimum volume.
- ▶ In this fact pattern, the minimum guarantee is not substantive. As a result, the MSA does not create enforceable rights and obligations on its own.
- ▶ However, the MSA combined with a PO collectively creates enforceable rights and obligations for the parties to the contract. Determining whether the minimum volume guarantee is not enforceable because of a lack of historical enforcement may require consultation with legal advisors.
- ▶ Collectibility of substantially all the consideration (including the shortfall penalty) is considered probable; therefore, all five contract existence criteria are met.

If any of the five contract existence criteria are not met, a contract does not exist for revenue recognition purposes regardless of whether a legal contract exists. ASC 606 includes the following guidance, which is applied when an arrangement with a customer does not meet the contract existence criteria:

- ▶ Continuous reassessment of whether the contract existence criteria are subsequently met
- ▶ Accounting for consideration received from customer before contract existence criteria are met.



#### NONREFUNDABLE PAYMENTS RECEIVED FROM A CUSTOMER BEFORE THE CONTRACT EXISTENCE CRITERIA ARE MET

Regardless of whether the consideration received from the customer is nonrefundable, a manufacturing entity cannot recognize revenue based on cash collected from the customer unless either the contract existence criteria are subsequently met (in which case the manufacturing entity follows Steps 2 through 5 for recognizing revenue) or one of the three events in ASC 606-10-25-7 has occurred (see Section 2.4 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#)).

#### Contract Enforceability and Termination Clauses

A manufacturing entity applies ASC 606 to the term of the contract during which the parties have enforceable rights and obligations. The term may be affected by termination clauses such as a customer's right to terminate a contract or any penalties payable upon termination.

The term of a contract in which each party has the unilateral enforceable right to terminate without penalty does not extend beyond the then-current period. However, if only one party could terminate the contract without penalty, some enforceable rights and obligations may exist even if the contract term is limited to the then-current period. For example, if only the customer could terminate without penalty, the manufacturing entity is obliged to stand ready to perform at the customer's discretion. In effect, the customer could extend the contract by not exercising its

termination rights, which might represent a material right. A material right exists when a customer receives a benefit that it would not have received without entering into the contract, such as favorable pricing or future purchase rights. In manufacturing arrangements, material rights most commonly arise from prospective volume discounts, future purchase discounts, or similar pricing incentives. See Section 7.4 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#), for discussion on customer options and material rights.

The Transition Resource Group (TRG) discussed how to consider termination rights when establishing the contract term:



#### TRG DISCUSSIONS: CONTRACT ENFORCEABILITY AND TERMINATION CLAUSES

Although ASC 606 contains guidance on when a contract exists, practitioners questioned how to assess whether a contract exists for accounting purposes (and, if so, how to determine the contract's duration) if the contract between an entity and its customer contains termination clauses. In deliberating how such clauses must be considered by an entity, the TRG generally agreed with the conclusions illustrated in the following examples:

##### Example A

An entity enters a contract with a customer to provide services until the contract is terminated. Each party can terminate the contract without compensating the other party for termination (that is, there is no termination penalty).

The duration of the contract does not extend beyond the services already provided.

##### Example B

An entity enters a contract with a customer to provide services for two years. Each party can terminate the contract at any time 15 months after the start of the contract without compensating the other party for termination.

The duration of the contract is 15 months.

##### Example C

An entity enters a contract with a customer to provide services for two years. Either party can terminate the contract by compensating the other party.

The duration of the contract is the specified contractual period of two years.

##### Example D

An entity enters a contract with a customer to provide services for 24 months. Either party can terminate the contract by compensating the other party. The entity has a past practice of allowing customers to terminate the contract at the end of 12 months without enforcing collection of the termination penalty.

In this case, whether the contractual period is 24 months or 12 months depends on whether the past practice is considered by law to restrict the parties' enforceable rights and obligations, which can vary by jurisdiction. The entity's past practice of allowing customers to terminate the contract at the end of month 12 without enforcing collection of the termination penalty affects the contract term only if that practice changes the parties' legally enforceable rights and obligations. If that past practice does not change the parties' legally enforceable rights and obligations, the contract term is 24 months.

**BDO INSIGHT 2: EFFECT OF TERMINATION PROVISIONS ON ENFORCEABLE RIGHTS AND OBLIGATIONS**

The revenue recognition guidance is applied to the period for which enforceable rights and obligations exist between a manufacturing entity and its customer. A manufacturing entity must evaluate substantive termination provisions (termination rights, termination penalties, or other payments) in a contract with a customer as well as customary business practices to determine whether the duration for which enforceable rights and obligations exist is shorter or longer than the contractually stated term.

To meet the definition of a contract, both parties must be committed to performing their obligations. Therefore, in determining the contract term, a manufacturing entity does not assume that a breach of contract will occur, and termination provisions related to breach of contract or termination for cause are not considered. For example, a customer may have the unilateral right to cancel a contract if a manufacturing entity fails to maintain specified product quality levels consecutively for three months. In that case, the termination for cause provision does not affect the determination of the contract term at contract inception.

If the customer has the unilateral right to terminate the contract without incurring a substantial penalty, for accounting purposes, the contract term is limited to the period before the date the termination right can be exercised. Periods after that date are considered renewal options and must be evaluated when determining whether the contract includes a material right (see Section 7.4.2 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#)).

**BDO INSIGHT 3: ANALYZING TERMINATION PENALTIES**

ASC 606 does not define the terms "penalty" or "termination penalty," nor does it contain bright lines for determining whether a termination penalty is substantive. In analyzing whether either party must compensate the other to exercise a termination right, a manufacturing entity evaluates any amount payable upon termination that is unrelated to the payments due for the goods or services transferred up to the termination date. Therefore, the analysis is not restricted only to payments explicitly characterized as termination penalties. Rather, it also includes the substance of the payments made to compensate the other party for terminating a contract before the end of the stated term.

Additionally, the analysis of termination penalties is not restricted to cash payments. Determining what constitutes a termination penalty and whether the termination penalty is substantive requires the application of professional judgment based on the facts and circumstances.

**BDO INSIGHT 4: SIGNIFICANCE OF THE CONTRACT TERM**

A manufacturing entity must first determine the duration of the contract (or contract term) to apply certain aspects of the five-step revenue recognition model (for example, identifying performance obligations, determining the transaction price, and recognizing revenue upon satisfaction of a performance obligation). The contract term is also important when determining whether a practical expedient can be elected. For example, a manufacturing entity can elect the practical expedient on significant financing components in Step 3 for a short contract term (one year or less).

Determining the contract term is generally not complex when a contract has a stated duration and neither party has the unilateral right to cancel the contract. It also might not be particularly relevant to revenue recognition if the only promises are goods that are delivered at a point in time. However, determining the contract term can be more challenging when either party has cancellation rights. Analyzing cancellation rights to determine the contract term may require the application of professional judgment based on the facts and circumstances. In some cases, legal advice may be required to determine the duration for which enforceable rights and obligations exist.

### Combination of Contracts

Two or more contracts entered at or near the same time and with the same customer (or related parties of the customer, as defined in ASC 850, *Related Party Disclosures*) are accounted for as if they were a single contract, if **any** of the following criteria is met:



The contracts are negotiated as a package with a single commercial objective.



The consideration in one contract depends on the price or performance of any other contracts.



The goods or services (or some thereof) that are promised in the contracts represent a single performance obligation.

A necessary condition for two or more contracts to be combined is that they must be executed at or near the same time with the same customer (or the customer's related parties).

However, a manufacturing entity cannot combine contracts with different counterparties who are not related parties, even if they are negotiated as a package with the same commercial objective, as discussed in the following SEC staff speech:



#### SEC STAFF GUIDANCE

##### [Remarks before the 2016 Baruch College Financial Reporting Conference](#)

Wesley R. Bricker, Deputy Chief Accountant, SEC's Office of the Chief Accountant

May 5, 2016

##### **Contract Combination Guidance – Limited to a Customer and Its Related Parties**

*[The Office of the Chief Accountant] also addressed the contract combination guidance, noting the guidance in Topic 606 explicitly limits what contracts may be combined. The staff objected to a registrant's proposal to extend the contract combination guidance beyond contracts with the same customer or related parties of the same customer.*

**BDO INSIGHT 5: COMBINING CONTRACTS REQUIRES JUDGMENT**

Determining whether multiple contracts entered with the same customer (or its related parties) at or near the same time must be combined requires the application of professional judgment based on the facts and circumstances. A manufacturing entity considers the facts and circumstances surrounding those contracts, including the pricing and the nature of the goods or services being transferred, to evaluate the substance of the contracts and whether they must be combined.

The phrase “at or near the same time” is not defined under ASC 606, and manufacturing entities may establish accounting policies to do so (for example, 90 days). Because ASC 606 does not include a bright line, determining whether any contracts executed shortly outside the defined time frame are within the scope of contract combination guidance requires the application of professional judgment based on the facts and circumstances.

**BDO INSIGHT 6: CONTRACT COMBINATION GUIDANCE – DIFFERENT DEPARTMENTS OF AN ENTITY**

A manufacturing entity may enter contracts with different departments or divisions of the customer entity. Regardless of whether the departments function independently within the customer entity, the contracts fall within the scope of contract combination guidance and must be combined if the contract combination requirements are met.

Similarly, when evaluating contracts with different departments of a government body (federal, state, local, or foreign), we believe different departments under the control of the same government body are generally considered part of a single entity. For example, separate contracts with different departments of the U.S. federal government may be combined if the contract combination requirements are met.

**Contract Modifications**

ASC 606 includes a comprehensive model to account for modifications of customer contracts. A contract modification is a **change** in the contract’s **scope or price** approved by parties to the contract and might be referred to as a “change order,” “variation,” or “amendment.” Accounting adjustments are made for a contract modification only when new enforceable rights and obligations are created or existing ones are changed.

Depending on its nature, a contract modification may be accounted for under any one of the following approaches. See Section 7.3 of BDO’s Blueprint, [Revenue Recognition Under ASC 606](#), for details.



A **separate** (and additional) contract with **no adjustments** to revenue recognized from the existing contract.



A **termination of the existing contract** and the creation of a **new contract** with **prospective adjustments** to revenue recognized from the existing contract.



A **continuation** of the existing contract with **cumulative catch-up adjustments** to revenue recognized to date from the existing contract.

A **combination** of the two approaches.

**BDO INSIGHT 7: CONTRACT MODIFICATIONS ARE COMMON IN MANUFACTURING ARRANGEMENTS**

Contract modifications occur frequently in manufacturing contracts and may arise from customer-requested engineering changes, revised product specifications, changes in committed purchase volumes under master supply agreements, additional production runs, or pricing amendments resulting from commodity cost fluctuations, tariffs, or supply-chain developments.

The accounting outcome for a contract modification depends on the specific facts and circumstances, including whether the modification adds distinct goods or services and whether the pricing reflects their standalone selling prices. Consequently, similar modifications may result in different accounting outcomes, including treatment as a separate contract, a prospective adjustment, a cumulative catch-up adjustment, or a combination of those approaches.

Because the accounting for a modification may depend on performance obligations identified at contract inception and whether those performance obligations have already been satisfied, manufacturing entities should implement processes to identify and evaluate approved change orders, amendments, and similar contract revisions as they occur.

**Portfolio Approach**

The five-step revenue recognition model applies to individual contracts. However, a manufacturing entity can apply the model to a portfolio of contracts (or performance obligations) with similar characteristics if it reasonably expects that the effects would not differ materially if applied to individual contracts. For example, a manufacturing entity may elect this practical expedient to estimate aggregate returns for a group of similar sale transactions for which a right of return is granted.

**STEP 2: IDENTIFY THE PERFORMANCE OBLIGATIONS IN THE CONTRACT**

After identifying the contract for accounting purposes in Step 1, at contract inception a manufacturing entity identifies the promised goods and services within the contract and determines which of those goods and services are separate performance obligations.

A performance obligation is a promise to transfer to a customer **either**:

- ▶ 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 have the same pattern of transfer to the customer.

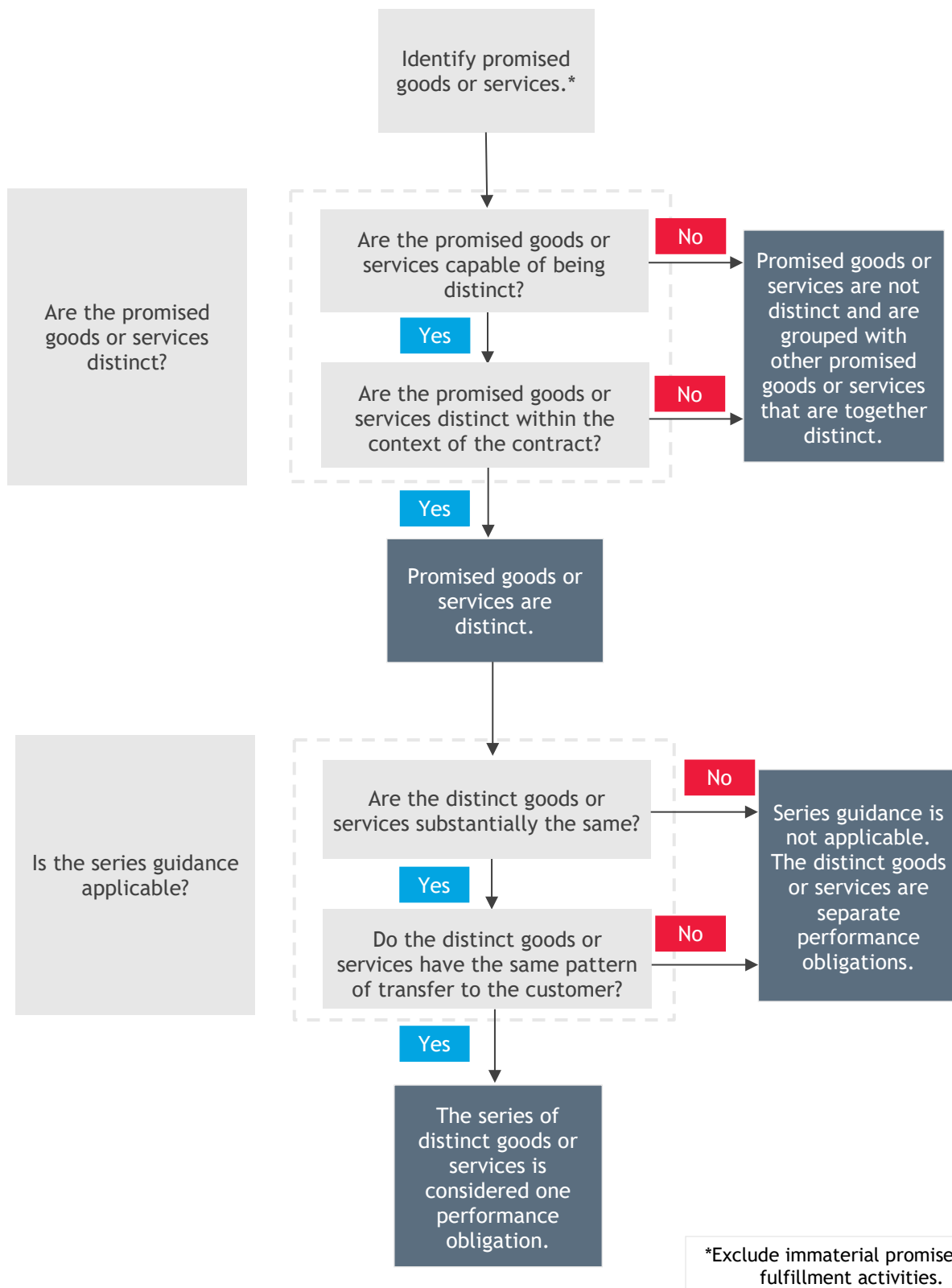
In Steps 3 through 5, the transaction price in a contract is allocated to each performance obligation in the contract, and the allocated transaction price is recognized in revenue when or as the performance obligation it relates to is satisfied.

**BDO INSIGHT 8: PERFORMANCE OBLIGATION IS THE UNIT OF ACCOUNT FOR REVENUE RECOGNITION**

Appropriate identification of the performance obligations in a contract is crucial because each performance obligation is a separate unit of account for determining when and how much revenue to recognize.

Further, the accounting for contract modifications is based on, among other things, whether a promised good or service is distinct (and therefore a performance obligation) and whether a performance obligation in a contract has been satisfied before the modification date. Therefore, even if a contract includes multiple performance obligations that are satisfied concurrently and could practically be accounted for as a single performance obligation, a manufacturing entity is required to correctly identify performance obligations in the original contract if that contract is modified.

The following diagram provides an overview of Step 2:



**BDO INSIGHT 9: REASSESSING PERFORMANCE OBLIGATIONS**

The performance obligations identified in a contract are not reassessed unless the contract is modified, and the modification is not accounted for separately from the existing contract.

**Promises in Contracts with Customers**

To identify the performance obligations in a contract with a customer, a manufacturing entity must first identify at contract inception all the promised goods or services in that contract. Generally, the contract explicitly identifies all goods or services an entity promises to transfer to a customer.

In some cases, promises to provide goods or services might be **implied** by the manufacturing entity's customary business practices, published policies, or specific statements if, at the time of entering the contract, the customer has a reasonable expectation that it will receive specified goods or services from the manufacturing entity. For example, an entity's contracts may not provide an extended warranty, but if it has historically repaired or replaced a malfunctioning product at any point during the expected useful life of the product it sells, a customer may reasonably expect it to continue that practice, creating an implicit warranty promise.

**Promises to a Customer's Customer**

Granting a right to goods or services to be provided in the future that a customer can transfer to its customer is a promised good or service in a contract. For example, when a manufacturer sells an automobile to its customer, a dealership, the manufacturer might promise to provide additional goods or services, such as maintenance, to the dealer's customer.

In this example, the manufacturer's promise to provide a good or service that the dealer can pass on to its own customer is a performance obligation for the manufacturer if that promise could be identified (explicitly or implicitly) in the manufacturer's contract with the dealer.

**Tooling and Set-Up Activities**

Activities performed to fulfill a contract that do not transfer goods or services to the customer are not considered promised goods or services in a contract, even if those activities are required to successfully transfer the goods or services for which the customer has contracted.

Manufacturing entities often incur significant costs at the inception of a contract for tooling, equipment, and engineering start-up activities, often referred to as **preproduction activities**. Manufacturers need to consider whether preproduction activities are a promised good or service or fulfillment activities, which requires judgment and consideration of the facts and circumstances.

To determine whether a preproduction activity is a promised good or service in a contract, a manufacturer evaluates whether control of that good or service is transferred to the customer (for example, whether the customer will own the results of the preproduction activity even if the contract is terminated). The transfer of control indicates that the preproduction activity is a promised good or service.

**EXAMPLE 5: TOOLING AND SET-UP ACTIVITIES****FACTS**

- ▶ A manufacturing entity manufactures parts for the automobile industry and has contracted with a customer to supply pistons. Each piston is determined to be a distinct performance obligation. To fulfill the contract, the manufacturing entity must:
  - Purchase a diamond-core cutting machine (\$500,000) and tooling (\$200,000).
  - Incur engineering costs (\$100,000) to configure the production line.

- ▶ The manufacturing entity receives \$1 million from the customer at contract inception to compensate for the preproduction activities.
- ▶ The manufacturing entity retains title to the equipment, tooling, and any patents or other IP that results from the engineering activities.
- ▶ The manufacturing entity is also responsible for maintaining and directing the use of the tooling and equipment.

## CONCLUSION

The preproduction activities are not promised goods or services and are not separate performance obligations. The manufacturing entity includes the upfront \$1 million payment in the transaction price and recognizes it in revenue as control of each piston transfers to the customer.

## ANALYSIS

- ▶ The manufacturing entity determines that the contract includes a promise to transfer pistons to the customer and that the preproduction activities do not result in control of additional goods or services being transferred to the customer. Therefore, the preproduction activities are not promised goods or services and cannot be a separate performance obligation within the contract.
- ▶ The manufacturing entity includes the upfront \$1 million payment in the transaction price (see Step 3) and initially records it as a contract liability (deferred revenue).
- ▶ A portion of the contract liability is derecognized and credited to revenue as control over each piston is transferred to the customer (presuming the contract consists of multiple performance obligations – that is, each piston is a separate performance obligation).
- ▶ See Step 5 for discussion on recognizing revenue when or as a performance obligation is satisfied.

## BDO INSIGHT 10: PREPRODUCTION ACTIVITIES

If preproduction activities do not represent a separate performance obligation and are related to a performance obligation for which revenue is recognized over time (instead of a point in time), the activities are not considered when measuring progress toward completion of that performance obligation because they do not result in control of a good or service being passed to the customer. In other words, the manufacturer does not recognize revenue as a result of incurring the \$800,000 of preproduction activities in Example 5. Instead, those costs are treated as costs to fulfill a contract.

In contrast, if the preproduction activities are determined to be a promised good or service, a portion of the transaction price is allocated to that good or service as either a single performance obligation or as part of a combined performance obligation that includes the preproduction activities with other goods and services.

See Contract Costs for discussion on accounting for the costs of contracts with customers.

**BDO INSIGHT 11: PREPRODUCTION ACTIVITIES FOR LONG-TERM SUPPLY CONTRACTS**

ASC 340-10, *Other Assets and Deferred Costs – Overall*, includes guidance on accounting for the costs of designing and developing “molds, dies, and other tools that will be used in producing” products under a long-term supply agreement. ASC 606 did not amend or supersede the ASC 340-10 guidance on preproduction costs. Therefore, manufacturers that conclude that their preproduction costs are within the scope of ASC 340-10 continue to follow that guidance. Also, manufacturing entities apply the guidance in ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers*, to account for preproduction costs that are not within the scope of ASC 340-10. See Contract Costs for discussion on accounting for the costs of contracts with customers.

**TRG DISCUSSIONS: PREPRODUCTION ACTIVITIES – ANALYZING CONTROL**

In November 2015, the TRG discussed whether preproduction activities are a promised good or service or are included in the measure of progress toward complete satisfaction of a performance obligation that is satisfied over time.

The TRG observed that entities may find it helpful to consider the core principle of ASC 606, which is that:

*“An entity shall recognize revenue to depict the transfer of promised goods and 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.”*

Further, ASC 606 specifies that the good or service is transferred when or as the customer obtains control.

The FASB staff provided an example to illustrate an entity’s assessment of whether control of a good or service is transferred to the customer when the entity is having difficulty determining whether preproduction activities are a promised good or service: An entity is performing engineering and development activities as part of developing a new product for a customer, and the customer will own the patents and other IP that results from those activities. The entity would likely conclude that it is transferring control of that IP to the customer and that the engineering and development activities therefore are promised goods or services in the contract.

The FASB staff used that straightforward example to illustrate a case in which it was clear that control transferred to the customer.

However, sometimes an entity needs to apply judgment to determine whether control of a good or service transfers to the customer. ASC 606 includes criteria for determining whether an entity transfers control of a good or service over time and therefore satisfies a performance obligation over time. The FASB staff indicated that whether the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs might apply to preproduction activities.

An entity might not always be able to readily identify whether this criterion is met. In those circumstances, an entity considers whether another entity would need to reperform the work the entity has completed to date if that other entity were to fulfill the remaining performance obligation. For example, consider a scenario in which an entity performs engineering and development activities as part of developing a new product for a customer. If the entity provides the customer with periodic progress reports (in a level of detail that would not require the customer to contract with another entity to reperform the work), or if the entity must provide the customer with the design information completed to date in the case of a termination of the contract, the entity likely would conclude that control of that service has transferred to the customer.

As another example, when a piece of equipment is transferred over time, an entity has determined that the customer has control over the asset because the entity has a right to payment for an asset with no alternative use.

The entity might include labor costs in a cost-to-cost measure of progress for constructing the piece of equipment. The labor itself is not a separate promised good or service to the customer in the contract. However, each time the worker turns a wrench, the asset (the equipment) is changed, and the customer obtains control of that changed asset.

Similarly, an entity might determine the preproduction cost should be included in the measure of progress depending on the circumstances of the arrangement. However, if the arrangement involves significant costs for the entity near the start of the arrangement, and the activities giving rise to those costs do not transfer a good or a service to the customer, the entity considers the guidance on adjustments to the measure of progress when using a cost-based input method. Application of that guidance requires an entity to consider whether the costs for some activities must be excluded from the measure of progress or whether the input method must be adjusted to recognize revenue only to the extent of that cost incurred.

See Step 5 for discussion on the notion of control, recognizing revenue over time or at a point in time, measure of progress, and adjustments to the measure of progress when using a cost-to-cost method.

### Shipping and Handling Activities

A manufacturing entity that promises to transfer goods to a customer may perform shipping and handling activities related to those goods. If the shipping and handling activities are performed **before** the customer obtains control of the goods, the activities are not promised services to the customer but rather activities to fulfill the manufacturing entity's promise to transfer goods.

If shipping and handling activities are performed **after** a customer obtains control of the good, the manufacturing entity may **elect** to account for shipping and handling as activities to fulfill the promise to transfer the good rather than as additional promised services. If the accounting policy election is not made, the manufacturing entity evaluates shipping and handling activities as promised services and potential performance obligations.

