Bruce Pounder, CMA, CFM, Editor

Revenue Recognition: New Answers to "How Much?" and "When?"

The FASB recently made two significant changes to its revenue standards. For many entities, the changes will alter the amount and timing of reported revenue as well as impose additional disclosure requirements.

From a financial-statement preparer's perspective, "How much?" and "When?" are the central questions of revenue recognition. Unfortunately, clear answers to those questions are often elusive because of the complexities of modern commerce. Over time, the U.S. Financial Accounting Standards Board (FASB) has responded by promulgating a plethora of highly prescriptive rules on revenue recognition. Even though the FASB continues to work with the International Accounting Standards Board (IASB) to overhaul and converge the revenue provisions of U.S. Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS), entities that prepare financial statements in accordance with U.S. GAAP have no choice but to "play by the rules" in the short term.

Last month, the FASB changed the rules. Specifically, it issued two Accounting Standards Updates (ASUs) relating to certain aspects of revenue accounting and reporting under U.S. GAAP. In this month's column, I'll provide a high-level explanation of why the answers to "How much?" and "When?" are likely to change for many reporting entities and give other implications of the FASB's actions.

Multiple Elements vs. Multiple Deliverables

U.S. GAAP contains many rules designed to address complexities present in the kinds of revenue arrangements that are common today. One example of such rules is that every revenue arrangement must be analyzed by the vendor (or service provider) to determine whether or not the arrangement consists of multiple *elements*, also referred to as multiple *units of accounting*. In a multiple-element arrangement, the amount and timing of revenue to be recognized must be determined separately for each element. The rules for multiple-element arrangements, which were historically documented in Emerging Issues Task Force (EITF) Issue No. 00-21, are currently found in FASB *Accounting Standards Codification*™ (ASC) Subtopic 605-25, *Revenue Recognition > Multiple-Element Arrangements*.

Vendors often enter into revenue arrangements that involve multiple deliverables. Under a multiple-deliverable arrangement, a vendor may make multiple deliveries of the same product over time, may deliver different products at different times, or may perform the same or different services over different time frames, possibly in conjunction with the delivery of products under the same arrangement.

The key thing to understand is that just because an arrangement involves multiple deliverables, it doesn't necessarily involve multiple elements (i.e., units of accounting) for purposes of revenue recognition under U.S. GAAP. On October 7, 2009, the FASB issued ASU No. 2009-13, "Multiple-Deliverable Revenue Arrangements," to provide updated guidance to vendors in assessing whether they should consider the deliverables in a multiple-deliverable arrangement to be multiple units of accounting or a single unit of accounting. This ASU modified the multiple-element assessment criteria, which may in itself cause a multiple-deliverable arrangement that had previously been considered to consist of a single unit of accounting to be considered to consist of multiple units of accounting and vice-versa. Because revenue is typically recognized at different times for different units of accounting, a change in the single-element vs. multiple-element classification of an arrangement would probably shift the timing of revenue recognition for the arrangement even though the total amount of revenue to be recognized for the arrangement would remain unchanged.

ASU No. 2009-13 also changed the requirements for allocating the total consideration that the vendor is entitled to receive from a multiple-deliverable arrangement to the individual deliverables. If the multiple-deliverable arrangement involves multiple units of accounting, changing the allocation of consideration to the individual deliverables could result in a change to the amount of revenue to be recognized for each unit of accounting. And because revenue would typically be recognized at different times for the different units of accounting, shifting the amount of revenue to be recognized among the units is likely to shift the timing of revenue recognition for the arrangement, again without changing the amount of revenue to be recognized for the arrangement as a whole.

Regardless of whether the timing of revenue recognition will or won't change for a particular multiple-deliverable arrangement, ASU No. 2009-13 imposes new disclosure requirements on all vendors that are parties to multiple-deliverable arrangements. In general, vendors will have to provide both qualitative and quantitative information regarding:

- The significant judgments made in applying the ASU's new guidance and
- Changes in either those judgments or the application of the guidance that may significantly affect the timing or amount of revenue recognition.

Bruce Pounder will present the "Codification Tips and Tricks" session at the North Carolina Association of CPAs' Annual Symposium on November 17, 2009. For more information, visit www.ncacpa.org/Conferences/SYM09.

Products Containing Embedded Software

On the same day that it issued ASU No. 2009-13, the FASB also issued ASU No. 2009-14, "Certain Revenue Arrangements that Include Software Elements," which applies to revenue arrangements that involve tangible products and software. ASU No. 2009-14 amends ASC Topic 985, *Software* (originally documented in AICPA Statement of Position 97-2, *Software Revenue Recognition*, and EITF Issue No. 03-05, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software*), so as to remove from the Topic's scope the sale of a tangible product containing software components and nonsoftware components that function together to deliver the product's essential functionality. Such products include iPhones and many other popular consumer-electronics devices sold today. The ASU also provides guidance on determining whether the software deliverables in an arrangement that includes a tangible product are within the scope of ASC 985. ASC Subtopic 605-25, as amended by ASU No. 2009-13, would be used to allocate revenue to deliverables in an arrangement that includes such products.

The most significant potential impact of the redefinition of ASC Topic 985's scope is that revenue from a tangible product containing embedded software may be recognized far sooner than it has been. For example, in following traditional GAAP, Apple has typically spread the recognition of revenue from iPhone and Apple TV sales over a two-year period during which the company provides free software updates. For a quarter's worth of deliveries of those products, Apple defers the recognition of hundreds of millions of dollars of revenue to future quarters. Under the new rules, however, Apple is likely to recognize a significant portion of that revenue immediately rather

continued on page 61

Financial Reporting

continued from page 20

than in future quarters. Thus, the new rules could provide a "top line" boost to companies in high-tech industries.

Effective Date and Transition Provisions

The amended guidance arising from ASU Nos. 2009-13 and 2009-14 shall be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. An entity that reports on a calendar-year basis would therefore be required to apply the amended guidance in preparing its 2011 financial statements