If a manufacturing entity opts for the accounting policy election:

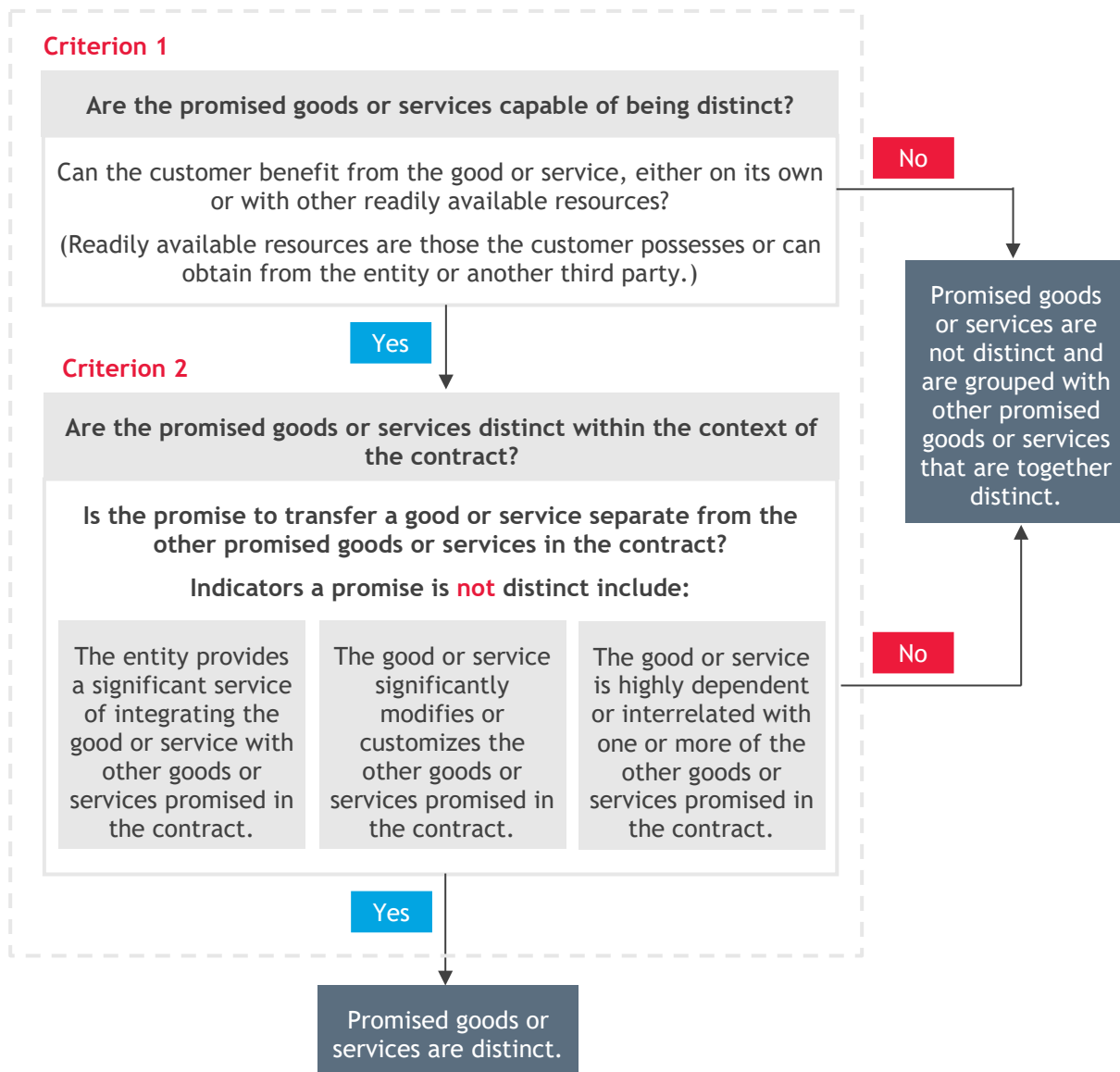
- ▶ Shipping and handling activities are not identified as separate performance obligations and no revenue is allocated to them.
- ▶ If revenue for related goods is recognized before the shipping and handling activities occur, a manufacturing entity must accrue the related costs of those activities.

The accounting policy election must be applied consistently to similar types of transactions.

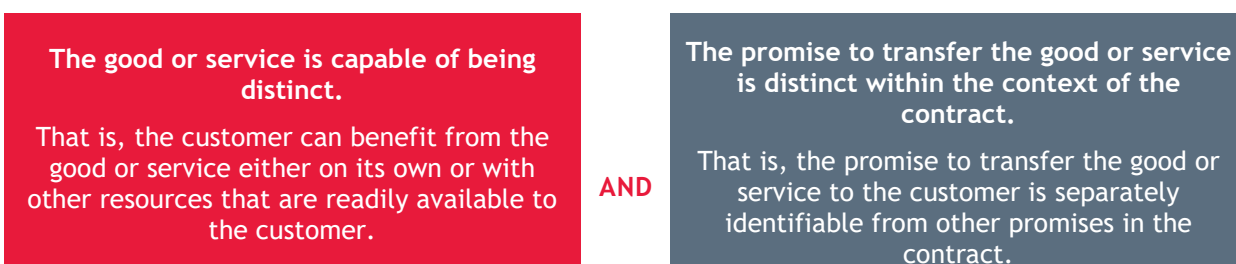
### Distinct Goods or Services

After identifying all explicit and implicit promised goods or services in the contract, a manufacturing entity determines which of those promised goods or services (or bundle of goods and services) are distinct and hence represent separate performance obligations. If a promised good or service is not distinct, the manufacturing entity must combine it with other promised goods or services until a bundle of goods or services that is distinct can be identified.

The following diagram illustrates the guidance on determining whether a promised good or service is distinct and therefore a separate performance obligation:



As illustrated in the diagram, for a good or service to be distinct, **both** of the following criteria must be met:



### **BDO INSIGHT 12: IDENTIFYING DISTINCT GOODS OR SERVICES REQUIRES JUDGMENT**

An entity may need to perform a detailed analysis of contractual terms and conditions, unique facts and circumstances, and customer expectations and apply significant judgment to determine whether a promise in a contract is a distinct good or service (and thus constitutes a performance obligation) or must be combined with other promises in the contract to create a single performance obligation. An entity may also consider other information, such as marketing materials, to assist in its determination of its performance obligations. However, all facts and circumstances should be considered because marketing descriptions are not determinative.

The identification of distinct goods or services in a contract requires the application of professional judgment based on the facts and circumstances, as illustrated in the following examples.

#### **EXAMPLE 6 (ADAPTED FROM ASC 606-10-55-150A THROUGH 55-150C): PROMISES ARE SEPARATELY IDENTIFIABLE – INSTALLATION**

##### **FACTS**

- ▶ An entity contracts with a customer to sell machinery and installation services.
- ▶ Installation of the machinery is not complex and can be provided by the entity or other entities.
- ▶ The entity identifies two promised goods and services in the contract:
  - Machinery.
  - Installation service.

##### **CONCLUSION**

The entity identifies two performance obligations in the contract, machinery and the installation services, because each promise is distinct and separately identifiable.

##### **ANALYSIS**

##### **Capable of Being Distinct**

- ▶ The customer can benefit from the machinery on its own, by using it or reselling it for an amount greater than scrap value, or with other readily available resources (that is, installation services available from other entities).
- ▶ The customer can benefit from the installation service promised by the entity with other resources it will already have obtained from the entity under the contract (that is, the machinery).
- ▶ Therefore, the entity determines that the machinery and installation services are capable of being distinct.

**Distinct in the Context of the Contract**

- ▶ The entity determines whether its promises to transfer the machinery and to provide the installation services are each separately identifiable. It considers the following to determine whether the machinery and the installation services are inputs into a combined item:
  - The entity is not providing a significant integration service. In other words, the entity has promised to deliver the machinery and then install it; the entity would be able to fulfill its promise to transfer the equipment separately from its promise to subsequently install it. The entity has not promised to combine the machinery and the installation services in a way that would transform them into a combined output.
  - The entity's installation services will not significantly customize or significantly modify the machinery.
  - Although the customer can benefit from the installation services only after it has obtained control of the machinery, the installation services do not significantly affect the machinery because the entity would be able to fulfill its promise to transfer the machinery independently of its promise to provide the installation services. In other words, there is no two-way interdependency between the machinery and installation services. Because the machinery and the installation services do not significantly affect each other, they are not highly interdependent or highly interrelated.
- ▶ Thus, the entity determines that the machinery and installation services are not inputs into a combined item and identifies two performance obligations (the machinery and installation services) in the contract. Each of the three factors contributes to, but is not individually determinative of, the conclusion that the equipment and the installation services are separately identifiable.

**EXAMPLE 7 (ADAPTED FROM ASC 606-10-55-150A THROUGH 55-150F): PROMISES ARE SEPARATELY IDENTIFIABLE — INSTALLATION****FACTS**

Assume the same facts as in Example 3-6 except the customer is contractually required to purchase the installation service from the entity rather than from other entities.

**CONCLUSION**

The entity identifies two performance obligations in the contract, the machinery and the installation service, because the promises are distinct and separately identifiable, even though the contract requires the customer to buy installation from the entity.

**ANALYSIS****Capable of Being Distinct**

- ▶ For the same reasons as in Example 3-6, the entity's promises to transfer the machinery and installation services to the customer are capable of being distinct, despite the contractual limitations preventing the customer from purchasing the installation service from other entities.
- ▶ That is because the assessment of whether a customer can benefit from a good or service on its own is based on the characteristics of the good or service itself (the machinery or installation service in this example) rather than any contractual limitations.
- ▶ The contractual requirement to use the entity's installation service does not change the characteristics of the machinery or installation service, nor does it change the entity's promise to the customer.

**Distinct in the Context of the Contract**

- ▶ The entity performs the same analysis of whether the machinery and installation services are separately identifiable as in Example 3-6 and identifies two performance obligations (the machinery and installation services) in the contract.

**EXAMPLE 8 (ADAPTED FROM ASC 606-10-55-140A THROUGH 55-140C): SIGNIFICANT INTEGRATION SERVICE AND HIGH INTERDEPENDENCY AND INTERRELATION IN MANUFACTURING CONTRACT****FACTS**

- ▶ A manufacturer enters a contract with a customer to deliver multiple units of a highly complex, specialized device.
- ▶ The contract requires the manufacturer to establish a manufacturing process to produce the contracted units.
- ▶ The specifications are unique to the customer based on a custom design owned by the customer and were developed under the terms of a separate contract that is not part of the current negotiated exchange.
- ▶ The manufacturer is responsible for the overall contract management, which requires the performance and integration of various activities, including procuring materials; identifying and managing subcontractors; and performing manufacturing, assembly, and testing.
- ▶ Each unit of the device can function independently of the other units.

**CONCLUSION**

The goods and services in the contract are not distinct, and the manufacturer accounts for them as a single performance obligation.

**ANALYSIS**

- ▶ Each unit is capable of functioning independently, so the customer can benefit from each device on its own. Therefore, the manufacturer determines that each unit of the device is capable of being distinct.
- ▶ The manufacturer considers the nature of its promise in the contracts and observes that it has promised to establish and provide a service of producing the full complement of devices for which the customer has contracted.
- ▶ The manufacturer is responsible for overall contract management and for providing a significant service of integrating various goods and services (the inputs) into its overall service and the resulting devices (the combined output). Therefore, the manufacturer determines that the devices and various promised goods and services inherent in manufacturing those devices are not separately identifiable.
- ▶ The manufacturer provides a manufacturing process specific to its contract with a customer. Also, the nature of the manufacturer's performance, particularly, the significant integration of various activities, means that a change in one of the manufacturer's activities to produce the highly complex, specialized devices has a significant effect on the other activities required to produce those devices, such that the manufacturing entity's activities are highly interdependent and highly interrelated.
- ▶ Therefore, the manufacturer concludes that the goods and services in the contract are not distinct, and it accounts for all the goods and services as a single performance obligation.

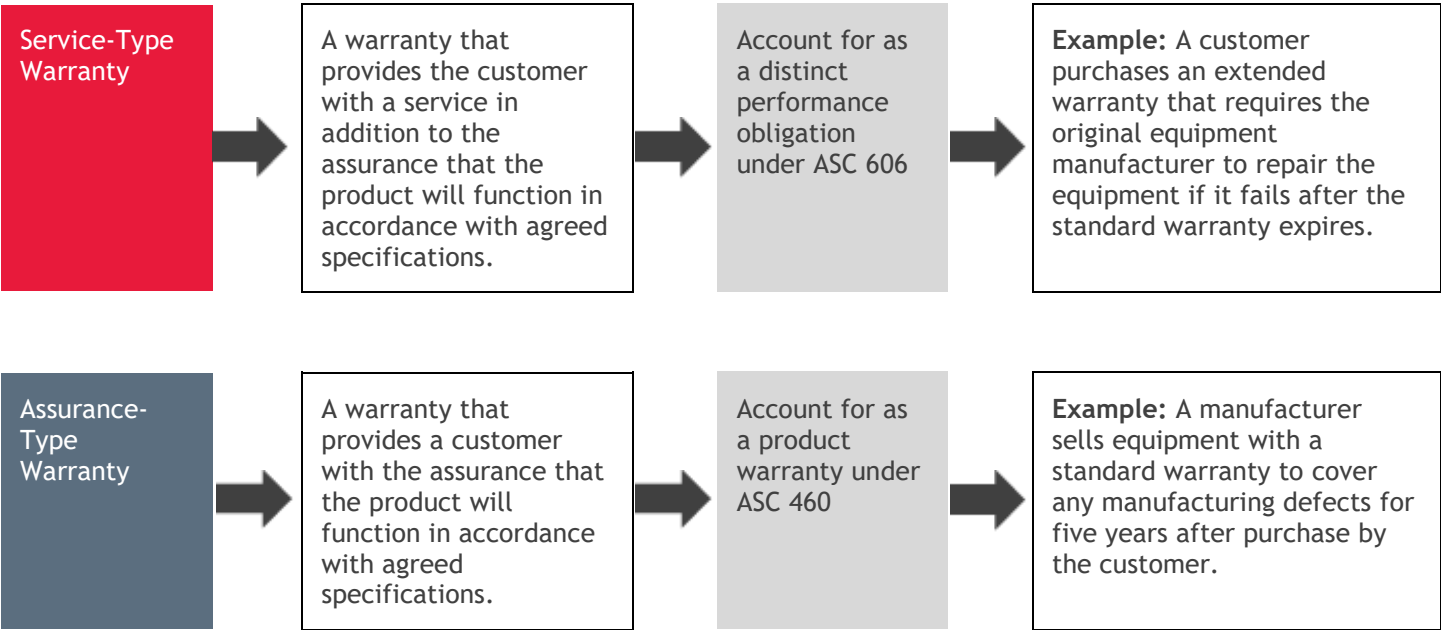
**Warranties**

A manufacturing entity may provide a warranty in connection with the sale of a good or service in accordance with the contract, the law, or the manufacturing entity's customary business practices. The nature of a warranty can vary significantly across industries and contracts.

**BDO INSIGHT 13: CASH WARRANTIES ARE CONSIDERED A RIGHT OF RETURN NOT A WARRANTY LIABILITY**

In most cases, a warranty requires the seller to either repair or replace the defective product. However, some contracts require the seller to provide a cash payment (or a credit) to the customer. We believe that a warranty obligation that requires refunding the purchase price to the customer should be accounted for as a right of return (see Step 3) rather than a warranty. However, if the agreement requires the seller to replace or remediate the defective product, the obligation should be accounted for as a warranty. Additional scenarios may require additional analysis. For example, an arrangement may require the seller to provide a cash payment to the customer in the amount of repairs obtained by the customer from a third party. Determining the appropriate accounting for various warranty provisions requires judgment based on facts and circumstances.

ASC 606 differentiates between assurance- and service-type warranties:



If a customer can purchase a warranty separately (for example, because the warranty is priced or negotiated separately), the warranty is a service-type warranty accounted for as a separate performance obligation. It represents a distinct service the manufacturing entity promises to provide to the customer in addition to the product that has the functionality described in the contract.

Even if a warranty is not sold separately, a manufacturing entity evaluates whether the warranty, or a part thereof, provides the customer with a service in addition to an assurance that the product complies with agreed specifications (that is, an assurance component). In assessing whether a warranty provides a customer with a service in addition to the assurance component, a manufacturing entity considers factors such as:

|                                                                                                                                    |                                                                                                                                                                                                                                                                        |
|------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|  <b>Whether the Warranty Is Required by Law</b> | A law requiring a manufacturing entity to provide a warranty indicates that the warranty is not a performance obligation because such laws typically exist to protect customers from the risk of purchasing defective products.                                        |
|  <b>Length of the Warranty Coverage Period</b>  | A longer coverage period indicates that it is more likely that the promised warranty is a performance obligation because a manufacturing entity is more likely to provide a service in addition to the assurance that the product complies with agreed specifications. |



### Nature of the Tasks the Manufacturing Entity Promises to Perform

If a manufacturing entity must perform specified tasks to provide the assurance that a product will function in accordance with agreed specifications (for example, return shipping service for defective products), those tasks likely do not give rise to a performance obligation.

If a warranty, or a part thereof, does not provide a customer with a service in addition to the assurance that a product complies with agreed specifications, then a manufacturing entity must account for that warranty in accordance with the guidance on product warranties in ASC 460, *Guarantees*. However, if a warranty, or a part of a warranty, provides a customer with a service in addition to the assurance that the product complies with agreed specifications, the promised service represents a service-type warranty that is a separate performance obligation from the product. Therefore, a manufacturing entity must allocate the transaction price to the product and the service-type warranty in Step 4. Further, if a manufacturing entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, it must account for both as a single performance obligation distinct from the related product.

## EXAMPLE 9: LIFETIME WARRANTY

### FACTS

- ▶ A manufacturing entity manufactures high-end designer computer carrying cases.
- ▶ Each case comes with a lifetime warranty on parts and labor that covers any type of damage, no matter what the cause.
- ▶ There is no local law requiring the manufacturing entity to provide lifetime warranty on the cases.
- ▶ The length of time covered by the warranty is the lifetime of the case.
- ▶ The warranty covers damage beyond manufacturing defects.

### CONCLUSION

The manufacturing entity determines the contract includes both an assurance warranty and service warranty.

### ANALYSIS

- ▶ Each contract includes both an assurance and service warranty because:
  - There is no local law requiring the manufacturer to provide lifetime warranty on the cases.
  - The length of time covered by the warranty is the lifetime of the case.
  - The warranty covers damage beyond manufacturing defects.
- ▶ The manufacturing entity devises an accounting policy, controls, and processes to:
  - Identify the implicit assurance warranty period and the likely period over which customers will benefit from the service warranty.
  - Determine the portion of the transaction price allocable to the service warranty.
  - Recognize the amount of revenue allocated to the service warranty over the anticipated period that customers will benefit from the implied service warranty.
- ▶ Revenue recognition for the service warranty begins at the end of the assurance warranty period unless the manufacturing entity concludes that it cannot reasonably separate the assurance warranty and the service warranty. In that case, revenue recognition commences when control of the computer case transfers to the customer.
- ▶ See Step 5 for discussion on recognizing revenue when or as a performance obligation is satisfied.



## TRG DISCUSSIONS: WARRANTIES

In March 2015, the TRG discussed a fact pattern that included a lifetime warranty similar to that in Example 9. In discussing the fact pattern, the FASB staff considered two aspects of the guidance on warranties:

- ▶ If an entity is required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation.
- ▶ A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation.

The FASB staff said the two aspects of the guidance on warranties must not be applied by analogy to warranties that are not required by law. Such an analogy disregards the nature of the promise given to the customer, the three factors in ASC 606 for determining whether a warranty is a performance obligation, and the overall facts and circumstances of the arrangement.

The FASB staff stated that while not determinative in isolation, the length of the warranty is an important consideration under ASC 606. Overall, an entity must not focus its assessment on when the fault in the product arises. Rather, an entity must evaluate if the substance of the warranty reflects an additional service, considering the promises made and using the three factors in ASC 606 to assess whether the warranty is a performance obligation.

An evaluation of whether a warranty provides a service in addition to the assurance that the product complies with agreed specifications requires judgment and consideration of the facts and circumstances.

### BDO INSIGHT 14: WARRANTIES

A manufacturing entity determines the amount of transaction price to be allocated to a separately priced extended warranty contract using a standalone selling price methodology, rather than simply using the contractually stated price (see Step 4). Also, regardless of whether a warranty is separately priced, a manufacturing entity determines whether a portion of the warranty represents a service warranty that must be accounted for separately. Reaching a conclusion about whether a manufacturing entity is providing a service warranty – and, if so, measuring the standalone selling price (SSP) of that service warranty – requires the application of professional judgment based on the facts and circumstances.

Further, manufacturing entities accrue the costs related to assurance warranties under ASC 460.

A law that requires a manufacturing entity to pay compensation if its products cause harm or damage does not create a performance obligation. For example, if a manufacturer sells laptops in a jurisdiction where the law holds the manufacturer liable for any damages that might be caused by a consumer using a product for its intended purpose, the legal requirements do not create a performance obligation. Similarly, a manufacturing entity's promise to indemnify the customer for liabilities or damages arising from claims of patent, copyright, trademark, or other infringement by the manufacturing entity's products does not create a separate performance obligation. Rather, a manufacturing entity accounts for such obligations in accordance with ASC 450-20, *Contingencies – Loss Contingencies*.

## STEP 3: DETERMINE THE TRANSACTION PRICE

After identifying the performance obligations in a contract in Step 2, a manufacturing entity determines the transaction price for the contract. Determining the transaction price is an important step in the five-step revenue recognition model because the transaction price is the amount a manufacturing entity allocates to the performance obligations in a contract and ultimately recognizes as revenue when or as the performance obligations are satisfied.

The transaction price is the amount of consideration a manufacturing entity expects to be entitled to in exchange for transferring goods or services to a customer. The following diagram illustrates the key concepts in determining the transaction price:



The transaction price is often the amount specified in the contract. However, determining transaction price is more challenging if the contracts include variable consideration, a significant financing component, noncash consideration or consideration payable to a customer.

### Variable Consideration

Variable consideration can arise in any circumstance in which the amount of consideration the manufacturing entity is entitled to varies. A manufacturing entity must estimate the amount of consideration it expects to be entitled to in exchange for transferring the promised goods or services to a customer. Examples of common types of variable consideration that may exist in a contract with a customer include:

- ▶ Discounts
- ▶ Rebates
- ▶ Refunds
- ▶ Credits
- ▶ Incentives
- ▶ Performance bonuses
- ▶ Penalties
- ▶ Price concessions

ASC 606 requires a manufacturing entity to **estimate** variable consideration initially at contract inception and **update** that estimate at the end of each reporting period. The estimated amount of variable consideration is included in the transaction price only if it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty from the variable consideration is subsequently resolved.

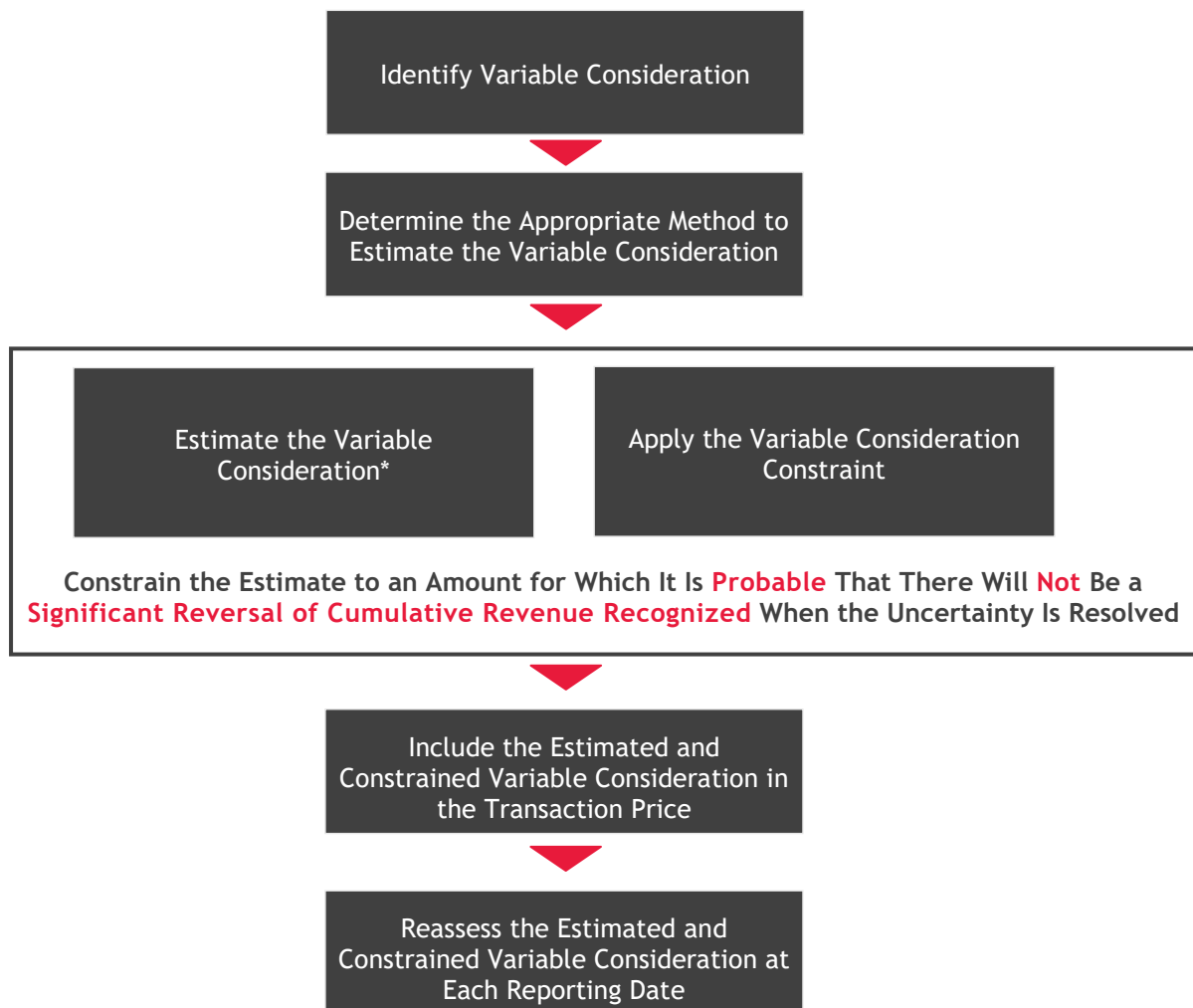
#### BDO INSIGHT 15: FOREIGN CURRENCY-DENOMINATED CONTRACTS DO NOT CREATE VARIABLE OR NONCASH CONSIDERATION

Entities that operate in multiple countries may enter contracts that are denominated in a currency other than the entity's functional currency. The foreign currency to be paid by the customer does not represent variable consideration. Rather, the customer commits to a fixed amount of consideration in the contractual currency.

Additionally, foreign currency does not represent noncash consideration, rather it is cash denominated in a foreign currency.

An entity applies the guidance in ASC 830, *Foreign Currency Matters*, to remeasure consideration denominated in a foreign currency in its functional currency at the appropriate foreign exchange rate. Although exchange rate fluctuations will affect the translation of the contractual amount into the entity's functional currency, those fluctuations generally reflect application of ASC 830, rather than an uncertainty in the transaction price.

The following diagram provides an overview of the accounting considerations for variable consideration:



**BDO INSIGHT 16: ESTIMATING VARIABLE CONSIDERATION**

ASC 606 requires manufacturing entities to estimate variable consideration with limited exceptions. While estimating revenue reflects the principle in ASC 606 that the amount recognized in revenue closely depicts the transfer of control, it introduces uncertainty in the measurement of revenue. Estimating variable consideration requires the application of professional judgment based on the facts and circumstances.

Although determining the transaction price requires several estimates about the future, the estimates are based on the goods and services to be transferred in accordance with the existing contract. Expectations about whether the contract will be canceled, renewed, or modified are **not** considered when estimating the transaction price.

**Estimating Variable Consideration**

When the consideration promised in a contract with a customer includes a variable amount, a manufacturing entity estimates the amount of variable consideration it expects to be entitled to in exchange for promised goods or services in the contract by using **either** of the following two methods:

- ▶ **The expected value:** The sum of probability-weighted amounts in a range of possible consideration amounts. It may be an appropriate estimate of the variable consideration if a contract includes a large number of possible outcomes or if a manufacturing entity has many contracts with similar characteristics.
- ▶ **The most likely amount:** The single most likely amount in a range of possible consideration amounts (that is, the single most likely outcome of the contract). It may be an appropriate estimate of the variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

**SELECT A METHOD TO ESTIMATE VARIABLE CONSIDERATION**

Selecting a method to estimate a variable consideration is **not** intended to be a free choice; rather, a manufacturing entity must determine which method it expects to better predict the amount of consideration to which it will be entitled and apply that method consistently for similar types of contracts.

**INFORMATION CONSIDERED IN ESTIMATING A VARIABLE CONSIDERATION**

A manufacturing entity must consider all the information (historical, current, and forecast) that is reasonably available to the manufacturing entity to identify a reasonable number of possible amounts of variable consideration. Typically, that information would be similar to the information the manufacturing entity's management used during the bid-and-proposal process and when it established prices for the promised goods or services.

**CONSISTENT APPLICATION OF THE METHOD SELECTED TO ESTIMATE AN UNCERTAINTY**

A manufacturing entity applies one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which it expects to be entitled.

However, that does not mean that a manufacturing entity would need to use one method to measure each uncertainty in a single contract. Rather, a manufacturing entity may use different methods for different uncertainties in a single contract.

**Constraining Estimates of Variable Consideration**

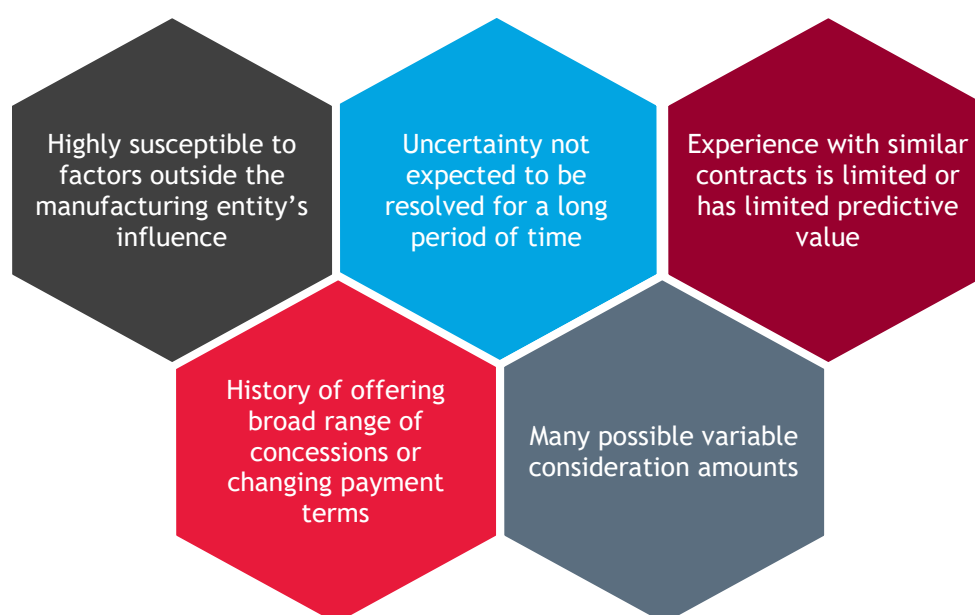
Estimating the amount of variable consideration introduces uncertainty to the measurement of revenue. To reduce the possibility that variable consideration recognized in one reporting period is reversed in a subsequent period, the estimated amount of variable consideration included in the transaction price is limited to the amount for which it is **probable** that there will **not** be a significant reversal of cumulative revenue recognized when the uncertainty from the variable consideration is subsequently resolved. That concept is known as the “variable consideration constraint,” and it restricts revenue recognition by using measurement uncertainty as the basis for determining whether to recognize revenue (and if so, how much).

The term “probable” is widely used and understood in practice and is defined in ASC 450, *Contingencies*, as “*the future event or events are likely to occur.*”

In assessing whether it is probable that a significant reversal of cumulative revenue recognized will not occur once the uncertainty related to the variable consideration is subsequently resolved, a manufacturing entity evaluates **both**:

**Likelihood of a revenue reversal****AND****Magnitude of the revenue reversal**

The following are examples of factors that may increase the likelihood or the magnitude of a revenue reversal:



**BDO INSIGHT 17: CONSTRAINING ESTIMATES OF VARIABLE CONSIDERATION**

When variable consideration has a wide range of potential outcomes, it is highly unlikely that the transaction price will be constrained to zero.

Further, when a manufacturing entity applies the portfolio approach to estimate variable consideration for multiple similar contracts or performance obligations, it would be rare for variable consideration included in the transaction price to be fully constrained because that would require an assumption that the outcome of every instance of uncertainty would be zero.

Regardless of whether a manufacturing entity elects to use the portfolio approach, we believe that a manufacturing entity must consider its past experience with similar contracts with similar customers when determining the amount of variable consideration to be included in the transaction price unless the experience with those past contracts is not reflective of the expected outcome of the current contract, which would be unusual.

Conversely, the constraint may reduce the amount of variable consideration included in the transaction price to zero when the outcome is binary (for example, a \$100,000 bonus may be earned based on the achievement of a performance milestone) and significant uncertainty exists regarding the outcome.

Also, in some instances the requirement to limit the estimated variable consideration to an amount that is not probable of being reversed could result in recognizing revenue in an amount that is less than a manufacturing entity's best estimate.

Reaching a conclusion on whether and how much to constrain the estimate of variable consideration requires the application of professional judgment based on the facts and circumstances.


**TRG DISCUSSIONS: VARIABLE CONSIDERATION AND CONSTRAINING ESTIMATE — IS THE CONSTRAINT APPLIED AT THE CONTRACT OR PERFORMANCE OBLIGATION LEVEL?**

Some contracts that include more than one performance obligation have both fixed and variable consideration.

In January 2015, the TRG considered whether the requirement to constrain the recognition of any variable consideration should apply at the contract level or performance obligation level when the variable consideration has not been allocated proportionately to all performance obligations in a contract. See Step 4 for discussion on allocation of consideration to performance obligations.

The TRG generally agreed that the constraint on variable consideration is applied at the contract level and not at the performance obligation level because the unit of account for determining the transaction price in Step 3 is the contract.

**Volume-Based Discount That Applies Retrospectively**

A manufacturing entity may provide a discount that applies retrospectively to all or some purchases under a contract with a customer when a specified volume or purchase threshold is met. Discounts that apply retrospectively usually represent variable consideration. A manufacturing entity estimates the purchase volume and the volume-based discount in determining the transaction price at contract inception and updates that estimate throughout the term of the contract. The discount is included in the transaction price to the extent that it is probable that a significant reversal of cumulative revenue will not occur when the volume uncertainty is resolved. See Example 8 for an illustration.

**EXAMPLE 10 (ADAPTED FROM ASC 606-10-55-216 THROUGH 55-220): VOLUME DISCOUNT INCENTIVE – RETROSPECTIVE REDUCTION****FACTS**

- ▶ A manufacturing entity enters a contract with a customer on January 1, 20X1, to sell a product for \$10 per unit.
- ▶ The price per unit is retrospectively reduced to \$9 per unit if the customer purchases more than 10,000 units of the product in a calendar year.
- ▶ In Q1 (quarter ended March 31, 20X1), the manufacturing entity sells 100 units of the product to the customer. On that date, the manufacturing entity estimates that the customer's purchases will not exceed the 10,000 unit threshold required for the volume discount in the calendar year.
- ▶ In April 20X1, the manufacturing entity's customer acquires another manufacturing entity.
- ▶ In Q2 (quarter ended June 30, 20X1), customer purchases 5,000 additional units.

**CONCLUSION**

The manufacturing entity recognizes \$1,000 of revenue for Q1 (the quarter ended March 31, 20X1) and \$44,900 of revenue for Q2 (the quarter ended June 30, 20X1) after updating the transaction price for the retrospective volume discount.

**ANALYSIS**

- ▶ The manufacturing entity determines that the consideration in the contract is variable because of the retrospective reduction in price per unit of the products sold to the customer.

**Constraining Estimates of Variable Consideration**

- ▶ The manufacturing entity sells 100 units of the product to the customer in the first quarter ended March 31, 20X1.
- ▶ On that date, the manufacturing entity estimates that the customer's purchases will not exceed the 10,000 unit threshold required for the volume discount in the calendar year. The manufacturing entity has significant experience with this product and this customer's purchasing pattern, so it concludes that it is probable that a significant reversal in the cumulative amount of revenue recognized (that is, \$10 per unit) will not occur when the uncertainty regarding the total number of products purchased in that calendar year is resolved.
- ▶ Therefore, the manufacturing entity recognizes revenue of \$1,000 (100 units \* \$10 per unit) for the quarter ended March 31, 20X1.

**Reassessment of Variable Consideration**

- ▶ In April 20X1, the manufacturing entity's customer acquires another manufacturing entity, and in the second quarter ended June 30, 20X1, it purchases an additional 5,000 products. Considering that new fact, the manufacturing entity estimates that the customer's purchases will exceed the 10,000 unit threshold for the calendar year and that it will therefore be required to retrospectively reduce the price per unit to \$9.
- ▶ Therefore, the manufacturing entity updates its transaction price (and cumulative revenue recognized) to \$45,900 (5,100 units \* \$9 per unit) to reflect the reduced price per unit of \$9 for the sale of 5,100 units.
- ▶ The manufacturing entity recognizes \$44,900 in the quarter ended June 30, 20X1. The amount is calculated as \$45,000 for the sale of 5,000 units (5,000 units \* \$9 per unit) less the change in transaction price of \$100 (100 units \* \$1 price reduction per unit).

**BDO INSIGHT 18: DISCOUNT ON FUTURE PURCHASES**

A manufacturing entity may offer discounts to a customer for future purchases, for example, if the customer exceeds a certain volume threshold under a contract. The customer's option to acquire additional goods or services in future at a discount may provide the customer with a material right. Therefore, if the pricing structure of a contract provides the customer with a discount on future purchases, the manufacturing entity must determine whether the contract conveys a material right to the customer. If a material right exists, it is accounted for as a separate performance obligation, which results in a deferral of the consideration in the contract allocated to the material right. The deferred amount is recognized in revenue when the customer exercises its option for future purchases at a discount or that option expires. See Section 7.4 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#), for discussion on material rights.

Determining whether a customer option for future purchases represents a material right requires the application of professional judgment based on the facts and circumstances.

**Sale with a Right of Return**

A manufacturing entity may transfer control of a product to a customer and also grant the customer the right to return the product for various reasons (such as dissatisfaction with the product) and receive a full or partial refund of any consideration paid; another product in exchange; or a credit that can be applied against amounts owed, or that will be owed, to the manufacturing entity.

A sale with a right of return creates variability in the transaction price, and a manufacturing entity must apply the guidance on estimating variable consideration (including the guidance on constraining estimates of variable consideration) to determine the amount of consideration to which the manufacturing entity expects to be entitled (that is, excluding the products expected to be returned).

Exchanges by customers of one product for another of the same type, quality, condition, and price (for example, one color or size for another) are **not** considered returns for the purposes of applying the guidance on sales with a right of return.

Further, contracts in which a customer may return a defective product in exchange for a functioning product are evaluated in accordance with the guidance on warranties. However, a warranty that requires a cash payment is treated as a right of return (see Step 2).

For any amounts received (or receivable) to which it does not expect to be entitled, the manufacturing entity does not recognize revenue when it transfers products to customers. Instead, it recognizes those amounts received (or receivable) as a refund liability. Recognition of revenue is limited to the amount of consideration to which the manufacturing entity expects to be entitled, so amounts received for products expected to be returned are not recognized in revenue. The manufacturing entity also recognizes an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

Subsequently, at the end of each reporting period, the manufacturing entity must update its assessment of amounts for which it expects to be entitled in exchange for the transferred products and make a corresponding change to the transaction price — and, therefore, of revenue recognized. A manufacturing entity must also update the asset and adjustment to cost of sales representing its right to recover products upon settling the refund liability.

**EXAMPLE 11 (ADAPTED FROM ASC 606-10-55-202 THROUGH 55-207): RIGHT OF RETURN****FACTS**

- ▶ A manufacturing entity enters 100 contracts with customers.
- ▶ Each contract includes the sale of one product for \$10 for a total consideration of \$1,000 (100 total products \* \$10).
- ▶ Customers pay cash when control of products transfers to them.

- ▶ The manufacturing entity's customary business practice is to allow customers to return any unused product within 30 days for a full refund.
- ▶ The manufacturing entity's cost of each product is \$6.
- ▶ The manufacturing entity applies the portfolio approach to the 100 contracts because it reasonably expects that the effects on the financial statements from applying a portfolio approach would not differ materially from applying the guidance to the individual contracts within the portfolio.
- ▶ Using the expected value method, the manufacturing entity estimates three products will be returned (i.e., 97 products will not be returned).
- ▶ The manufacturing entity estimates the costs of recovering the products to be immaterial and expects the returned products can be resold at a profit.

### CONCLUSION

Upon transfer of control of the 100 products, the manufacturing entity recognizes \$970 of revenue and a \$30 refund liability.

### ANALYSIS

- ▶ The manufacturing entity determines that the consideration received from the customers is variable because the contracts allow customers to return the products.
- ▶ The manufacturing entity decides to use the expected value method to estimate the variable consideration, which is the method it expects to better predict the amount of consideration to which it will be entitled because there is a range of possible outcomes for how the variability will be resolved.
- ▶ Using the expected value method, the manufacturing entity estimates that three products will be returned (that is, 97 products will not be returned).
- ▶ The manufacturing entity also applies the guidance on constraining variable consideration to determine whether the estimated amount of variable consideration of \$970 ( $\$10 \times 97$  products) can be included in the transaction price. It determines that:
  - Although the returns are outside its influence, the manufacturing entity has significant experience in estimating returns for this product and customer class.
  - The uncertainty will be resolved within a short time because the return period is 30 days.
- ▶ Therefore, the manufacturing entity concludes that it is probable that a significant reversal in the cumulative amount of revenue recognized (that is, \$970) will not occur because the uncertainty is subsequently resolved over the return period.
- ▶ The manufacturing entity estimates the costs of recovering the products to be immaterial and expects that the returned products can be resold at a profit.
- ▶ Upon transfer of control of the 100 products, the manufacturing entity recognizes revenue of \$970 and does not recognize revenue for the three products that it expects to be returned (see Chapter 6 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#)).
- ▶ The manufacturing entity records the following journal entries:

|        |                  |    |        |                                                |
|--------|------------------|----|--------|------------------------------------------------|
| Debit  | Cash             | \$ | 1,000  | \$10 * 100 products transferred to customers   |
| Credit | Revenue          |    | \$ 970 | \$10 * 97 products not expected to be returned |
| Credit | Refund Liability |    | 30     | \$10 * 3 products expected to be returned      |

(Recognition of revenue and a refund liability for the payment received)

|       |               |    |     |                                               |
|-------|---------------|----|-----|-----------------------------------------------|
| Debit | Cost of Sales | \$ | 582 | \$6 * 97 products not expected to be returned |
|-------|---------------|----|-----|-----------------------------------------------|

|        |           |        |                                                                                                   |
|--------|-----------|--------|---------------------------------------------------------------------------------------------------|
| Credit | Asset     | 18     | \$6 * 3 products the manufacturing entity has the right to recover upon settling refund liability |
| Credit | Inventory | \$ 600 | \$6 * 100 products transferred to customers                                                       |

(Recognition of cost of sales for products not expected to be returned and an asset for the products expected to be returned.)

### Noncash Consideration

A manufacturing entity may enter a contract with a customer under which the payment is in a form other than cash. The noncash consideration could be in the form of goods or services; a financial instrument (such as stock or warrants); or property, plant, and equipment; or cryptocurrencies (such as Bitcoin).

A manufacturing entity must measure noncash consideration at its estimated fair value at contract inception (that is, when the five contract existence criteria in Step 1 are met) to determine the transaction price for contracts in which a customer promises noncash consideration. If a manufacturing entity cannot reasonably estimate the fair value of the noncash consideration, it must measure the noncash consideration indirectly by reference to the SSP of the goods or services promised to the customer (or class of customer) in exchange for the consideration.

#### BDO INSIGHT 19: ESTIMATING FAIR VALUE OF NONCASH CONSIDERATION

Estimating the fair value of the noncash consideration received in exchange for transferring goods or services can be challenging in some circumstances (for example, when a manufacturing entity receives shares in a private manufacturing entity that is in start-up stage). However, we believe it would be unusual for a manufacturing entity to assert that it cannot reasonably estimate the fair value of the noncash consideration, especially if the consideration is in the form of a financial instrument (for example, shares).

Once recognized, any asset arising from the noncash consideration is measured and accounted for in accordance with other relevant U.S. GAAP.

A customer might contribute goods or services to a manufacturing entity (for example, a customer in a manufacturing contract might supply materials, equipment, or labor the manufacturing entity will use in performing the manufacturing services). In those circumstances, a manufacturing entity must assess whether it obtains control of the contributed goods or services. If so, those contributed goods or services are accounted for as noncash consideration received from the customer, and the contractual transaction price is increased by the estimated fair value of the noncash consideration. Similarly, the value of such contributed materials is included in the cost of the good or service, effectively resulting in a gross up of the income statement. If the manufacturing entity does not obtain control of the contributed goods or services, the estimated fair value of those items is not included in the transaction price.

#### BDO INSIGHT 20: GOODS OR SERVICES RECEIVED FROM A CUSTOMER

In some circumstances a customer may provide goods or services that a manufacturing entity subsequently integrates with other goods or services into a combined output that it then sells to the customer. If the manufacturing entity controls the goods or services received from the customer before integrating them into a combined output, they are considered noncash consideration. The value of such goods or services is included in the consideration in the contract and thus in revenue, and that value is included in cost of goods sold or cost of services. However, if the customer retains control of them, the goods or services are not considered noncash consideration. In that situation, a manufacturing entity must consider whether the promise is to modify or enhance an asset controlled by the customer, resulting in over-time revenue recognition (see Step 5).

We believe the following indicators may be relevant in determining whether a manufacturing entity obtains control of goods provided by the customer:

- ▶ Does the manufacturing entity obtain title to the goods or does the customer retain title?
- ▶ If the contract is terminated, must the manufacturing entity return any unused goods to the customer?
- ▶ Are the goods proprietary to the customer or are they fungible?
- ▶ Could the manufacturing entity obtain the goods from an unrelated third party?
- ▶ Does the manufacturing entity have the contractual and practical ability to redirect the goods to another customer?

While it is less common for a customer to contribute services a manufacturing entity controls, in some instances, a manufacturing entity might provide a significant service of integrating services provided by the customer with other goods and services provided by the manufacturing entity into a single combined output (see Step 5).

Determining whether such goods or services are noncash consideration requires judgment based on the facts and circumstances.

#### EXAMPLE 12: CUSTOMER PROVIDES PROPRIETARY RAW MATERIALS

##### FACTS

- ▶ A manufacturing entity enters a contract with a customer to manufacture a chemical solvent.
- ▶ The customer holds a patent on the formula for the chemical solvent and the chemical precursor used in the manufacturing process.
- ▶ The customer provides the chemical precursor to the manufacturing entity to manufacture the chemical solvent.
- ▶ The contract prohibits the manufacturing entity from using the chemical precursor for any reason other than to manufacture the chemical solvent for sale to the customer.
- ▶ Any unused chemical precursor remaining at the end of the contract term must be returned to the customer.

##### CONCLUSION

The manufacturing entity does not control the chemical precursor; therefore, the chemical precursor received from the customer is not noncash consideration.

##### ANALYSIS

- ▶ In determining whether it controls the chemical precursor received from the customer, the manufacturing entity considers that:
  - The customer holds the patent on the formula for the chemical precursor.
  - The manufacturing entity cannot use the chemical precursor for any reason other than to manufacture the chemical solvent.
  - Any unused chemical precursor at the end of the contract term must be returned to the customer.
- ▶ The manufacturing entity concludes that it does not control the chemical precursor.
- ▶ Therefore, the chemical precursor received from the customer is not considered noncash consideration.

**EXAMPLE 13: CUSTOMER PROVIDES GENERIC RAW MATERIALS****FACTS**

- ▶ A manufacturing entity enters a contract with a customer to manufacture a chemical solvent.
- ▶ The formula for the chemical solvent includes a chemical precursor that is not proprietary to the customer and can be obtained from various sources.
- ▶ The customer previously purchased a large volume of the chemical precursor from another supplier. The customer transfers the chemical precursor to the manufacturing entity to use in manufacturing the chemical solvent.
- ▶ The manufacturing entity owns additional volumes of the chemical precursor that are indistinguishable from that received from the customer.
- ▶ The manufacturing entity will add the chemical precursor received from the customer to its existing stock, such that any amounts used to manufacture the chemical solvent under the contract will not be identifiable.
- ▶ The contract provides a reduced cash price for the first 1,000 units of chemical solvent, which is approximately the number of units that can be manufactured with the volume of chemical precursor provided by the customer.
- ▶ Once the manufacturing entity uses all the chemical precursor provided by the customer, it will be responsible for obtaining more.

**CONCLUSION**

The manufacturing entity controls the chemical precursor received from the customer; therefore, the chemical precursor is noncash consideration.

**ANALYSIS**

- ▶ The manufacturing entity concludes that it controls the chemical precursor because:
  - The chemical precursor is not proprietary to the customer and can be obtained from multiple sources.
  - The contract does not require the manufacturing entity to use the chemical precursor received from the customer in manufacturing the chemical solvent. Instead, it provides a reduced cash price for the initial 1,000 units.
  - The manufacturing entity plans to co-mingle the chemical precursor received from the customer with other quantities already owned and use it to fulfill multiple customer contracts.
- ▶ Therefore, the manufacturing entity concludes that the chemical precursor received from the customer is noncash consideration.
- ▶ It includes the value of the precursor in consideration in the contract and recognizes it as revenue as it transfers chemical solvent to the customer.
- ▶ The cost of the precursor received from the customer is recognized as inventory when received (with an offsetting contract liability), and as cost of goods sold as units of solvent are transferred to the customer.

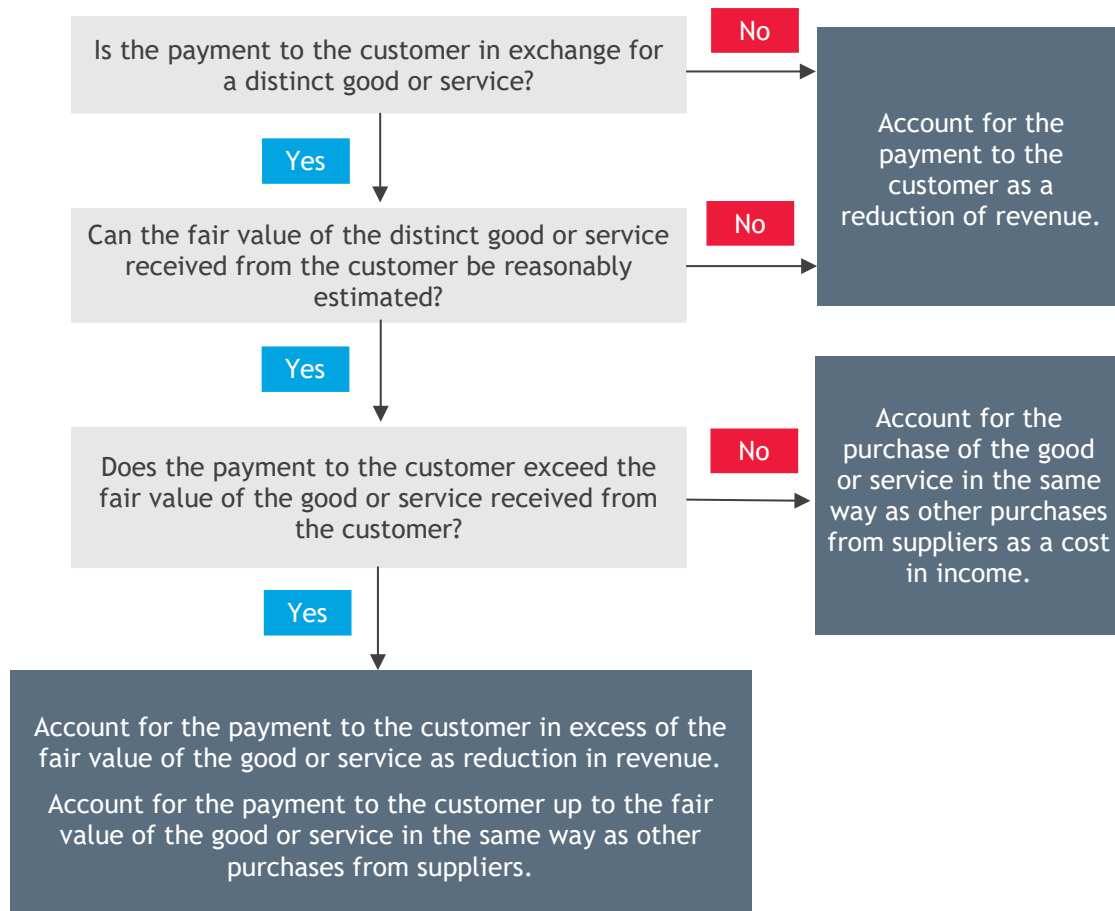
**Consideration Payable to a Customer**

In some cases, a contract between a manufacturing entity and a customer may require a manufacturing entity to pay consideration to its customers or customer's customer (for example, a manufacturing entity may sell a product to a distributor and subsequently issue a credit to a customer of that distributor). Consideration payable to a customer includes:

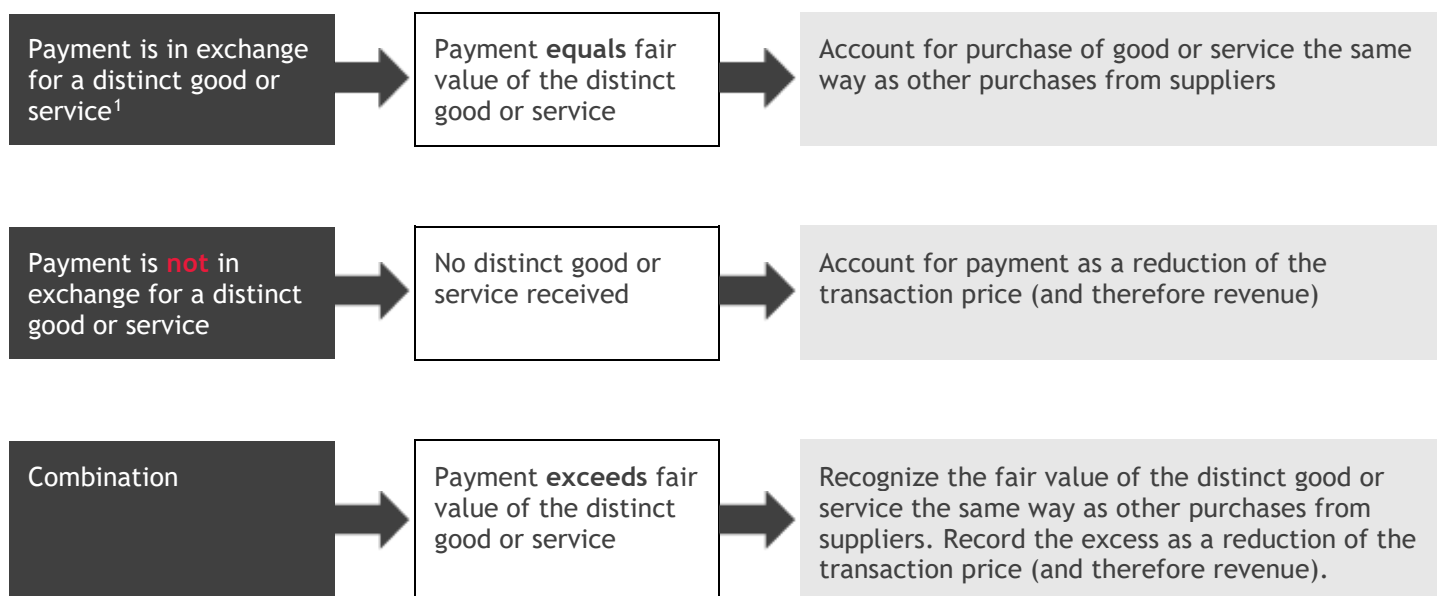
- ▶ Cash amounts a manufacturing entity pays, or expects to pay, to the customer (or to other parties that purchase the manufacturing entity's goods or services from the customer).

- ▶ Credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the manufacturing entity (or to other parties that purchase the manufacturing entity's goods or services from the customer).
- ▶ Equity instruments (liability or equity classified) granted in conjunction with selling goods or services (for example, shares or share options).

The following diagram provides an overview of a manufacturing entity's recognition of consideration payable to a customer:



Consideration payable to a customer might be a payment in exchange for goods or services received from the customer, a discount or refund for goods or services transferred to the customer, or a combination of both. The amount of consideration received from a customer for goods or services and the amount of consideration paid to that customer for goods or services could be linked even if they are separate events. For example, a manufacturing entity might overpay for the goods or services it purchases from its customer, and the customer might make inflated payments to the manufacturing entity for purchasing goods or services from it. To faithfully depict revenue in those cases, any amount accounted for as a payment to the customer for goods or services received is limited to the fair value of those goods or services, with any amount over fair value recognized as a reduction of the transaction price (and therefore revenue).



### CONSIDERATION PAYABLE TO A CUSTOMER MAY BE VARIABLE

If the consideration payable to a customer includes a variable amount, a manufacturing entity must estimate the transaction price and assess whether the estimate of variable consideration must be constrained (see Step 3).

If consideration payable to a customer is accounted for as a reduction of the transaction price (and therefore revenue), a manufacturing entity recognizes the reduction of revenue when or as the **later of either** of the following events occurs:

- ▶ The manufacturing entity recognizes revenue for the transfer of the related goods or services to the customer (see Step 5).
- ▶ The manufacturing entity pays or promises to pay (explicitly or implicitly based on its customary business practices) the consideration even if the payment is conditional on a future event. For example, a promise to pay a customer that is conditional on the customer making a specified number of purchases would be reflected in the transaction price when the manufacturing entity makes the promise. That promise represents variable consideration, so the guidance on estimating variable consideration and constraining that estimate (that is, the probability of the customer making the future purchases) must also be considered.

If a payment to a customer is accounted for as a reduction of the transaction price, a manufacturing entity recognizes less revenue when or as it satisfies any related performance obligations. However, a manufacturing entity sometimes promises to pay consideration to a customer only after it has satisfied its performance obligations and therefore after it has recognized revenue. In those cases, a reduction in revenue is recognized immediately.

<sup>1</sup> See Chapter 3 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#).

### **BDO INSIGHT 21: CONSIDERATION PAYABLE TO A CUSTOMER THAT IS VARIABLE — IMPLIED PRICE CONCESSION — TIMING OF RECOGNITION**

A manufacturing entity's past practice of providing discounts or other price concessions may represent an implied consideration payable to a customer in the form of variable consideration. Variable consideration is generally estimated and recognized in revenue before the uncertainty underlying the variability is resolved. If the implied payment to the customer is variable, it may be recognized in revenue (as a reduction) before the manufacturing entity makes the payment or explicitly promises to make the payment to the customer as discussed by the TRG (see Step 3 for discussion on variable consideration).



### **TRG DISCUSSIONS: INTERACTION OF THE GUIDANCE ON VARIABLE CONSIDERATION AND CONSIDERATION PAYABLE TO A CUSTOMER**

In January and March 2015, the TRG discussed the appropriate timing for recognizing consideration payable to a customer that is variable. It noted that the guidance on consideration payable to a customer states that such amounts are recognized as a reduction of revenue at the later of when:

- ▶ The related revenue is recognized.
- ▶ The entity pays or promises to pay such consideration.

Some TRG members highlighted that if an entity intends to provide its customer with a price concession when entering the contract (regardless of the form of the price concession; for example, cash payment, rebate, account credit, or coupon), the contract includes variable consideration, and the entity must consider that price concession when estimating variable consideration. If the contract includes variable consideration because of an expected price concession, the entity would not wait until it has communicated the price concession to the customer to recognize a reduction in revenue under the "later of" requirement. Instead, the entity re-estimates the expected price concession at each reporting date.

In reaching that conclusion, the TRG considered the following example:

- ▶ An entity that manufactures consumer goods enters a contract to sell a new product to a customer, a retail store chain, on December 15. Before delivering any of the new products to the retail store chain, the entity's marketing department assesses whether the entity should offer one-dollar-off coupons in newspapers to encourage customers to buy the new product. The entity will reimburse the retail store chain for any coupons redeemed. The entity has not historically offered similar coupons.
- ▶ The entity delivers the new consumer goods (1,000 units at \$10 per unit) to the retail store chain on December 28. The customer has no right to return the products.
- ▶ On December 31, the entity decides to make the coupon offering. On January 2, the entity communicates to its customers that it will reimburse the retail store chain on March 30 for any coupons redeemed by the retail store's customers. The entity prepares its financial statements based on a calendar year-end.

TRG members generally agreed that the reversal of revenue from consideration payable to a customer must be made at the earlier of the date when there is a change in the transaction price and when the consideration payable to a customer is promised, especially if the entity has a past practice of granting a discount. That determination requires judgment.

In the example above, at contract inception, the entity must consider its past practice and other factors (for example, its intent to offer coupons or whether the customer has a reasonable expectation that a concession will be provided in the form of consideration payable to the customer) to determine whether the transaction price is variable. If so, the coupon offering constitutes variable consideration and reduces the transaction price. If all

requirements in Step 5 have been met to recognize revenue for the sale of 1,000 units of consumer goods on December 28, the entity would reduce the revenue recognized on that date to reflect the estimated amount of coupon offering (consideration payable to customer). That estimate will be reassessed on December 31 (the reporting date) in accordance with the guidance on variable consideration.

If the coupon offering does not constitute variable consideration, the guidance on variable consideration does not apply and the later of requirement on recognizing consideration payable to a customer applies. In that scenario, the entity would reduce its revenue to recognize the coupon offering on January 2.

The following examples illustrate application of the guidance on consideration payable to a customer.

#### EXAMPLE 14: CONSIDERATION PAYABLE TO CUSTOMER

##### FACTS

- ▶ A manufacturing entity sells a product to its customer for \$100.
- ▶ The contract requires the manufacturing entity to pay the customer \$25.

##### CONCLUSION

The manufacturing entity treats the \$25 payable to the customer as a reduction of the transaction price unless the payment is in exchange for distinct goods or services from the customer.

##### ANALYSIS

###### Scenario A

- ▶ The customer is not providing any distinct goods and services to the manufacturing entity.
- ▶ Therefore, the transaction price (and, hence, revenue) recognized by the manufacturing entity for the sale of the product is reduced to \$75 (\$100 – \$25).

###### Scenario B

- ▶ The contract requires the customer to provide a service to the manufacturing entity. That service is considered distinct, and its estimated fair value is \$25.
- ▶ Therefore, the transaction price (and, hence, revenue) recognized by the manufacturing entity for the sale of the product is \$100. The manufacturing entity separately recognizes the purchase of services from its customer for \$25 under other U.S. GAAP.

###### Scenario C

- ▶ Consider the same facts in Scenario B with the exception that the estimated fair value of the distinct service provided by the customer to the manufacturing entity is \$15.
- ▶ Therefore, the transaction price (and, hence, revenue) recognized by the manufacturing entity for the sale of the product is reduced to \$90 (\$100 – \$10).
- ▶ The excess of the consideration payable to the customer (\$25) over the fair value of the distinct service the manufacturing entity receives from the customer (\$15) is \$10. The manufacturing entity separately recognizes the purchase of services from its customer for \$15 under other U.S. GAAP.

**EXAMPLE 15 (ADAPTED FROM ASC 606-10-55-251 THROUGH 55-254): CONSIDERATION PAYABLE TO CUSTOMER FACTS**

- ▶ A manufacturing entity that manufactures consumer products enters a contract to sell goods to a customer (a large supermarket group) for one year.
- ▶ The customer is contractually required to purchase at least \$10 million of goods during the year.
- ▶ The customer also is contractually required to change the shelving at the stores that will sell the retail goods.
- ▶ To compensate the customer for making those changes, the manufacturing entity makes a nonrefundable payment of \$1 million to the customer at contract inception.

**CONCLUSION**

The manufacturing entity accounts for the \$1 million payment to the customer as a reduction in the transaction price when the manufacturing entity recognizes revenue for the transfer of retail goods.

**ANALYSIS**

- ▶ The payment by the manufacturing entity to its customer does not result in the manufacturing entity obtaining a distinct good or service.
- ▶ Although the customer will use the shelving to sell the retail goods purchased from the manufacturing entity, the manufacturing entity does not obtain control of any rights to those shelves.
- ▶ Therefore, the manufacturing entity accounts for the \$1 million payment to the customer as a reduction in the transaction price when the manufacturing entity recognizes revenue for the transfer of retail goods. The \$1 million payment is recorded as an asset and is amortized as a reduction of revenue as the related sales of retail goods are recognized, resulting in total revenue recognition of \$9 million for the contract.

**BDO INSIGHT 22: DISTINCT GOOD OR SERVICE – SLOTTING FEES**

A manufacturer often pays consideration to a retailer to obtain prominent positioning for its goods in the retailer's shops. Those payments are sometimes referred to as "slotting fees." Whether the retailer provides a distinct good or service to the manufacturer depends on the facts and circumstances; specifically, whether the manufacturer obtains control of a good or service provided by the retailer. However, we believe it would be rare for that type of payment to result in the manufacturer receiving control of a distinct good or service.

**BDO INSIGHT 23: GOOD OR SERVICE RECEIVED FROM A CUSTOMER**

Accounting for payments to customers is a key aspect of ASC 606 and could have a significant effect on a manufacturing entity's financial statements. ASC 606 focuses on whether a good or service received from a customer is distinct to determine whether a payment to a customer is accounted for as a reduction in revenue or as a cost in the income statement. Sometimes, general terms such as marketing fees, advertising fees, transportation fees, or warehousing fees are used to describe payments to customers. While those types of fees may be commonly presented as selling expenses or cost of sales when paid to service providers that are not customers, manufacturing entities must not assume that is the appropriate presentation when they are included in a contract with a customer. Rather, manufacturing entities must evaluate whether the payments to customers are made in exchange for distinct goods or services. If the good or service received from the customer is not distinct, the payment to the customer is presented as a reduction of revenue, rather than as a cost of sales or selling expense.

Determining whether a good or service is distinct requires the application of professional judgment based on the facts and circumstances.

**BDO INSIGHT 24: DISTINCT GOOD OR SERVICE – MARKETING ACTIVITIES**

Sometimes it is challenging to determine whether a payment to a customer is in exchange for a distinct good or service when a manufacturing entity compensates its customer for the costs of marketing the manufacturing entity's products. The FASB acknowledged that in BC256 of ASU 2014-09:

*“The Boards decided that the only circumstance in which a manufacturing entity should account for any good or service received in the same way as for other purchases from suppliers is if the good or service is distinct. Previous guidance in U.S. GAAP on the consideration that a vendor gives to a customer used the term identifiable benefit, which was described as a good or service that is ‘sufficiently separable from the recipient’s purchase of the vendor’s products such that the vendor could have entered into an exchange transaction with a party other than a purchaser of its products or services in order to receive that benefit.’ The Boards concluded that the principle in Topic 606 for assessing whether a good or service is distinct is similar to the previous guidance in U.S. GAAP.*

Therefore, we believe the following indicators may be relevant when determining whether the marketing activities provide a service that is distinct from the sales of the manufacturing entity's products to that customer:

- ▶ Does the marketing activity reach end consumers beyond customers of the manufacturing entity's customers?
- ▶ Could the specific marketing activities be obtained from an unrelated third party?
- ▶ Are the marketing activities expected to result in an increase in sales to parties other than the customer providing the marketing services?
- ▶ Which manufacturing entity controls the marketing activities, including making decisions about the content of the marketing materials?

A manufacturing entity may sell goods or services to a customer, such as a retailer, for further resale and receive in-store marketing services from the retailer (or digital advertising services on the retailer's website) to promote the resale of those goods or services to end customers. In that scenario, we believe it would be unusual to conclude that the marketing service is distinct from the revenue transaction because the retailer would not provide the marketing services if it were not also purchasing the goods or services from the manufacturing entity.

**EXAMPLE 16: ADVERTISING FEE PAYABLE TO CUSTOMER — REDUCTION IN REVENUE****FACTS**

- ▶ A manufacturing entity that manufactures health supplement products enters a contract to sell its products to a customer that is a large distributor.
- ▶ The customer resells the products to end consumers on a large online retail platform.
- ▶ The customer is contractually required to purchase at least \$20 million of products from the manufacturing entity during the year.
- ▶ The manufacturing entity is required to make a payment of \$7 million to the customer as a nonrefundable advertising and marketing fee.
- ▶ The customer uses the advertising and marketing fee to promote the manufacturing entity's product on the online retailer's platform.
- ▶ The advertisements placed by the customer are linked to the customer's product page (that is, the customer's online shop) on the online retail platform.
- ▶ An end consumer who sees the advertising and clicks to purchase the product is directed to the customer's product page on the retail platform to make the purchase.

**CONCLUSION**

The manufacturing entity treats the \$7 million advertising and marketing fee payable to the customer as a reduction of the transaction price, resulting in a reduction in revenue.

**ANALYSIS**

- ▶ The manufacturing entity determines that the payment of the advertising fee to the customer is not in exchange for a distinct advertising service purchased by the manufacturing entity from the customer.
- ▶ Although the customer uses the advertising fee to promote the manufacturing entity's products, the promotional activities result in a direct benefit to the customer in the form of increased sales. The advertisements are linked to the customer's online retail shop and directly benefit the customer.
- ▶ The customer would not provide the advertising and marketing services if it were not also purchasing the products from the manufacturing entity.
- ▶ Therefore, the manufacturing entity accounts for the \$7 million payment to the customer as a reduction in the transaction price when it recognizes revenue for the transfer of the products, resulting in total revenue recognition of \$13 million for the contract (assuming the customer does not purchase additional products from the manufacturing entity).

**EXAMPLE 17: ADVERTISING FEE PAYABLE TO CUSTOMER — SELLING EXPENSE****FACTS**

- ▶ Consider the same facts as in Example 16, except the customer places advertisements for the manufacturing entity's products on various third-party search engines and social media platforms.
- ▶ The advertisements are linked to the manufacturing entity's website such that an end consumer who sees the advertising and clicks to purchase the product is led to the manufacturing entity's website to make the purchase.

**CONCLUSION**

The manufacturing entity recognizes the \$7 million payment to the customer as selling expenses.

**ANALYSIS**

- ▶ The manufacturing entity determines that the payment of the advertising fee to the customer is in exchange for a distinct advertising service purchased by the manufacturing entity from the customer.
- ▶ The advertising is broad based and reaches potential customers outside the customer's own customers and may lead to additional sales for the manufacturing entity (rather than for the customer).
- ▶ Assuming the \$7 million fee does not exceed the fair value of the advertising and marketing services, the manufacturing entity recognizes the \$7 million payment to the customer as selling expenses.

**TRG DISCUSSIONS: UPFRONT PAYMENT TO A CUSTOMER OR POTENTIAL CUSTOMER**

In November 2016, the TRG discussed the accounting for upfront payments to customers. A manufacturing entity may make an upfront payment to a customer to, for example:

- ▶ Reimburse the customer for costs associated with entering a contract (such as costs for setting up a new vendor or costs to shut down operations that will be outsourced to the vendor).
- ▶ Obtain a contract with a customer in a competitive environment (pay-to-play or exclusivity).
- ▶ Provide additional incentives or discounts to customers.

Upfront payments to customers that are not in exchange for a distinct good or service are accounted for as a reduction of the transaction price. However, recognizing a payment to a customer as a reduction in revenue may result in a loss recognition in some scenarios. For example:

- ▶ A manufacturing entity may make an upfront payment to a potential customer in anticipation of future purchases from the customer before obtaining a contract with the customer.
- ▶ A manufacturing entity may make an upfront payment to a customer it has a contract with. However, the upfront payment may relate to the current contract as well as any anticipated future contracts.

The TRG discussed two views about the timing of when the reduction in revenue for an upfront payment should be recorded:

- ▶ **View A:** Payments to customers are capitalized and amortized as a reduction of revenue as the related goods or services that are expected to be purchased by the customer are transferred to the customer. The asset is assessed for impairment in subsequent reporting periods. Under this view, the payment to a customer might be recognized in profit or loss over a period that is longer than the current legally enforceable contract. This view is appropriate only if the payment meets the definition of an asset in FASB Concepts Statement No (CON). 6, *Elements of Financial Statements*,<sup>2</sup> and future purchases are expected.
- ▶ **View B:** Payments to customers are recognized as a reduction of revenue from the existing contract. If a contract with the customer does not exist, the entire payment is immediately recognized in profit or loss. The TRG noted that for this view to apply, the payment must relate to the existing contract only.

<sup>2</sup> CON 6 was superseded by Chapter 4 of CON 8, *Conceptual Framework for Financial Reporting* in July 2024. As asset is now defined as "a present right of an entity to an economic benefit."

TRG members agreed that applying either view is not a policy election. Rather, a manufacturing entity must understand the reasons for the payment, any rights and obligations resulting from the payment, the nature of any promises in the contract, and other relevant facts and circumstances for each arrangement when determining the appropriate accounting.

Finally, the TRG said the assessment requires significant judgment in some cases and that appropriate disclosures in the financial statements might be important.

### **BDO INSIGHT 25: AMOUNTS RECEIVED FROM A SUPPLIER**

Although ASC 606 addresses a manufacturing entity's accounting for consideration payable to a customer, it does not directly address how a manufacturing entity accounts for amounts received from a supplier. ASC 705-20, *Cost of Sales and Services – Accounting for Consideration Received From a Vendor*, provides guidance on accounting for consideration received from a supplier. We believe that in Example 15, the supermarket should reflect a reduction in the cost of inventory purchased (and, hence, ultimately a reduction in cost of sales) rather than revenue or a contribution offset against the costs of changing the shelving. Specifically, the supermarket should recognize a \$1 million liability for the slotting fee it received as an offset against the cost of inventory when the future purchases occur.

In that example, the manufacturer is not the retailer's customer (that is, the changes to the shelving are not an output of the retailer's ordinary activities and do not represent a good or service that is distinct from its purchases from the manufacturer). This approach results in consistency in the accounting between the manufacturer and the retailer because if the manufacturer is not receiving a distinct good or service for the consideration paid to the retailer, the retailer is similarly not providing a distinct good or service to the manufacturer. That treatment is consistent with the guidance in ASC 705-20.

However, in other circumstances, a retailer can receive consideration from manufacturers that would constitute revenue for the retailer, as illustrated by the following three scenarios:

#### **Scenario A: Discount granted based on purchases not related to manufacturers' products**

A manufacturer and retailer agree on a promotion under which:

- ▶ The retailer's customers receive coupons based on their total purchases in the retailer's store regardless of whether the purchased products are manufactured by the manufacturer or another party (\$10 coupon for each \$100 of purchases).
- ▶ The retailer's customers use the coupons to acquire the manufacturers' products at a discounted price in the retailer's stores.
- ▶ The manufacturer bears the difference between the sales price and the discounted price granted to the customer.

The manufacturer's product has a selling price of \$60. An end customer purchases that product from the retailer in exchange for three coupons with a total value of \$30 and cash of \$30. The manufacturer reimburses \$30 cash to the retailer, which is the face value of the coupons used by the end customer. The retailer recognizes revenue of \$60, which includes the \$30 cash received from the end customer and the \$30 cash reimbursement from the manufacturer for the coupon used by the end customer.

#### **Scenario B: Promotional discount granted to the customer**

A manufacturer and retailer agree on a promotional pricing for a product manufactured by the manufacturer and sold by the retailer to end customers. The retailer generally purchases the manufacturer's product for \$85 for sale to end customers at \$102. During the promotional period, the retailer sells the product for \$97 to its customers. The manufacturer reimburses the retailer for the incremental discount of \$5 over the regular retail price of \$102.

For each sale of the product, the retailer recognizes revenue of \$102, which includes the price paid by its customer (\$97) plus the amount reimbursed by the manufacturer (\$5).

**Scenario C: Discount granted to the end customer based on coupons issued by the manufacturer**

A manufacturer (not the retailer) initiates a promotional campaign under which end customers receive coupons issued by the manufacturer when they purchase the manufacturer's products from a retailer. The manufacturer bears the difference between the retail price and the discounted price. A customer receives a coupon for \$10 off the purchase of one of the manufacturer's products.

The manufacturer's product has a selling price of \$60, and an end customer purchases the product in exchange for a coupon with a value of \$10 and cash of \$50. The retailer receives \$10 from the manufacturer. The retailer recognizes revenue in an amount of \$60, which includes the \$50 cash received from the end customer and the \$10 cash reimbursement from the manufacturer for the coupon used by the end customer.

**All Scenarios: Payment on behalf of the customer**

In all three scenarios, although the payments received by the retailer are from the manufacturer (the supplier), the payments are received on behalf of the retailer's customer, so the retailer recognizes the amounts due from the manufacturer as revenue. If the manufacturer reimburses the retailer at an amount that exactly matches the discount the end customer receives, the coupon has in effect been issued by the manufacturer (not the retailer) to the end customer and therefore is recognized as revenue by the retailer. In those scenarios, there is no payment to a customer from the perspective of the retailer, so there is no reduction in revenue or a rebate for the cost of inventory sold.

However, from the manufacturer's perspective, the reimbursement of coupons is a payment to its customer (the retailer) and therefore results in a reduction of revenue recognized by the manufacturer.



**FASB PROJECT: CONSIDERATION PAYABLE TO A CUSTOMER**

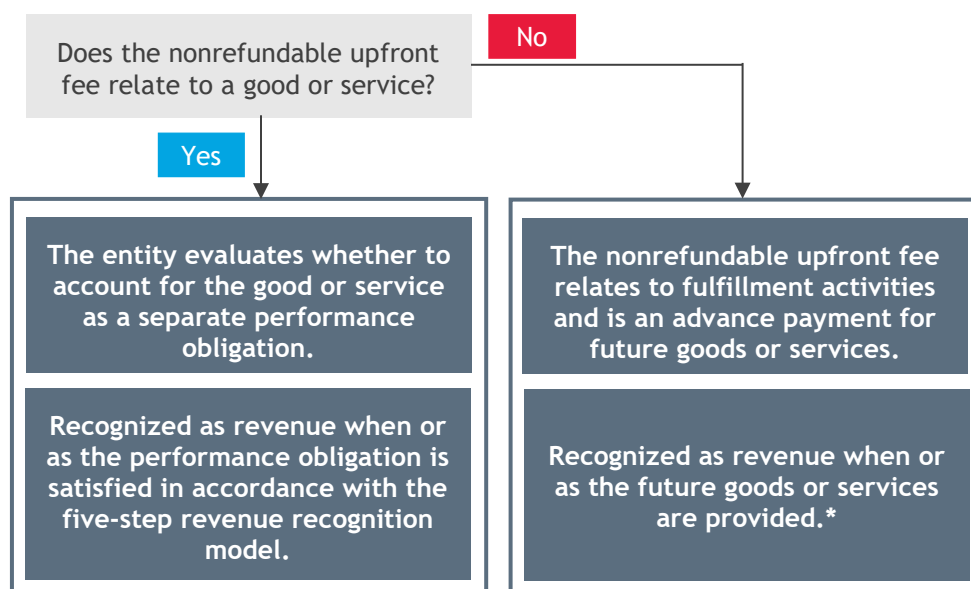
In June 2026, the FASB added a project to its agenda to consider when payments made on behalf of a customer or to a customer of an entity's customer are accounted for as consideration payable to a customer. The FASB has tentatively concluded that such payments are accounted for as consideration payable to a customer when either (a) there is an explicit or implicit promise to the customer that such payments will be made or (b) the payment represents an in-substance price concession that the customer has a reasonable expectation will be made to the customer's customer. The FASB also plans to add illustrative examples to ASC 606-10-55 addressing payments to a customer's customer and payments made on behalf of a customer. Readers should monitor the [FASB website](#) for developments.

**Nonrefundable Upfront Fees**

A manufacturing entity may charge a customer a nonrefundable upfront fee at or near contract inception, such as for:

- ▶ Setup or tooling fees in some manufacturing contracts
- ▶ Initial fees in some supply contracts.

The following diagram illustrates the key accounting considerations for nonrefundable upfront fees:



\*The revenue recognition period generally extends beyond the initial contract term if the entity grants the customer a renewal option that is determined to be a material right.

When a contract includes a nonrefundable upfront fee, a manufacturing entity assesses whether that fee relates to the transfer of a promised good or service in Step 2 and accounts for the fee as follows:

- ▶ If the nonrefundable upfront fee relates to a good or service, the manufacturing entity evaluates whether to account for the good or service as a separate performance obligation.
- ▶ If the nonrefundable upfront fee does not result in the transfer of a promised good or service to the customer but rather relates to fulfillment activities, the fee is an advance payment for future goods or services and therefore is recognized as revenue when those future goods or services are provided. The revenue recognition period generally extends beyond the initial contract term if the manufacturing entity grants the customer renewal options for the contract that are determined to be material rights.

In many cases, even though a nonrefundable upfront fee may relate to an activity the manufacturing entity must undertake at or near contract inception to fulfill the contract, that activity might not result in the transfer of a promised good or service to the customer but instead be a fulfillment activity (see Step 2).

### Accounting Policy Election for Taxes

A manufacturing entity can make an accounting policy election to exclude from the measurement of transaction price all taxes assessed by a taxing authority related to the specific transaction and collected from the customer. Examples include sales, use, value added, and some excise taxes. If a manufacturing entity elects the policy, such tax amounts are presented net (that is, as reductions of the transaction price (or revenue) rather than as costs in the income statement). If a manufacturing entity does not elect the policy, it must analyze each jurisdiction where it operates to determine whether such amounts are included in or excluded from the transaction price.

**BDO INSIGHT 26: TARIFFS AND THE ACCOUNTING POLICY ELECTION FOR TAXES**

A manufacturing entity that imports foreign goods might have to pay tariffs imposed by the government. The tariff is the importer's own cost of acquiring the goods and must be recognized when incurred. In other words, even if the manufacturing entity is able to pass through some (or all) of the cost to its customers, the ability to do so is separate from its obligation to pay the government. The manufacturing entity is not acting as the government's agent (which differs from when the manufacturing entity collects sales taxes from its customers on behalf of the government). Therefore, tariffs are not sales taxes and are ineligible for the accounting policy election for taxes. Instead, any tariffs charged through to the manufacturing entity's customers are additional consideration for the goods or services promised to the customer.

**STEP 4: ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS**

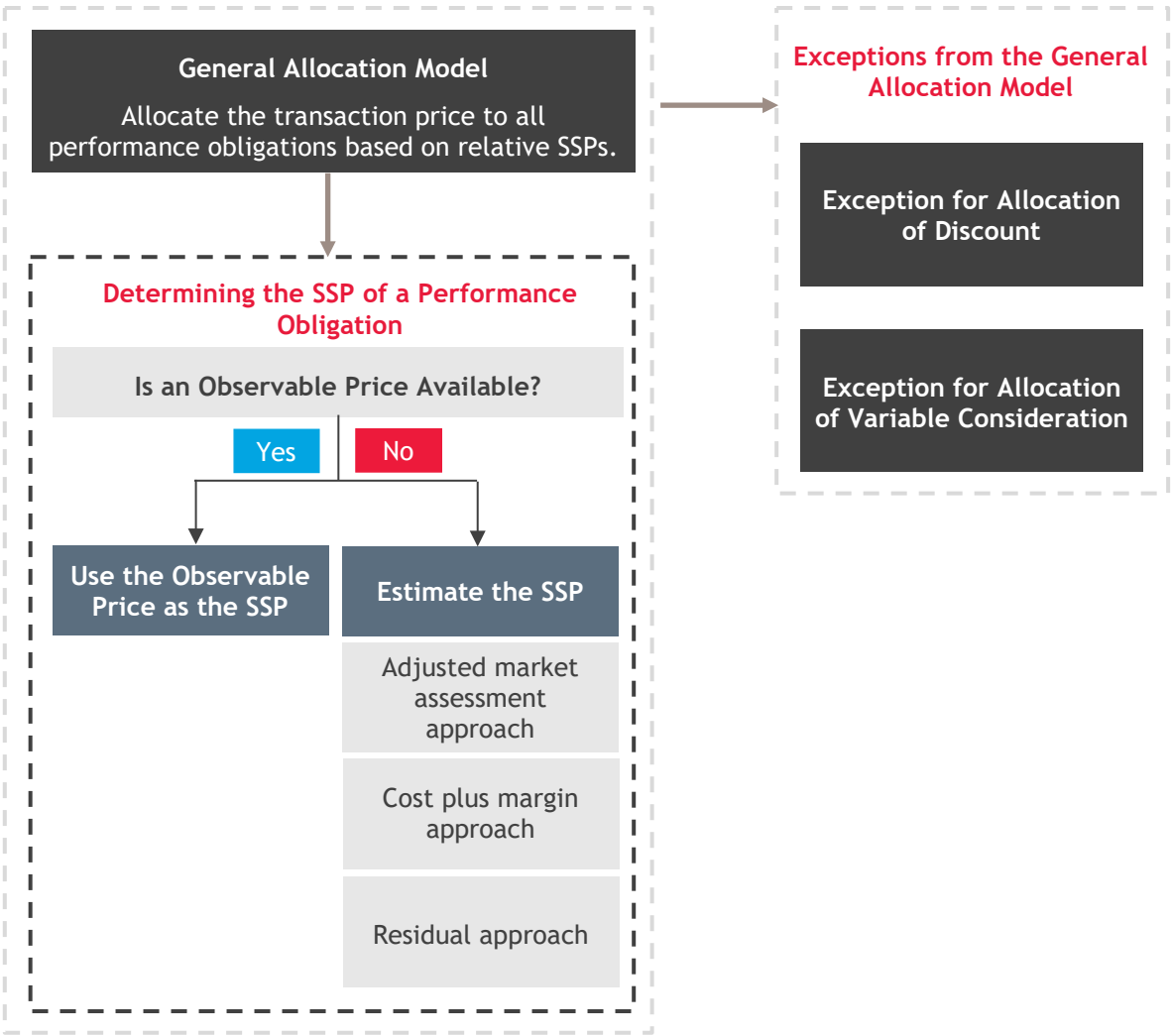
After determining the transaction price for the contract in Step 3, a manufacturing entity must allocate the transaction price to the performance obligations identified in the contract in Step 2. The amount allocated to each performance obligation is ultimately recognized in revenue when or as that obligation is satisfied.

ASC 606 includes an allocation objective that generally requires the allocation of transaction price to each performance obligation based on the relative **standalone selling price** (SSP) of the goods or services underlying each performance obligation. That allocation approach is sometimes referred to as the "general allocation model."

There are two **exceptions** to the general allocation model for specific discounts and variable consideration:

- ▶ **Allocation of a Discount:** Unless there is observable evidence that an entire discount relates to one or more (but not all) performance obligations in a contract, the discount is allocated proportionately to all performance obligations in the contract based on relative SSPs.
- ▶ **Allocation of Variable Consideration:** Variable consideration (and subsequent changes to that amount) is allocated entirely to a single performance obligation (or a distinct good or service that forms part of a single performance obligation that meets the definition of a series) if **both** of the following criteria are met:
  - The terms of a variable payment relate specifically to the manufacturing entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).
  - When considering all the performance obligations and payment terms in the contract, the allocation of the variable amount in its entirety to a performance obligation (or distinct good or service) is consistent with the allocation objective that the transaction price must be allocated to each performance obligation (or distinct good or service) to reflect the consideration to which the manufacturing entity expects to be entitled in exchange for transferring the promised good or service.

The following diagram summarizes the key concepts in Step 4:



## Determining Standalone Selling Price

In Step 4, determining the appropriate SSP for each performance obligation is the first step to determining the amount to allocate to each performance obligation in a contract. At contract inception, a manufacturing entity must determine the SSP of each performance obligation in the contract and allocate the transaction price to each performance obligation on a relative SSP basis.

### BDO INSIGHT 27: APPROPRIATE LEVEL FOR DETERMINING STANDALONE SELLING PRICE

The SSP is determined at the performance obligation level. When a single performance obligation comprises multiple goods or services, the SSP of that performance obligation is determined by considering the price at which a manufacturing entity would sell the bundle separately to a customer. That price could be different than the sum of the prices at which a manufacturing entity would separately sell the individual goods or services making up the bundle.

For example, consider a manufacturing entity that manufactures and sells solar panels and related design and installation services as a bundle that constitutes a single performance obligation. The manufacturing entity enters a contract to sell that bundle, along with a distinct post-installation maintenance service, to a customer. To allocate the transaction price to the two performance obligations (the bundle and the maintenance service), the manufacturing entity must assess the SSPs of the bundle and maintenance service. In determining the SSP of the bundle, the manufacturing entity must consider the price at which it would sell the bundle separately to a customer rather than the price at which it would separately sell the promised goods or services underlying the bundle (solar panels and design and installation) to a customer.

The best evidence of SSP is the **observable price** of a good or service when the manufacturing entity sells that good or service separately in similar circumstances to similar customers.

If the SSP is **not** directly observable, a manufacturing entity **estimates** that price at an amount that would result in the allocation of the transaction price meeting the allocation objective.



### CONTRACTUALLY STATED PRICE IS NOT PRESUMED TO BE THE STANDALONE SELLING PRICE

While a contractually stated or list price for a good or service might be the SSP for that good or service, it must not be presumed to be SSP. For example, a manufacturing entity might typically grant discounts from its list prices, or it might not sell the distinct good or service separately from other goods or services. In those scenarios, the list price of a distinct good or service does not provide a directly observable price of that good or service.



### INFORMATION CONSIDERED IN ESTIMATING STANDALONE SELLING PRICE

When estimating an SSP, a manufacturing entity must consider all information reasonably available, including:

- ▶ Reasonably available data points, such as the costs incurred to manufacture or provide the good or service, related profit margins, published price listings, third-party or industry pricing, and the pricing of other goods or services in the same contract.
- ▶ Market conditions, including supply and demand for the good or service in the market, competition, restrictions, and trends.

- ▶ Manufacturing entity-specific factors, such as business pricing strategy and practices.
- ▶ Information about the customer or class of customer, such as type of customer, geographical region, and distribution channel.

In considering the information available to estimate an SSP, a manufacturing entity must **both**:

- ▶ Maximize the use of observable inputs.
- ▶ Apply estimation methods consistently in similar circumstances.

### Methods for Estimating SSP

Suitable methods for estimating the SSP of a good or service include, but are not limited to, the following three approaches:

- ▶ Adjusted market assessment approach
- ▶ Expected cost plus a margin approach
- ▶ Residual approach

ASC 606 does not specify a hierarchy of evidence to estimate the SSP of a good or service.

#### Adjusted Market Assessment Approach

The adjusted market assessment approach:

- ▶ Requires an evaluation of the market in which a manufacturing entity sells goods or services to estimate the price that a customer in that market would be willing to pay for those goods or services.
- ▶ May include referring to prices from the manufacturing entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the manufacturing entity's costs and margins.

#### Expected Cost Plus a Margin Approach

The expected cost plus a margin approach requires a manufacturing entity to forecast its expected costs of satisfying a performance obligation and then add an appropriate profit margin.

### **BDO INSIGHT 28: DETERMINING THE APPROPRIATE PROFIT MARGIN**

When a manufacturing entity estimates SSP using the cost-plus-margin approach, the margin must reflect the price the manufacturing entity could charge in a specific market for a specific product or service. A manufacturing entity may use different profit margins for different products and services (including within the same contract), classes of customers, or geographical markets.

A manufacturing entity determines the appropriate margin by considering manufacturing entity-specific and market factors such as:

- ▶ The nature of the good or service.
- ▶ Historical margins of similar goods or services when selling the good or service on a standalone basis.
- ▶ Average industry margins.
- ▶ Current market and economic conditions that may affect the profit margin a market would be willing to pay.

The list of factors is not exhaustive, and no single factor is determinative. Determining the appropriate margin to use in a cost-plus-margin approach requires the application of professional judgment based on the facts and circumstances.

### Residual Approach

The residual approach requires an estimation of the SSP by reference to the total transaction price less the sum of the observable SSPs of other goods or services promised in the contract. It may be used to estimate the standalone selling price of a good or service only if **both** of the following conditions are met:

The manufacturing entity has observable standalone selling prices for one or more other goods or services promised in the contract. That is, at least one good or service promised in the contract is sold on a standalone basis in other situations.

AND

The manufacturing entity sells the same good or service to different customers at or near the same time for a broad range of amounts (that is, the selling price is highly variable because a representative SSP is not discernible from past transactions or other observable evidence).

OR

The manufacturing entity has not yet established a price for that good or service, and the good or service has not previously been sold on a standalone basis (that is, the selling price is uncertain).

When the residual approach is used to determine the SSP of a distinct good or service, the outcome of that approach cannot realistically result in an SSP of zero if the good or service is in fact distinct. To be distinct, a good or service must have value on a standalone basis. Therefore, if the residual approach results in no, or very little, consideration being allocated to a performance obligation, the manufacturing entity must consider whether that estimate is appropriate in those circumstances. If not, the manufacturing entity must use another method to estimate SSP.

### Other Approaches

According to ASC 606-10-32-34, the adjusted market assessment, cost-plus-margin, and residual approaches are acceptable methods to estimate SSP, but other methods may also be appropriate.

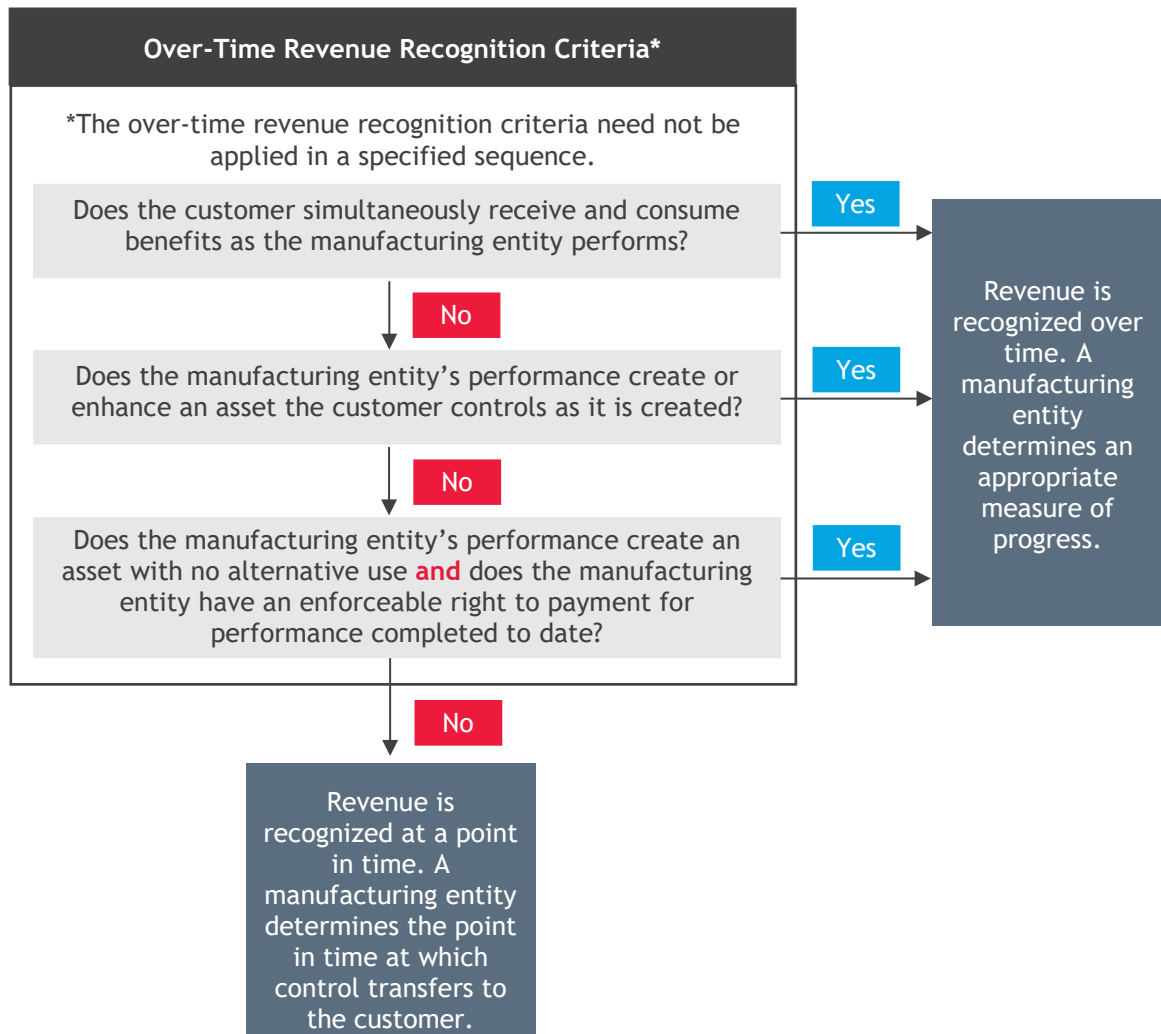
## STEP 5: RECOGNIZE REVENUE WHEN OR AS THE PERFORMANCE OBLIGATION IS SATISFIED

After allocating (Step 4) the transaction price (determined in Step 3) to the performance obligations identified in the contract (Step 2), a manufacturing entity assesses when it satisfies each performance obligation by transferring a promised good or service to the customer and recognizes revenue allocated to each performance obligation when or as that performance obligation is satisfied. A manufacturing entity satisfies its performance obligation in a contract by transferring control of the promised good or service underlying that performance obligation to the customer, which may be at a point in time or over time.

Assessing when control of a good or service is transferred to a customer is a critical aspect of ASC 606. Control in the context of ASC 606 is the ability to direct the use of, and obtain substantially all the remaining benefits from, an asset. ASC 606 includes indicators to help apply the control principle.

ASC 606 includes three criteria to determine whether a performance obligation is satisfied over time. A manufacturing entity must first consider those criteria to determine if a performance obligation is satisfied over time. If none of the three criteria are met, the performance obligation is satisfied at a point in time. The manufacturing entity then considers the indicators of control to determine at what point in time the control transfers to the customer.

The following diagram gives an overview of those requirements:



For each performance obligation satisfied over time, a manufacturing entity recognizes revenue over time by measuring the progress toward complete satisfaction of that performance obligation.

#### **BDO INSIGHT 29: SEQUENCE FOR DETERMINING WHETHER A PERFORMANCE OBLIGATION IS SATISFIED OVER TIME OR AT A POINT IN TIME**

ASC 606 establishes a sequence for analyzing whether a performance obligation is satisfied at a point in time or over time. The three criteria in ASC 606-10-25-27 establish whether a performance obligation is satisfied over time. An entity must first evaluate each performance obligation against each of those criteria to conclude whether a performance obligation is satisfied over time. If none of the over-time revenue recognition criteria are met, the performance obligation is satisfied at a point in time. An entity cannot omit the analysis of the over-time revenue recognition criteria and default to a conclusion that a performance obligation is satisfied at a point in time. Rather, to conclude that a performance obligation is satisfied at a point in time, an entity must first conclude that none of the over-time revenue recognition criteria are met,

## Over-Time Revenue Recognition Criteria

Below is a discussion of the three over-time revenue recognition criteria to determine whether a performance obligation is satisfied over time.

### First Criterion: Customer Simultaneously Receives and Consumes Benefits as the Manufacturing Entity Performs

If a customer simultaneously receives and consumes the benefits provided by a manufacturing entity's performance as the manufacturing entity performs, the manufacturing entity transfers control of a good or service underlying a performance obligation to the customer over time and therefore revenue attributed to that performance obligation is recognized over time. This criterion is generally applicable in typical service contracts such as repair and maintenance agreements and service warranties.

### Second Criterion: Performance Creates or Enhances an Asset the Customer Controls as It Is Created

If a manufacturing entity's performance creates or enhances an asset (for example, work in process) the customer controls as the asset is created or enhanced, the manufacturing entity transfers control of a good or service underlying a performance obligation to the customer over time. Therefore, revenue attributed to that performance obligation is recognized over time. In those cases, because the customer controls any work in process, the customer is obtaining the benefits of the goods or services the manufacturing entity is providing, so the performance obligation is satisfied over time.

To determine whether a customer controls an asset that is being created or enhanced by a manufacturing entity's performance as it is created or enhanced, a manufacturing entity must apply the guidance on control, including considering whether the indicators of control are met related to any work in process as the promises are being delivered.

### **BDO INSIGHT 30: ANALYSIS OF OVER-TIME REVENUE RECOGNITION CRITERIA IN CONTRACTS WITH THE U.S. GOVERNMENT**

Contracts with the U.S. government under the federal acquisition regulations (FAR) generally require analysis of the second and third over-time revenue recognition criteria (that is, the criterion that a manufacturing entity's performance creates or enhances an asset that the customer controls and the criterion that a manufacturing entity's performance creates an asset with no alternative use to the manufacturing entity and the manufacturing entity has an enforceable right to payment for performance created to date).

Contracts governed by FAR generally include termination clauses that provide the federal government with the right to obtain any work in process throughout the contract period if the contract is terminated before completion. The customer's ability to terminate the contract and obtain the interim work product is an indicator of control that must be analyzed with other rights, such as rights to payment and transfer of legal title, but often results in meeting the criterion that a manufacturing entity's performance creates or enhances an asset the customer controls.

Contracts governed by FAR may also contain substantive contractual restrictions that prevent a manufacturing entity from redirecting completed products to another manufacturing entity if the contract with the federal government is terminated. The manufacturing entity also typically has an enforceable right to payment for performance completed to date under the standard FAR payment terms, resulting in those contracts meeting the criterion that a manufacturing entity's performance creates an asset with no alternative use to the manufacturing entity and the manufacturing entity has an enforceable right to payment for performance created to date.

In some cases, a manufacturing entity may serve as a subcontractor under a FAR contract. The subcontract may implicitly or explicitly refer to FAR provisions. Whether and how FAR applies to contracts with subcontractors is generally a legal question. Determination of the applicability of FAR to a particular contract and the related analysis of the over-time revenue recognition criteria in ASC 606-10-25-27(b) and (c) requires the application of judgment based on all facts and circumstances.

### Third Criterion: Performance Does Not Create an Asset with an Alternative Use to the Manufacturing Entity and the Manufacturing Entity Has an Enforceable Right to Payment for Performance Completed to Date

If a manufacturing entity's performance does not create an asset with an alternative use to the manufacturing entity **and** the manufacturing entity has an enforceable right to payment for performance created to date, the manufacturing entity transfers control of a good or service underlying a performance obligation to the customer over time. Therefore, revenue attributed to that performance obligation is recognized over time.

The third over-time criterion consists of two sub-criteria, **both** of which must be met:

- ▶ No alternative use.
- ▶ An enforceable right to payment.

#### Performance Does Not Create an Asset with an Alternative Use

An asset created by a manufacturing entity's performance does not have an alternative use to a manufacturing entity if **either** of the following applies:

- ▶ The manufacturing entity is restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset.
- ▶ The manufacturing entity is limited practically from readily directing the asset in its completed state for another use.

At contract inception, a manufacturing entity must assess whether the asset in its completed form has an alternative use to the manufacturing entity. After contract inception, a manufacturing entity does not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantively changes the performance obligation.



#### CONTRACTUAL RESTRICTIONS AND PRACTICAL LIMITATIONS

In assessing whether an asset has an alternative use to a manufacturing entity, a manufacturing entity must consider the effects of contractual restrictions and practical limitations on the manufacturing entity's ability to readily direct that asset for another use, such as selling it to a different customer. However, the probability of the contract with the customer being terminated is not relevant in assessing whether the manufacturing entity would be able to readily direct the asset for another use.

#### Substantive Contractual Restriction

A contractual restriction on a manufacturing entity's ability to direct an asset for another use must be substantive for the asset to have no alternative use to the manufacturing entity.

- ▶ A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the manufacturing entity sought to direct the asset for another use.
- ▶ A contractual restriction is not substantive if, for example, an asset is largely interchangeable with other assets the manufacturing entity could transfer to another customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract. For example, when the asset being sold is mass produced and it would be straightforward to substitute an equivalent item for a particular item subject to an existing contract, with the original item being sold to another customer, any contractual restriction is not substantive even if each of the items produced could be specified individually by each customer from a range of options. In that situation, the contractual restriction is not substantive because it is straightforward to produce another item with the same options and therefore meet the requirements of a particular contract.

**EXAMPLE 18: CONTRACTUAL RESTRICTION IS NOT SUBSTANTIVE — SALE OF A CAR****FACTS**

- ▶ A manufacturing entity enters a contract to sell a car with customer-specific customizations, such as color, wheels, and interior finishes.
- ▶ The contract states the manufacturing entity cannot sell the customized car to another customer.
- ▶ The manufacturing entity manufactures cars using a standardized production process allowing the same options and customizations to be applied to any car without significant additional cost.
- ▶ If another customer ordered an identical configuration, the manufacturing entity produces another car with the same specifications without incurring significant effort or cost.

**CONCLUSION**

The contractual restriction in the contract is not substantive.

**ANALYSIS**

- ▶ ASC 606 states that a restriction on redirecting an asset for another use is not substantive when the seller can produce a substantially similar asset at minimal cost.
- ▶ Although the contract prohibits selling the specific customized car to another customer, the manufacturing entity easily reproduces an identical car with the same options through its normal manufacturing process.
- ▶ Because customization (colors, wheels, interior) involves routine configurations rather than meaningful design changes, the manufacturing entity does not lose the ability to direct the asset for an alternative use.
- ▶ Since the manufacturing entity can fulfill another customer's needs by producing the same customized configuration without significant additional cost, the restriction does not limit the manufacturing entity's practical ability to redirect the car.
- ▶ Therefore, the contractual restriction is not substantive, and the manufacturing entity retains control of the asset until transfer to the customer.

**CONTRACTUAL RESTRICTIONS THAT PROVIDE A PROTECTIVE RIGHT TO THE CUSTOMER**

Contractual restrictions that provide a protective right to the customer are not sufficient to establish that an asset has no alternative use to the manufacturing entity. A protective right typically results in the manufacturing entity having the practical ability to physically substitute or redirect the asset without the customer's awareness of or objections to the change. Consider an example in which a contract states that a manufacturing entity cannot transfer a good because a customer has legal title to the goods in the contract. However, the customer's legal title to the goods is intended to protect the customer in the event of the manufacturing entity's liquidation, and the manufacturing entity can physically substitute and redirect the goods to another customer for little cost. In that example, the contractual restriction is merely a protective right and does not indicate that control of the goods has transferred to the customer.

**Practical Limitation**

A practical limitation on a manufacturing entity's ability to direct an asset for another use exists if a manufacturing entity would incur significant economic losses to direct the asset for another use. A significant economic loss could arise because the manufacturing entity would either incur significant costs to rework the asset or only be able to sell

the asset at a significant loss. For example, a manufacturing entity may be practically limited from redirecting assets that either have customer-specific design specifications or are located in remote areas.

The notion of alternative use is provided in the guidance to exclude the circumstances in which a manufacturing entity's performance would not result in the transfer of control of goods or services to the customer over time. Specifically, when the manufacturing entity's performance creates an asset with an alternative use to the manufacturing entity, for example a standard inventory-type item that could be used to fulfil different contracts with different customers, the manufacturing entity could readily direct the asset to another customer. In those cases, the customer cannot control the asset as it is being created because absent any contractual restrictions, the customer does not have the ability to restrict the manufacturing entity from directing that asset to another customer.

Further, when a manufacturing entity creates an asset that is highly customized for a specific customer, the asset would be less likely to have an alternative use to the manufacturing entity because the manufacturing entity would incur significant costs to reconfigure the asset for sale to another customer or would need to sell the asset for a significantly reduced price. In that case, the customer could be regarded as receiving the benefit of that performance and as a result, controlling the goods or services (that is, the asset being created) as the performance occurs if the manufacturing entity also has a right to payment.

In addition, although the level of customization might be a helpful factor to consider in assessing whether an asset has an alternative use, it is not a determinative factor because in some cases, an asset may be standardized but still might have no alternative use to a manufacturing entity because of substantive contractual restrictions that prevent the manufacturing entity from readily directing that specific asset to another customer. If a contract precludes a manufacturing entity from transferring an asset to another customer and that restriction is substantive, the manufacturing entity does not have an alternative use for that asset because it is legally obligated to direct the asset to the customer. This fact indicates that the customer controls the asset as it is created because the customer has the present ability to restrict the manufacturing entity from directing that asset to another customer if the manufacturing entity also has a right to payment.

In determining whether the manufacturing entity is limited practically from directing the asset for another use, a manufacturing entity considers the characteristics of the asset that will ultimately be transferred to the customer. For some assets, the critical factor in making the assessment is whether the asset that is ultimately transferred could be redirected without a significant cost of rework. For example, in some manufacturing contracts, the basic design of the asset is the same across multiple contracts, but the customization in each contract is substantial. Therefore, redirecting the asset from one contract in its completed state to another customer requires significant rework.

#### **EXAMPLE 19: (ADAPTED FROM ASC 606-10-55-165 THROUGH 55-168) – ASSET HAS NO ALTERNATIVE USE TO THE MANUFACTURING ENTITY**

##### **FACTS**

- ▶ A manufacturing entity builds satellites for various customers, such as governments and commercial entities.
- ▶ The design and construction of each satellite differ substantially based on each customer's needs and the type of technology that is incorporated into the satellite.
- ▶ The manufacturing entity enters a contract with a customer to build a specialized satellite.
- ▶ The contract does not preclude the manufacturing entity from directing the completed satellite to another customer.
- ▶ The manufacturing entity's sole performance obligation in the contract is to build the satellite.

##### **CONCLUSION**

The manufacturing entity concludes that the specialized satellite has no alternative use to the manufacturing entity.

**ANALYSIS**

- ▶ The manufacturing entity assesses at contract inception whether its performance obligation to build the satellite is satisfied over time.
- ▶ The manufacturing entity observes that although the contract does not preclude the manufacturing entity from directing the completed satellite to another customer, it would incur significant costs to rework the design and function of the satellite to direct that specific satellite to another customer.
- ▶ As a result, the manufacturing entity determines that the satellite built for the customer has no alternative use to the manufacturing entity because the customer-specific design of the satellite limits the manufacturing entity's practical ability to readily direct the satellite to another customer.

**EXAMPLE 20: ASSET IN ITS COMPLETED FORM HAS NO ALTERNATIVE USE TO THE MANUFACTURING ENTITY****FACTS**

- ▶ A manufacturing entity manufactures metal pipe fittings for industrial use.
- ▶ The manufacturing entity manufactures generic pipe fittings for off-the-shelf sales and customized pipe fittings for the specialized needs of a specific customer.
- ▶ The manufacturing entity often uses a generic pipe fitting to customize it according to a customer's specifications.
- ▶ The manufacturing entity is unable to sell a customized pipe fitting to other customers.
- ▶ The manufacturing entity enters a contract with a customer to manufacture a customized pipe fitting.
- ▶ The contract does not preclude the manufacturing entity from directing the customized pipe fitting to another customer.
- ▶ The basic design of the customized pipe fitting (metal type, shape, etc.) is the same as for a generic pipe fitting.
- ▶ The manufacturing entity's sole performance obligation in the contract is to manufacture a customized pipe fitting.

**CONCLUSION**

The manufacturing entity concludes that the customized pipe fitting has no alternative use in its completed form.

**ANALYSIS**

- ▶ The manufacturing entity assesses at contract inception whether its performance obligation to manufacture a customized pipe fitting is satisfied over time.
- ▶ Because the basic design of the specialized pipe fitting is the same as for a generic pipe fitting, the manufacturing entity can redirect the work in process (asset) to another customer or for another purpose until the customization begins in the manufacturing process.
- ▶ The asset remains generic and interchangeable up to a point in the manufacturing process. However, the completed asset (the customized pipe fitting) cannot be sold to another customer and redirecting it to another customer or for another purpose would require significant rework.
- ▶ Therefore, the manufacturing entity determines that the customized pipe fitting (that is, the asset in its completed form) has no alternative use to the manufacturing entity regardless of the following:
  - The asset is generic and can be redirected to another customer or for another purpose up to a certain point in the manufacturing process.
  - The manufacturing entity is not contractually precluded from directing the specialized pipe fitting to another customer.

- ▶ Assuming the manufacturing entity has an enforceable right to payment for performance completed to date, the performance obligation for the customized pipe fitting is satisfied over time, and the manufacturing entity recognizes revenue over time during the manufacturing process.
- ▶ However, the manufacturing entity begins to recognize revenue only when the customization begins in the manufacturing process. Before the customization begins, the manufacturing entity's performance does not transfer an asset to the customer but rather creates an asset (inventory) for the manufacturing entity.

### The Manufacturing Entity Has an Enforceable Right to Payment for Performance Completed to Date

Concluding that an asset has no alternative use is not sufficient to conclude that a customer controls an asset as it is being constructed. Rather, a manufacturing entity must also have an enforceable right to payment for performance completed to date to demonstrate that a customer controls an asset that has no alternative use as it is being created.



### EVALUATING ENFORCEABLE RIGHT TO PAYMENT FOR PERFORMANCE COMPLETED TO DATE

A manufacturing entity must consider the terms of the contract as well as any applicable laws when evaluating whether it has an enforceable right to payment for performance completed to date.

While the right to payment for performance completed to date need not be for a fixed amount, the manufacturing entity must be entitled to an amount that at least compensates the manufacturing entity for performance completed to date at all times throughout the duration of the contract if the contract is terminated by the customer or another party for reasons other than the manufacturing entity's failure to perform as promised.

### Amount That at Least Compensates the Manufacturing Entity for Performance Completed to Date

An amount that compensates a manufacturing entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by a manufacturing entity in satisfying the performance obligation plus a reasonable profit margin) rather than compensation for only the manufacturing entity's potential loss or profit if the contract was terminated.

### BDO INSIGHT 31: CONTRACTS PRICED AT LOSS AT CONTRACT INCEPTION

Sometimes contracts with customers are priced at a loss at contract inception. ASC 606-10-55-11 uses the term "reasonable profit margin" to describe what would constitute the amount that would at least compensate a manufacturing entity for performance completed to date. We believe a reasonable profit margin could be interpreted as the applicable loss margin in a contract that is priced at a loss at contract inception. If a manufacturing entity is entitled to a proportionate amount of the transaction price (even if it is priced at loss) for performance completed to date at all times throughout the contract duration, the manufacturing entity is entitled to an amount that would at least compensate it for performance completed to date.

See Section 7.6 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#), for a discussion of onerous contracts.

The compensation to which the manufacturing entity would be entitled upon termination by the customer might not always be the contract margin because the value transferred to a customer in a prematurely terminated contract may not be proportional to the value if the contract was completed. However, to demonstrate compensation for performance completed to date, the compensation must be **either**:

- ▶ A proportion of the expected profit margin in the contract that reasonably reflects the extent of the manufacturing entity's performance under the contract before termination by the customer (or another party) or

- ▶ A reasonable return on the manufacturing entity's cost of capital for similar contracts (or the manufacturing entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the manufacturing entity usually generates from similar contracts.

Further, in analyzing the compensation to which the manufacturing entity would be entitled upon termination by the customer, the focus must be on the amount to which the manufacturing entity would be entitled upon termination rather than the amount for which the manufacturing entity might ultimately be willing to settle in a negotiation.

#### **Existence and Enforceability of Right to Payment**

A manufacturing entity's right to payment for performance completed to date need not be a present unconditional right to payment. In many cases, a manufacturing entity could have an unconditional right to payment only at an agreed milestone or upon complete satisfaction of the performance obligation. In assessing whether it has a right to payment for performance completed to date, a manufacturing entity must consider whether it would have an enforceable right to demand or retain payment for performance completed to date if the contract was terminated before completion for reasons other than the manufacturing entity's failure to perform as promised.

In some contracts, a customer may have a right to terminate the contract only at specified times during the contract term, or the customer may not have any right to terminate the contract. If a customer acts to terminate a contract without having the right to terminate the contract at that time (including when a customer fails to perform its obligations as promised), the contract (or other laws) might entitle the manufacturing entity to continue to transfer to the customer the goods or services promised in the contract and require the customer to pay the contractually agreed consideration in exchange for those goods or services. In those situations, a manufacturing entity has a right to payment for performance completed to date because it has a right to continue to perform its obligations in accordance with the contract and to require the customer to perform its obligations, which include paying the promised consideration. That would be the case if the contract or other local laws require the manufacturing entity and customer to complete their respective obligations (often referred to as "specific performance").



#### **ASSESSMENT OF A RIGHT TO PAYMENT MAY EXTEND BEYOND THE CONTRACTUAL TERMS**

In assessing the existence and enforceability of a right to payment for performance completed to date, a manufacturing entity must consider the contractual terms, as well as any legislation or legal precedent that could supplement or override those contractual terms. That may include assessing whether:

- ▶ Legislation, administrative practice, or legal precedent confers upon the manufacturing entity the right to payment for performance completed to date even if that right is not contractually specified.
- ▶ Relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect.
- ▶ A manufacturing entity's customary business practices of choosing not to enforce a right to payment has resulted in the right being rendered unenforceable in that legal environment. However, even if a manufacturing entity may choose to waive its right to payment in similar contracts, it would continue to have a right to payment to date if, in the contract with the customer, its right to payment for performance to date remains enforceable.

That analysis may require a legal analysis involving the manufacturing entity's legal counsel.



### ASSESSMENT OF ENFORCEABLE RIGHT TO PAYMENT — PAYMENT SCHEDULE

A payment schedule and other related information specified in a contract do not necessarily indicate whether a manufacturing entity has an enforceable right to payment for performance completed to date. Although the contractually specified payment schedule and related information identify the timing and amount of consideration that is payable by a customer, the payment schedule and related information might not necessarily provide evidence of the manufacturing entity's right to payment for performance completed to date. For example, a contract with a payment schedule could specify that the consideration received from the customer is refundable for reasons other than the manufacturing entity failing to perform as promised in the contract. Also, a payment schedule might not adequately compensate a manufacturing entity for work performed at all points during the contract.



### ASSESSMENT OF ENFORCEABLE RIGHT TO PAYMENT — 100% NONREFUNDABLE UPFRONT PAYMENT

A 100% nonrefundable upfront payment would meet the right to payment for performance completed to date criterion if the manufacturing entity had an enforceable right to retain (and not refund) that payment if the customer terminated the contract; otherwise, it is questionable whether the manufacturing entity actually has a right to payment.

Also, different countries and sub-national jurisdictions may provide entities with legal rights that are applicable but not explicitly included in the contracts. For example, a contract might refer to compliance with applicable laws but not specify precisely what those laws are. Therefore, in the absence of contractually specified terms that provide evidence of an enforceable right to payment for performance completed to date, a manufacturing entity may need to review relevant legal precedence in its jurisdiction.

### BDO INSIGHT 32: ANALYZING RIGHT TO PAYMENT WHEN CONTRACT TERMS ARE SILENT

We generally believe if a contract's written terms do not specify the manufacturing entity's right to payment upon contract termination, an enforceable right to payment is presumed not to exist. That is based on the interpretation the FASB staff expressed at the June 2018 Private Company Council meeting:

*"The staff understands that questions have arisen about how to handle contracts in circumstances in which the manufacturing entity creates a good with no alternative use and the contract with the customer does not specify by its written terms the manufacturing entity's right to payment upon contract termination. Some stakeholders have asked whether it was the FASB's intent that companies analyze every law in every jurisdiction to determine whether there is recoverability. In the staff's view, a reasonable interpretation of the guidance is that when a contract's written terms do not specify the manufacturing entity's right to payment upon contract termination, an enforceable right to payment is presumed not to exist."<sup>3</sup>*

<sup>3</sup> FASB Staff Private Company Council Memo, *Definition of an Accounting Contract and Short Cycle Manufacturing (Right to Payment)*.

However, there may be circumstances in which an enforceable right to payment exists even though the contract is silent as to such rights. If a manufacturing entity asserts that it has such rights, we believe the manufacturing entity must support its assertion with legislation, administrative practice, or legal precedence confirming that an enforceable right to payment exists in the relevant jurisdiction. The fact that the manufacturing entity would have a basis for making a claim against the counterparty in a court of law would not be sufficient to support that an enforceable right to payment exists.

**EXAMPLE 21 (ADAPTED FROM ASC 606-10-55-169 THROUGH 55-172): ENFORCEABLE RIGHT TO PAYMENT FOR PERFORMANCE COMPLETED TO DATE**

**FACTS**

- ▶ A manufacturing entity enters a contract with a customer to build an item of equipment based on the customer's unique specifications.
- ▶ The contractually stated payment schedule requires the customer to make payments as follows:
  - An advance payment of 10% of the contract price at contract inception.
  - Regular payments throughout the construction period amounting to 50% of the contract price.
  - A final payment of 40% of the contract price after construction is complete and the equipment has passed the prescribed performance tests.
- ▶ The payments are nonrefundable unless the manufacturing entity fails to perform as promised.
- ▶ The manufacturing entity is entitled to retain any progress payments received from the customer if the customer terminates the contract before completion.
- ▶ The manufacturing entity has no further rights to compensation from the customer.

**CONCLUSION**

The manufacturing entity does not have an enforceable right to payment for performance completed to date.

**ANALYSIS**

- ▶ The manufacturing entity assesses at contract inception whether its performance obligation to build the equipment is satisfied over time. Because the equipment is constructed to the customer's unique specifications, the manufacturing entity concludes that the equipment has no alternative use.
- ▶ As part of that assessment, the manufacturing entity considers whether it has an enforceable right to payment for performance completed to date if the customer were to terminate the contract for reasons other than the manufacturing entity's failure to perform as promised.
- ▶ The manufacturing entity observes that it has the right to receive nonrefundable payments from the customer at various times during the contract term. However, the cumulative amount of those payments is not expected to at least correspond to the amount that would be necessary to compensate the manufacturing entity for performance completed to date at all points throughout the contract term.
- ▶ Instead, the cumulative amount of consideration paid by the customer at various times during the contract term might be less than the selling price of the partially completed item of equipment at that time.
- ▶ Therefore, the manufacturing entity determines that it does not have a right to payment for performance completed to date for the duration of the contract.
- ▶ Because the manufacturing entity does not have a right to payment for performance completed to date, its performance obligation is not satisfied over time in accordance with the criterion on whether a manufacturing entity's performance creates an asset with no alternative use to the manufacturing entity and the manufacturing entity has an enforceable right to payment for performance created to date.

**EXAMPLE 22: ENFORCEABLE RIGHT TO PAYMENT****FACTS**

- ▶ A manufacturing entity entered a contract with a customer to produce a highly specialized good that has no alternative use to the manufacturing entity because it is prohibited from selling that product to another customer.
- ▶ The customer commits to purchase a specific volume of the goods over the contract term because it needs a continuous supply of the product to avoid interruptions to its production process.
- ▶ The contract includes the following terms:
  - The customer must compensate the manufacturing entity for an amount equal to all costs incurred by the manufacturing entity to date plus an agreed margin if the customer terminates the contract without cause.
  - Payment by the customer is due upon delivery of the product.
  - Goods are shipped under free on board (FOB) destination terms\* to the customer's international premises, and the manufacturing entity insures the shipment against potential losses and damages that might affect the goods. Therefore, the customer will not pay for the products before delivery.
  - Shipment timing averages 30 days from the manufacturing entity's warehouse to the customer's international premises.

**CONCLUSION**

The manufacturing entity has an enforceable right to payment for performance completed to date throughout the contract term.

**ANALYSIS**

- ▶ The manufacturing entity determines that its performance obligation in the contract to manufacture and supply the goods does not meet the first two over-time recognition criteria because:
  - The customer does not consume the economic benefits of the goods while the manufacturing entity is producing the goods.
  - The customer does not control the goods while they are in production because among other factors, the manufacturing entity is producing the goods on the manufacturing entity's premises.
- ▶ The manufacturing entity considers whether it has an enforceable right to payment for performance completed to date and concludes that it has a contractual right to recover all costs incurred plus an appropriate margin at all times throughout the contract's duration. Therefore, the manufacturing entity has a present right to payment for any production completed to date.
- ▶ The manufacturing entity also considers that the customer has no obligation to pay if goods are lost or damaged during the shipping period. It concludes that its failure to complete its contractual obligations because the goods are lost or damaged during the shipping period does not mean it does not have an enforceable right to payment for performance completed to date.
- ▶ The possibility that a manufacturing entity might not perform its contractual obligations is not relevant to the analysis of whether a performance obligation is satisfied over time.

\*Under FOB destination terms, the buyer takes delivery of goods being shipped by a supplier once the goods arrive at the buyer's receiving dock.

**BDO INSIGHT 33: ASSUME PERFORMANCE OCCURS WHEN ANALYZING RIGHT TO PAYMENT**

In determining whether the third over-time criterion is met, ASC 606-10-25-29 requires a manufacturing entity to assess whether it has the right to payment for performance completed to date if the contract is terminated for reasons other than the manufacturing entity's failure to perform as promised. In other words, when assessing whether a contract provides for a right to payment upon termination, a manufacturing entity assumes that it will perform under the contract. We believe that if there were a significant risk that a manufacturing entity might not be able to perform its contractual obligations such that it would not be entitled to payment, it might not be able to conclude that a contract exists for accounting purposes.

**CONCLUSION THAT AN ASSET HAS AN ALTERNATIVE USE MAY CHANGE IN SUBSEQUENT CONTRACTS**

In some scenarios, a manufacturing entity's conclusion that an asset has no alternative use to the manufacturing entity may be reassessed for subsequent contracts with customers and could result in a different conclusion. Entities must monitor changes in product and market, such as increases in customer base and the emergence of an expanded resale market, to determine whether a reassessment of the conclusion that the asset has no alternative use is warranted for subsequent contracts.

However, the conclusion about whether an asset has an alternative use is not reassessed after contract inception for a specific contract unless that contract is modified and the modified contract is not accounted for as a separate contract.

**EXAMPLE 23: SUBSEQUENT CHANGE TO ASSESSMENT OF WHETHER ASSET HAS AN ALTERNATIVE USE TO THE MANUFACTURING ENTITY****FACTS**

- ▶ A manufacturing entity creates original parts for sale to an original equipment manufacturer (OEM) that is developing new products.
- ▶ Initially, the parts do not have an alternative use to the manufacturing entity because they can be sold only to the OEM.
- ▶ The contract with the OEM provides the manufacturing entity with a present right to payment for any production completed to date. Therefore, the performance obligation in the contract is satisfied over time.
- ▶ After a period, an aftermarket emerges such that the parts can now also be sold to other customers. Additional parts are manufactured under subsequent contracts with either the OEM or other customers in the aftermarket.

**CONCLUSION**

The conditions for recognizing revenue over time are not met for contracts entered after the aftermarket develops.

**ANALYSIS**

- ▶ Initially, the parts have no alternative use and the manufacturing entity has a present right to payment for any production completed to date. Therefore, the performance obligation in the contract is satisfied over time.

- ▶ The existence of several customers for the parts suggests that as more parts are manufactured under a new contract with a customer, those parts could be sold to other customers, with subsequent production of additional units being used to satisfy the original contract.
- ▶ That indicates that once an aftermarket emerges, the manufacturing entity may have an alternative use for parts being manufactured under any particular contract with a customer.
- ▶ Therefore, the conditions for recognizing revenue over time are not met for contracts entered after the aftermarket develops.

### Measuring Progress Toward Complete Satisfaction of a Performance Obligation

For each performance obligation satisfied over time, a manufacturing entity recognizes revenue over time by measuring the progress toward complete satisfaction of that performance obligation.

Appropriate methods of measuring progress include **output** methods and **input** methods. A manufacturing entity must consider the nature of the good or service that it promised to transfer to the customer to determine the appropriate method for measuring progress for a specific performance obligation.

A manufacturing entity must apply:

- ▶ A single method of measuring progress for each performance obligation satisfied over time.
- ▶ That method consistently to similar performance obligations and in similar circumstances.

#### BDO INSIGHT 34: SELECTION OF MEASURE OF PROGRESS

Determining an appropriate measure of progress may require significant judgment based on the facts and circumstances. While ASC 606 does not require a manufacturing entity to select a particular measure of progress for a particular type of performance obligation, a manufacturing entity does not have a free choice; instead, the measure selected must reasonably reflect the transfer of control of the promised goods or services to the customer. Therefore, a manufacturing entity must consider whether the selected measure of progress meets that objective.

When applying a method for measuring progress, a manufacturing entity must:

- ▶ Exclude from the measure of progress any goods or services for which the manufacturing entity does not transfer control to a customer.
- ▶ Include in the measure of progress any goods or services for which the manufacturing entity transfers control to a customer when satisfying that performance obligation.

A manufacturing entity must remeasure its progress toward complete satisfaction of a performance obligation satisfied over time at the end of each reporting period.

Also, a manufacturing entity must update its measure of progress to reflect any changes in the outcome of the performance obligation as circumstances change over time. Such changes to a manufacturing entity's measure of progress are accounted for as a change in an accounting estimate in accordance with ASC 250, *Accounting Changes and Error Corrections*.

#### Output Methods

The application of an output method results in revenue recognition based on direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as:

- ▶ Milestones reached
- ▶ Time elapsed
- ▶ Units produced or units delivered

In evaluating whether to apply an output method to measure its progress, a manufacturing entity must consider whether the output selected would faithfully depict the manufacturing entity's performance toward complete satisfaction of the performance obligation. An output method does not provide a faithful depiction of the manufacturing entity's performance if the output selected fails to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered (which exclude consideration for any work in process in the measurement of the output) would not faithfully depict a manufacturing entity's performance in satisfying a performance obligation if, at the end of the reporting period, the manufacturing entity's performance has produced work in process that is controlled by the customer.

### Input Methods

The application of an input method results in revenue recognition based on a manufacturing entity's efforts or inputs to the satisfaction of a performance obligation relative to the total expected inputs to the satisfaction of that performance obligation. If the manufacturing entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the manufacturing entity to recognize revenue on a straight-line basis. Examples of input methods include:

- ▶ Resources used
- ▶ Labor hours expended
- ▶ Costs incurred
- ▶ Time elapsed
- ▶ Machine hours used

A shortcoming of input methods is that there may not be a direct relationship between an entity's inputs and the transfer of control of goods or services to a customer. Therefore, to comply with the objective of measuring progress, an entity must exclude from an input method the effects of any inputs that do not depict the entity's performance in transferring control of goods or services to the customer.

Following are examples of adjustments to the measure of progress that may be required when using a cost-based input method:

- ▶ **Significant inefficiencies:** If a cost incurred does not contribute to a manufacturing entity's progress in satisfying the performance obligation, its effect must be excluded from the cost-based input method. For example, a manufacturing entity would not recognize revenue based on costs incurred that are attributable to significant inefficiencies in its performance that were not reflected in the price of the contract (such as the costs of unexpected amounts of wasted materials, labor, or other resources that were incurred to satisfy the performance obligation).
- ▶ **Uninstalled materials:** If a cost incurred is not proportionate to the manufacturing entity's progress in satisfying the performance obligation, the best depiction of the manufacturing entity's performance may be to adjust the input method to recognize revenue only to the extent of that cost incurred. For example, a faithful depiction of a manufacturing entity's performance might be to recognize revenue at an amount equal to the cost of a good used to satisfy a performance obligation if the manufacturing entity expects at contract inception that all the following conditions would be met:
  - The good is not distinct.
  - The customer is expected to obtain control of the good significantly before receiving services related to the good.
  - The cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation.
  - The manufacturing entity procures the good from a third party and is not significantly involved in designing and manufacturing the good (but the manufacturing entity is acting as a principal (see Section 7.2 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#), for discussion on principal-agent considerations)).

### Learning Curve

When determining the appropriate costs to include in the measure of progress and whether some costs incurred are attributable to significant inefficiencies, a manufacturing entity must consider the effects of any learning curves. A learning curve is the effect of efficiencies realized over time when a manufacturing entity's costs of performing a task decline in relation to the number of times the manufacturing entity performs that task. A learning curve can exist independently of a contract with a customer. For example, a typical contract manufacturer may become more efficient in its production process over time as it manufactures a product multiple times.

When a manufacturing entity's performance obligation is satisfied over time, applying a measure of progress based on costs incurred would result in a higher recognition of revenue and expense for the early units produced compared to the later units if the manufacturing entity incurs higher costs to produce the early units and relatively lower costs to produce the later units as production efficiencies are gained. In that scenario, a higher recognition of revenue and expense for the early units produced is appropriate because of the greater value of the manufacturing entity's performance in the early part of the contract. If a manufacturing entity were to sell only one unit, it would charge a customer a higher price for that unit than the average unit price the customer pays when the customer purchases more than one unit.

#### **BDO INSIGHT 35: COST-BASED INPUT METHODS**

Cost-based input methods are commonly used as a measure of progress for revenue recognition in the manufacturing industry. While ASC 606 allows the use of a cost-based input method to measure progress to recognize revenue, it provides very limited guidance on how to calculate the costs incurred and total expected costs (that is, the numerator and denominator), which provide the basis (or percentage) for recognizing a portion of the transaction price as revenue. Manufacturing entities must consider other U.S. GAAP that may be applicable to appropriately calculate the costs included in the numerator and the denominator. Significant inaccuracies in calculating costs may result in inappropriate revenue recognition. For example, not accruing costs incurred until invoices are paid may result in under-recognition of costs incurred and therefore an understatement of revenue.

#### **BDO INSIGHT 36: OVER TIME REVENUE RECOGNITION AND WORK IN PROCESS**

For performance obligations that are satisfied over time, a manufacturing entity generally does not recognize any work in process under ASC 330, *Inventory*, (or as an asset under other U.S. GAAP) because the fundamental principle underlying over time revenue recognition is that control of the good or service is transferred to the customer continuously as the manufacturing entity fulfills its contractual obligations. Any inventory or raw material costs that are specific to a performance obligation satisfied over time are expensed as those costs are assigned to that performance obligation and placed into production. As a result, if output methods are used to measure performance to date, entities may often find that profit margins vary over the contractual period. In some cases, losses may be experienced in some periods, particularly in the early stages of the contract, even though the contract is anticipated to be profitable overall because the measurement of cumulative (or periodic) outputs driving the amount of revenue recognized may not be commensurate with the cumulative (or periodic) costs incurred.

### **BDO INSIGHT 37: MEASURE OF PROGRESS — CUSTOMIZED PRODUCT THAT IS GENERIC UP TO A POINT IN THE CONSTRUCTION OR MANUFACTURING PROCESS**

A manufacturing entity may manufacture a customized product that remains generic up to the point in the manufacturing process when the customization begins but has no alternative use to the manufacturing entity in its completed form. If the manufacturing entity has an enforceable right to payment for performance completed to date, it recognizes revenue over the construction or manufacturing process.

However, before the customization, the manufacturing entity's performance does not transfer an asset to the customer but rather creates an asset (inventory) for the manufacturing entity, because the manufacturing entity can redirect the generic asset to another customer or for another purpose. Only when the customization begins does the manufacturing entity's performance transfer the work in process (asset) to the customer as the manufacturing entity performs. Therefore, the manufacturing entity begins to recognize revenue over time only when the customization begins.

If a manufacturing entity uses a cost-based measure of progress, the costs incurred before customization are included in the measure of progress to determine the revenue to be recognized once customization begins, and any related asset recognized for the work in process (for example, inventory) is recognized in expense at that point.

### **Performance Obligations Satisfied at a Point in Time**

A manufacturing entity satisfies a performance obligation at a point in time if the performance obligation does not meet the criteria for being satisfied over time. For a performance obligation satisfied at a point in time, the performance obligation is satisfied at the point in time at which control of the goods or services transfers to the customer. To determine the point in time at which a customer obtains control of a promised asset and the manufacturing entity satisfies a performance obligation, the manufacturing entity must consider the guidance on control.

Also, a manufacturing entity must consider indicators of the transfer of control, which include, but are not limited to:

|                                                                                                                     |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|---------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|  <b>Present Right to Payment</b> | A customer's present obligation to pay for an asset may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset.                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|  <b>Legal Title</b>              | Legal title may indicate whether the entity or a customer has the ability to direct the use of, and obtain substantially all the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. However, if an entity retains legal title solely as protection against the customer's failure to pay, those protective rights of the entity would not preclude the customer from obtaining control of an asset.                                                                        |
|  <b>Physical Possession</b>      | The customer's physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not necessarily coincide with control of an asset. For example, in some repurchase agreements or consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. |

|                                                                                                                                     |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|-------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|  <b>Significant Risks and Rewards of Ownership</b> | <p>The transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity must exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset.</p> |
|  <b>Acceptance</b>                                 | <p>The customer's acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset. An entity must evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred.</p>                                                                                                                                                                            |



### INDICATORS OF CONTROL — NOT A CHECKLIST

The indicators of control are not a list of conditions that must be met before a manufacturing entity can conclude that control of a good or service has transferred to a customer. Rather, the indicators are a list of factors that are often present if a customer has control of an asset. That list is provided to assist manufacturing entities in applying the principle of control. Accordingly, all indicators need not be present for a manufacturing entity to conclude that it has transferred control of a good or service.

### BDO INSIGHT 38: SIGNIFICANCE OF LOCAL LAWS IN DETERMINING THE PATTERN OF REVENUE RECOGNITION

In determining when to recognize revenue, it is important to understand the legal environment, as well as the contractual terms and conditions, because local laws and regulations may affect the assessment of whether control transfers to the customer over time or at a point in time, which is a specific date.

Also, application of the over-time revenue recognition criterion (whether a manufacturing entity's performance creates an asset with no alternative use to the manufacturing entity and the manufacturing entity has an enforceable right to payment for performance created to date) particularly affects the pattern and timing of revenue recognition for contract manufacturers. Manufacturing entities must consider their specific contracts with customers and legal environments to determine the appropriate patterns of revenue recognition under ASC 606.

### Repurchase Agreements

A repurchase agreement is a contract in which a manufacturing entity sells an asset to a customer and promises (or has the right) to repurchase the asset, either in the same contract or in another contract. The repurchased asset may be any of the following:

- ▶ The asset that was originally sold to the customer.
- ▶ An asset that is substantially the same as the asset originally sold to the customer.
- ▶ Another asset of which the asset that was originally sold is a component.

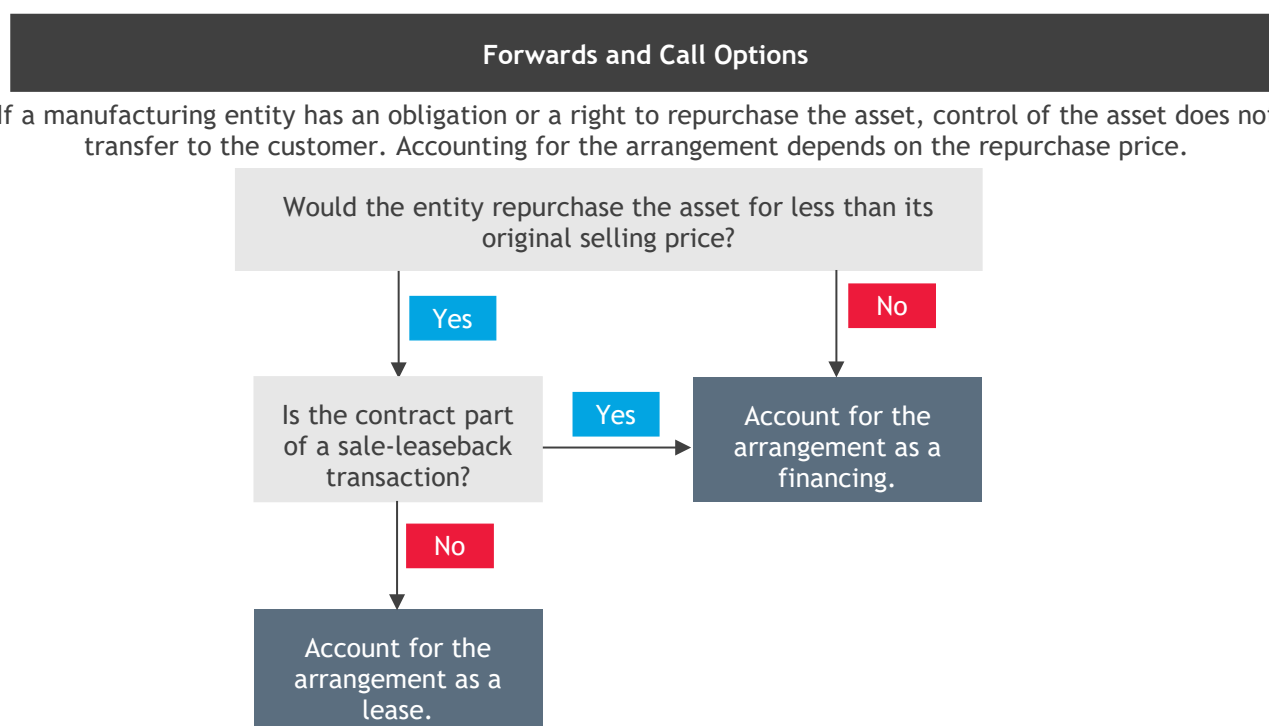
Repurchase agreements generally come in three forms:

- ▶ **A forward:** An entity's obligation to repurchase the asset.
- ▶ **A call option:** An entity's right to repurchase the asset.

- ▶ **A put option:** An entity's obligation to repurchase the asset at the customer's request.

### A Forward or a Call Option

The following diagram provides an overview of the accounting considerations for repurchase rights in a forward or call option:



If a manufacturing entity has an obligation or a right to repurchase the asset (that is, a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all the remaining benefits from, the asset even though the customer may have physical possession of it. Therefore, a manufacturing entity does not recognize revenue for that contract but instead, depending on the repurchase price of the asset as compared to its original selling price, accounts for that contract as a lease or financing.

- ▶ **A financing arrangement:** If the manufacturing entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset, the manufacturing entity must account for the arrangement as a financing arrangement. A manufacturing entity accounts for a financing arrangement as follows:
  - Continue to recognize the asset.
  - Recognize a financial liability for any consideration received from the customer.
  - Recognize as interest (and, if applicable, as processing or holding costs (for example, insurance)) any difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer.
- ▶ **A lease:** If the manufacturing entity can or must repurchase the asset for an amount that is less than the asset's original selling price and the contract is not part of a sale-leaseback transaction, the manufacturing entity must account for the arrangement as a lease in accordance with ASC 842.<sup>4</sup> If the contract is part of a sale-leaseback transaction, the manufacturing entity must account for the arrangement as a financing arrangement and not as a sale-leaseback under ASC 842-40.

<sup>4</sup> See BDO's Blueprint, [Accounting for Leases Under ASC 842](#), for guidance on ASC 842, *Leases*.

A manufacturing entity does not consider the likelihood that a call option will be exercised because the existence of the call option effectively limits the customer's ability to control the asset. However, a nonsubstantive call option is ignored in assessing whether and when the customer obtains control of a good.

A manufacturing entity considers the time value of money when comparing the repurchase price with the selling price of the asset.

A manufacturing entity must derecognize the liability and recognize revenue if the call option lapses unexercised.

#### **BDO INSIGHT 39: CONTINGENTLY EXERCISABLE REPURCHASE RIGHT HELD BY AN ENTITY**

ASC 606 does not include guidance on contingently exercisable repurchase rights held by an entity. A manufacturing entity must evaluate the substance of a repurchase right and the related facts and circumstances and determine whether control of an asset underlying the contingent repurchase right has transferred to a customer. A manufacturing entity may consider factors such as:

- ▶ The nature of the contingency.
- ▶ Whether the contingency is within the control of the manufacturer or the customer.
- ▶ The likelihood that the contingency will be met (but not the likelihood of exercise of the repurchase right).

The existence of a contingently exercisable repurchase right does not always preclude transfer of control to the customer. For example, if the contingency is outside its control, the manufacturing entity may conclude that control has transferred to the customer and account for the transaction as a sale with a right of return.

#### **Put Option**

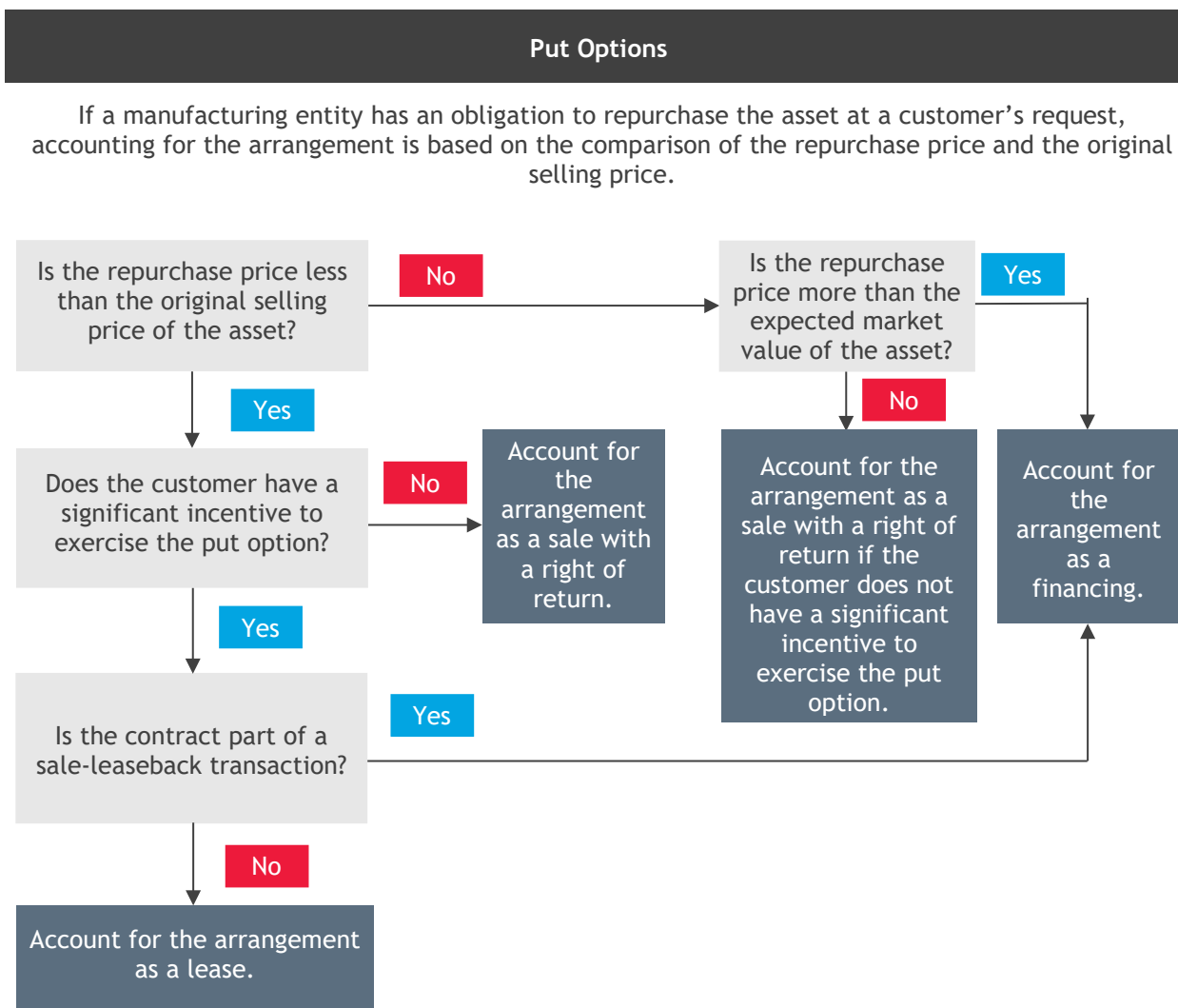
If a manufacturing entity has an obligation to repurchase the asset at a customer's request, accounting for the arrangement is based on a comparison of the repurchase price and the original selling price.

#### **BDO INSIGHT 40: TRADE-IN RIGHTS**

Some manufacturers provide customers with the right to trade in the original purchased good for a newer version of the good at a later date for a specified price. We believe that if the trade-in right requires the customer to enter a subsequent contract with the manufacturing entity, the right is a guarantee in the scope of ASC 460 as it does not meet the scope exception in ASC 460-10-15-7(k). For example, a trade-in right is a guarantee if the customer must enter a new equipment instalment plan to exercise its trade-in right under an existing equipment instalment plan. Trade-in rights in the scope of ASC 460 are measured at fair value and recorded as liabilities. Manufacturing entities exclude the trade-in right's fair value from the contract transaction price and account for the remaining transaction price in accordance with ASC 606.

If a trade-in right does not require a customer to enter a subsequent contract, the trade-in right is in the scope of ASC 606. As manufacturing entities have the obligation to repurchase the good at the customer's request, they assess such rights under the ASC 606 repurchase agreements guidance on put options discussed in this section.

The following diagram gives an overview of the accounting considerations for a manufacturing entity's repurchase obligation in a put option:



#### Repurchase Price Is Lower Than the Original Selling Price

If the customer can require a manufacturing entity to repurchase the asset at a price that is lower than the original selling price of the asset, then the manufacturing entity considers at contract inception whether the customer has a significant economic incentive to exercise that right. The exercise of that right by the customer results in the customer effectively paying the manufacturing entity consideration for the right to use that asset for a period of time. Therefore, if the customer has a significant economic incentive to exercise that right and the contract is not part of a sale-leaseback transaction, then the manufacturing entity must account for the agreement as a lease in accordance with ASC 842.<sup>5</sup> If the contract is part of a sale-leaseback transaction, then the manufacturing entity must account for the arrangement as a financing arrangement and not as a sale-leaseback under ASC 842-40.

<sup>5</sup> See BDO's Blueprint, [Accounting for Leases Under ASC 842](#), for guidance.

However, if the customer does not have a significant economic incentive to exercise its right at a price lower than the original selling price of the asset, then the manufacturing entity accounts for the agreement as if it were the sale of a product with a right of return (see Section 4.3.8 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#)).

To determine whether a customer has a significant economic incentive to exercise its right, a manufacturing entity must consider various factors, including the relationship of the repurchase price to the expected market value of the asset at the date of the repurchase and the amount of time until the right expires. For example, a repurchase price that is expected to significantly exceed the market value of the asset at the date of repurchase may indicate that the customer has a significant economic incentive to exercise the put option.

#### Repurchase Price Is Equal to or Greater Than the Original Selling Price

If the repurchase price of the asset is equal to or greater than the original selling price, the accounting is based on a comparison of the repurchase price and the expected market value of the asset as follows:

- ▶ If the repurchase price of the asset is more than the expected market value of the asset, then the contract is in effect a financing arrangement. A manufacturing entity must recognize a financial liability equal to the amount of consideration received, and the asset is not derecognized. Any difference between the consideration received from the customer and the amount paid to the customer in the future when the put right is exercised is recognized as interest expense, and as other holding costs such as insurance if applicable. If the put option lapses unexercised, the manufacturing entity derecognizes the liability and recognizes revenue.
- ▶ If the repurchase price of the asset is less than or equal to the expected market value of the asset, and the customer does not have a significant economic incentive to exercise its right, the manufacturing entity must account for the contract as if it were the sale of a product with a right of return.

A manufacturing entity considers the time value of money when comparing the repurchase price with the selling price of the asset.

#### BDO INSIGHT 41: REPURCHASE AGREEMENTS

The guidance on repurchase agreements in ASC 606 may have a significant impact on the manufacturing industry. For example, a manufacturer may sell a car to a customer while providing the customer the right to require the manufacturer to repurchase the car for a specified price after a period of time. The manufacturer must consider the exercise price of a customer put option to determine whether the nature of the arrangement is a sale or a lease. Also, a manufacturing entity must identify the various parties to the arrangements and their rights or obligations. For example, a manufacturing entity must consider:

- ▶ Whether the entity itself or an unrelated third-party finance entity grants the put option to the customer.
- ▶ If an unrelated third-party finance entity grants the put option to the customer, whether there are any associated contractual arrangements between the manufacturing entity and that third-party finance entity.

Reaching conclusions about accounting for repurchase agreements requires the application of professional judgment based on the facts and circumstances.

#### EXAMPLE 24 (ADAPTED FROM ASC 606-10-55-401 THROUGH 55-407): REPURCHASE AGREEMENTS – PUT OPTION: LEASE

##### FACTS

- ▶ A manufacturer enters a contract with a customer for the sale of an item of equipment on January 1, 20X1, for \$10 million.

- ▶ The contract includes a put option that obliges the manufacturer to repurchase the equipment at the customer's request for \$9 million on or before December 31, 20X1.
- ▶ The market value of the equipment is expected to be \$7.5 million on December 31, 20X1.

### CONCLUSION

The manufacturer accounts for the transaction as a lease under ASC 842.

### ANALYSIS

- ▶ To determine the accounting for the transfer of the equipment, the manufacturer assesses at contract inception whether the customer has a significant economic incentive to exercise the put option.
- ▶ The manufacturer observes that the repurchase price (\$9 million) significantly exceeds the expected market value (\$7.5 million) of the asset on the date of repurchase. It therefore concludes that the customer has a significant economic incentive to exercise the put option.
- ▶ The manufacturer determines there are no other relevant factors to consider in assessing whether the customer has a significant economic incentive to exercise the put option.
- ▶ Therefore, the manufacturer concludes that control of the equipment does not transfer to the customer because the customer is limited in its ability to direct the use of, and obtain substantially all the remaining benefits from, the equipment.
- ▶ The manufacturer accounts for the transaction as a lease under ASC 842.<sup>6</sup>

## EXAMPLE 25: REPURCHASE AGREEMENTS – CUSTOMER PUT OPTION

### FACTS

- ▶ A manufacturer of industrial equipment enters a contract with a customer to sell an item of equipment to the customer for a sales price of \$750.
- ▶ The cost of manufacturing the equipment is \$500.
- ▶ The expected useful life of the equipment is five years.
- ▶ The contract provides the customer with a right to return the equipment to the manufacturer after two years in exchange for a predetermined amount of \$450 (the repurchase price).
- ▶ At contract inception, the fair value of the equipment after two years is expected to be in the range of \$425 to \$475 with a linear distribution of expected values (that is, the mean of the estimates is \$450).
- ▶ The present value of the repayment obligation, discounted at the entity's incremental borrowing rate of 6%, is \$400.

### CONCLUSION

The manufacturer treats the transaction as a sale with a right to return.

### ANALYSIS

- ▶ The entity observes the following at contract inception:
  - The repurchase price of \$450 is less than the original sales price of \$750.

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<sup>6</sup> See BDO's Blueprint, [Accounting for Leases Under ASC 842](#), for guidance.

- The customer does not have a significant economic incentive to exercise the option to return the equipment because the repurchase price is not significantly more than the expected market value of the equipment, and no other factor would compel the customer to exercise the option.
- Therefore, the manufacturer accounts for the transaction as a sale with a right of return.

Consignment Arrangements

When a manufacturing entity delivers a product to another party (for example, a dealer, retailer, or distributor) for resale to end customers, the manufacturing entity must evaluate whether that other party has obtained control of the product at that point in time. A product delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product.

Indicators that an arrangement is a consignment arrangement include, but are not limited to:

|                                                                                     |                                                                                                                                                                                                                                   |
|-------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|    | The product is controlled by the manufacturing entity until a specified event occurs (for example, the subsequent sale of the product to a customer of the dealer, retailer, or distributor) or until a specified period expires. |
|   | The manufacturing entity can require the return of the product or transfer the product to a third party (for example, another dealer, retailer, or distributor).                                                                  |
|  | The dealer, retailer, or distributor does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).                                                                           |

BDO INSIGHT 42: CONTRACTS WITH PRICE PROTECTION CLAUSES

Sometimes a manufacturing entity may provide pricing protection to its customers that resell its products to end customers. For example, a manufacturing entity might provide a retrospective reduction in the purchase price if the entity lowers its price in the future or if the entity agrees to sell similar products to another customer at a lower price. Clauses such as “most favored nation” or “most favored customer” are common for providing such pricing protection to a customer. Further, a manufacturing entity may allow a customer (reseller) to return unsold items for a refund. While such provisions limit the customer’s risks associated with purchasing the goods, they do not necessarily preclude the customer from obtaining control of the items. Instead, those types of provisions typically result in the price per item being variable.

Bill-and-Hold Arrangements

A bill-and-hold arrangement is a contract under which a manufacturing entity bills a customer for a product but retains physical possession of the product until it is transferred to the customer in the future. For example, a customer may request a bill-and-hold arrangement because it lacks space for the product or has had delays in its production schedules.

When considering whether a manufacturing entity has satisfied its performance obligation to transfer a product under a bill-and-hold arrangement, a manufacturing entity must evaluate when the customer obtains control of that product. For some contracts, control of a product is transferred to customer either when the product is delivered to the

customer's site or when the product is shipped depending on the terms of the contract (including delivery and shipping terms). However, for some contracts, a customer may obtain control of a product even though that product remains in a manufacturing entity's physical possession. In those cases:

- ▶ The customer has the ability to direct the use of and obtain substantially all the remaining benefits from the product even though it has decided not to exercise its right to take physical possession of that product.
- ▶ The manufacturing entity does not control the product but rather provides custodial services to the customer over the customer's asset.

In addition to applying the guidance on transfer of control, **all** the following criteria must be met for a customer to have obtained control of a product in a bill-and-hold arrangement:

| CHARACTERISTIC                                                                      |                                                                                                                        |
|-------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|
|    | The reason for the bill-and-hold arrangement must be substantive (for example, the customer requests the arrangement). |
|    | The product must be identified separately as belonging to the customer.                                                |
|  | The product currently must be ready for physical transfer to the customer.                                             |
|  | The manufacturing entity cannot have the ability to use the product or to direct it to another customer.               |

#### **BDO INSIGHT 43: NO ABILITY TO USE THE PRODUCT OR DIRECT IT TO ANOTHER CUSTOMER**

The fourth criterion that must be met for a customer to have obtained control of a product in a bill-and-hold arrangement is that a manufacturing entity must not have the ability to use the product or direct it to another customer. That criterion is not evidenced solely by the fact that the manufacturing entity has identified and segregated a product separately as belonging to a customer. Rather, it focuses on the notion of control and requires an evaluation of whether the manufacturing entity continues to have the ability to direct the use of, and derive economic benefits from, a product, even if that product is identified and segregated for a particular customer.

For example, if the product is relatively homogenous such that a manufacturing entity could use the segregated product to fulfill an order from a different customer and then replace it, the fourth criterion is not met, so the initial customer does not control the product. Conversely, if a manufacturing entity has already transferred title to the segregated product to the customer, or if the product is serialized and the manufacturing entity must deliver products with specific serial numbers to the customer, the manufacturing entity does not have the ability to use that product or redirect it to another customer.

If a manufacturing entity recognizes revenue for the sale of a product on a bill-and-hold basis, it must consider whether it has any remaining performance obligations (for example, for custodial services) to which it needs to

allocate a portion of the transaction price. See Steps 2 and 4 for discussion on identification of performance obligations and allocation of transaction price to the performance obligations, respectively.

#### EXAMPLE 26 (ADAPTED FROM ASC 606-10-55-409 THROUGH 55-413): BILL-AND-HOLD ARRANGEMENT

##### FACTS

- ▶ A manufacturing entity enters a contract with a customer on January 1, 20X1, for the sale of an item of equipment and spare parts.
- ▶ The manufacturing lead time for the equipment and spare parts is two years.
- ▶ The promises to transfer the equipment and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time.
- ▶ Upon completion of manufacturing, the manufacturing entity demonstrates that the equipment and spare parts meet the contractually agreed specifications.
- ▶ On December 31, 20X2, the customer pays for both the equipment and spare parts but takes physical possession of the equipment only.
- ▶ Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the manufacturing entity's warehouse because of its proximity to the customer's factory.

##### CONCLUSION

The manufacturing entity has three performance obligations (equipment, spare parts, and custodial services) and recognizes revenue when or as control transfers to the customer.

##### ANALYSIS

- ▶ The following details of the arrangement indicate all the criteria for transfer of control in the bill-and-hold arrangement are met:
  - The customer has legal title to the spare parts.
  - The parts can be identified as belonging to the customer.
  - The manufacturing entity stores the spare parts in a separate section of its warehouse.
  - The parts are ready for immediate shipment at the customer's request.
  - The manufacturing entity expects to hold the spare parts for two to four years and does not have the ability to use the spare parts or direct them to another customer.
- ▶ The manufacturing entity identifies the promise to provide custodial services as a performance obligation because it is a service provided to the customer that is distinct from the equipment and spare parts.
- ▶ Therefore, the manufacturing entity accounts for three performance obligations in the contract: the promises to provide the equipment, the spare parts, and the custodial services. The transaction price is allocated to the three performance obligations, and revenue is recognized when or as control transfers to the customer.
- ▶ **Equipment:** The manufacturing entity determines that control of the equipment transfers to the customer on December 31, 20X2, when the customer takes physical possession.
- ▶ **Spare parts:** In determining when control of the spare parts transfers to the customer, the manufacturing entity recognizes revenue for the spare parts on December 31, 20X2, when control transfers to the customer. It notes that:
  - The manufacturing entity has received payment.
  - The customer has legal title to the spare parts.
  - The customer has inspected and accepted the spare parts.
  - All criteria for transfer of control in the bill-and-hold arrangement are met, which is necessary for the manufacturing entity to recognize revenue in a bill-and-hold arrangement.

- ▶ **Custodial services:** The manufacturing entity determines that the performance obligation to provide custodial services is satisfied over time as those services are provided.

#### **BDO INSIGHT 44: BILL-AND-HOLD ARRANGEMENTS**

Under ASC 606, some types of bill-and-hold arrangements may not qualify for revenue recognition until the delivery of the product to the customer's site or shipment (depending on the terms of the contract). Reaching a conclusion on when revenue from a bill-and-hold arrangement is recognized requires the application of professional judgment based on the facts and circumstances.

Further, consideration of the terms of bill-and-hold arrangements is required to determine whether there are additional performance obligations (for example, custodial services) to which some of the transaction price for the sale of goods must be allocated. Promises that are immaterial to the contract are not required to be accounted for as distinct performance obligations (see Chapter 3 of BDO's Blueprint, [Revenue Recognition Under ASC 606](#)). However, we believe it would be rare for custodial services included in a bill-and-hold arrangement to be considered immaterial in the context of the contract even if the SSP of such services is quantitatively small. To apply bill-and-hold accounting, the reason for the arrangement must be substantive, which indicates that the custodial services are likely important to the customer and thus qualitatively material.

### **Customer Acceptance**

A customer's acceptance of an asset may indicate that the customer has obtained control of the asset. Customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed specifications. A manufacturing entity must consider such clauses when evaluating when a customer obtains control of a good or service.

If a manufacturing entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed specifications in the contract, customer acceptance is a formality that would not affect the manufacturing entity's determination of when the customer has obtained control of the good or service. A manufacturing entity would determine whether the criteria related to customer acceptance have been met before receiving confirmation of the customer's acceptance if, for example, the customer acceptance clause is based on meeting objectively measurable criteria such as specified size and weight characteristics of the product. A manufacturing entity's experience with contracts for similar goods or services may provide evidence that a good or service provided to the customer is in accordance with the agreed specifications in the contract. If revenue is recognized before customer acceptance (for example, upon delivery), the manufacturing entity still must consider if there are any remaining performance obligations (for example, installation or maintenance of the equipment) and evaluate whether to account for them separately.

If a manufacturing entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed specifications in the contract, the manufacturing entity would not be able to conclude that the customer has obtained control until the manufacturing entity receives the customer's acceptance. In that situation, the manufacturing entity cannot determine that the customer can direct the use of, and obtain substantially all the remaining benefits from, the good or service until the customer's acceptance is received.

Also, if a manufacturing entity delivers products to a customer for trial or evaluation purposes and the customer is not committed to pay any consideration until the trial period lapses, control of the product is not transferred to the customer until either the customer accepts the product or the trial period lapses.

## CONTRACT COSTS

ASC 340-40 was issued concurrently with ASC 606 and provides specific guidance on the accounting for both the incremental costs of obtaining and the costs incurred in fulfilling a contract with a customer within the scope of ASC 606. Contract costs are initially recognized as an asset and expensed on a systematic basis that is consistent with the pattern of transfer to the customer of the good or service to which those costs relate.

### Incremental Costs of Obtaining a Contract

The incremental costs of obtaining a contract are those costs a manufacturing entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained. A sales commission that is paid only if the contract with a customer is executed is an example of a cost to obtain a contract.

A manufacturing entity must recognize the incremental costs of obtaining a contract with a customer as an **asset** if it expects to recover those costs.

Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained are recognized as an expense when incurred unless they are explicitly chargeable to the customer regardless of whether the contract is obtained.

As a **practical expedient**, the incremental costs of obtaining a contract can be recognized as an immediate expense rather than capitalized if the period over which they would otherwise be expensed (or amortized) is one year or less.

### Costs to Fulfill a Contract

The guidance in ASC 340-40 applies to costs incurred to fulfill a contract with a customer only if the costs are not within the scope of other U.S. GAAP, including:

- ▶ ASC 330, *Inventory*
- ▶ ASC 340-10-25-1 through 25-4 on preproduction costs related to long-term supply arrangements
- ▶ ASC 350-40, *Intangibles – Goodwill and Other – Internal Use Software*
- ▶ ASC 360, *Property, Plant and Equipment*
- ▶ ASC 985-20, *Software – Costs of Software to be Sold, Leased, or Marketed*

A manufacturing entity must account for the costs incurred in fulfilling a contract in accordance with other applicable GAAP, if those costs are within the scope of other U.S. GAAP. See BDO's Blueprint, [Accounting for Software Costs](#), for more guidance on ASC 350-40 and ASC 985-20.

A manufacturing entity recognizes an **asset** from the costs incurred to fulfill a contract only if those costs meet **all** the following criteria:

- ▶ The costs relate directly to a contract or anticipated contract the manufacturing entity can specifically identify. For example, costs of designing an asset transferred under a specific contract that has not yet been approved but is expected to be approved would be considered costs to fulfill a contract.
- ▶ The costs generate or enhance resources of the manufacturing entity that will be used in satisfying performance obligations in the future.
- ▶ The costs are expected to be recovered.

The following chart illustrates costs that relate directly to a contract or a specific anticipated contract and thus are capitalized and costs that must be expensed when incurred:



#### **COSTS THAT RELATE DIRECTLY TO A CONTRACT OR A SPECIFIC ANTICIPATED CONTRACT**

- ▶ Direct labor (for example, salaries and wages of employees who provide the promised services directly to the customer)
- ▶ Direct materials (for example, supplies used in providing the promised services to a customer)
- ▶ Allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance, and depreciation of tools and equipment used in fulfilling the contract)
- ▶ Costs that are explicitly chargeable to the customer under the contract
- ▶ Other costs that are incurred only because a manufacturing entity entered the contract such as payments to subcontractors



#### **COSTS THAT MUST BE EXPENSED WHEN INCURRED**

- ▶ General and administrative costs unless those costs are explicitly chargeable to the customer under the contract, in which case a manufacturing entity must evaluate whether those costs relate directly to a contract or a specific anticipated contract
- ▶ Costs of wasted materials, labor, or other resources not reflected in the contract price
- ▶ Costs that relate to partially or fully satisfied performance obligations in the contract (that is, costs that relate to past performance)
- ▶ Costs for which a manufacturing entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations)

#### **BDO INSIGHT 45: FULFILLMENT COSTS THAT RELATE TO PARTIALLY SATISFIED PERFORMANCE OBLIGATIONS**

Because fulfillment costs that relate to partially satisfied performance obligations cannot be capitalized, we generally do not expect any costs to fulfill an over-time contract to be capitalized under ASC 340-40 once control of the goods or services start transferring to the customer (that is, revenue recognition begins).

#### **BDO INSIGHT 46: PREPRODUCTION COSTS ASSOCIATED WITH LONG-TERM SUPPLY CONTRACTS**

Historically, there has been diversity in practice in accounting for preproduction costs associated with long-term supply contracts. ASC 340-10 provides guidance on accounting for the costs of designing and developing “molds, dies, and other tools that will be used in producing” products under a long-term supply agreement, and ASC 606 did not amend or supersede that guidance. Manufacturing entities that conclude that their preproduction costs are within the scope of ASC 340-10 should continue to follow that guidance. Manufacturing entities that conclude that the guidance in ASC 340-10 is not directly applicable should apply the guidance in ASC 340-40 instead.

#### **EXAMPLE 27: CONTRACT COSTS**

##### **FACTS**

- ▶ A manufacturer of solar panels enters a contract to sell 10,000 units at \$500 per unit to a new customer.
- ▶ Once the contract was signed, the manufacturing entity purchased tooling for \$25,000 and incurred engineering costs of \$100,000 to facilitate production of the solar panels.

- ▶ The tooling and engineering activities do not represent a good or service transferred to the customer (the manufacturing entity retains title to and control of the tooling and owns and controls all IP arising from the activities).

## CONCLUSION

All tooling and engineering costs are subject to other U.S. GAAP, so the manufacturing entity does not apply ASC 340-40.

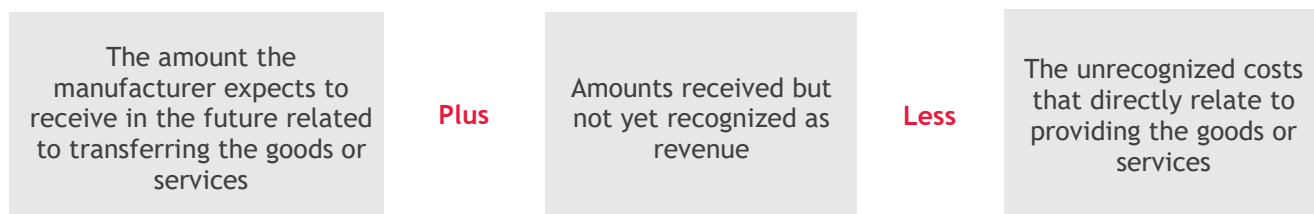
## ANALYSIS

- ▶ The manufacturing entity first determines if any of the costs are within the scope of other U.S. GAAP:
  - The tooling is equipment accounted for in accordance with ASC 360.
  - The manufacturing entity determines that the engineering activities are within the scope of ASC 730, *Research and Development*, and that the costs must be expensed as incurred because they meet the definition of development activities and are not specific to the customer contract. In other words, the manufacturing entity can use the IP resulting from the engineering efforts to fulfill other future customer orders.
- ▶ Because all costs incurred to begin delivering under the contract are subject to other U.S. GAAP, the guidance in ASC 340-40 does not apply.

## Amortization and Impairment of Capitalized Costs

An asset is amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. The asset may relate solely to the current contract or may also relate to future anticipated contracts. A manufacturing entity must update the amortization to reflect a significant change in its expected timing of transfer to the customer of the goods or services to which the asset relates. Such a change is accounted for as a change in accounting estimate in accordance with ASC 250.

In addition, a manufacturing entity recognizes an impairment charge in profit or loss if the carrying amount of a recognized asset exceeds:



In determining the consideration, a manufacturing entity must:

- ▶ Consider expected contract renewals and extensions (with the same customer).
- ▶ Use the principles for determining the transaction price except for the guidance on constraining estimates of variable consideration (see Step 3) and adjust that amount to reflect the effects of the customer's credit risk.

Subsequent reversal of a previously recognized impairment loss is not allowed.

Before a manufacturing entity recognizes an impairment loss for an asset recognized under ASC 340-40, it must recognize any impairment loss for assets related to the contract that are recognized in accordance with other U.S. GAAP, including ASC 330 and ASC 985-20. After applying the impairment test in ASC 340-40-35-3, a manufacturing entity must include the resulting carrying amount of the asset recognized under ASC 340-40 in the carrying amount of the asset group or reporting unit to which it belongs when applying the guidance in ASC 350, *Intangibles – Goodwill and Other*, and ASC 360. See BDO's Blueprint, Impairments under ASC 350 and ASC 360, for more guidance.

# APPENDIX A — BDO BLUEPRINTS



In addition to [Revenue Recognition Under ASC 606](#), BDO's Professional Practice — Accounting Group has issued the following Blueprints, which provide detailed accounting guidance, interpretive insights, and practical examples on complex areas of U.S. GAAP:

- ▶ [Accounting for Software Costs](#)
- ▶ [Statement of Cash Flows Under ASC 230](#)
- ▶ [Segment Reporting Under ASC 280](#)
- ▶ [Equity Method Investments Under ASC 323](#)
- ▶ [Impairments under ASC 350 and 360](#)
- ▶ [Share-based Payments Under ASC 718](#)
- ▶ [Business Combinations Under ASC 805](#)
- ▶ [Control and Consolidation Under ASC 810](#)
- ▶ [Accounting for Leases Under ASC 842](#)
- ▶ [Issuer's Accounting for Complex Financial Instruments](#)

BDO's Professional Practice — SEC Services Group has issued the following Blueprints to help SEC registrants apply the SEC's rules and regulations related to financial reporting:

- ▶ [Guide to Going Public](#)

## Series Overview: Building Knowledge

In addition to Blueprints, BDO's Professional Practice has issued a suite of publications related to U.S. GAAP and SEC rules and regulations:

- ▶ [Bulletins](#): short, timely communications delivering essential news, alerts, and developments in accounting and SEC reporting
- ▶ [Snapshots](#): summaries of SEC rules and regulations
- ▶ [SEC Reporting Insights](#), updated annually
- ▶ [Conference Highlights: Current SEC & PCAOB Developments](#), updated annually
- ▶ [Effective Date Reminders](#), updated annually
- ▶ [Industry Supplements](#)
- ▶ [Other publications](#) on new accounting standards and SEC rules and regulations.



For more on IFRS, visit BDO's [IFRS and Corporate Reporting](#) for more information.

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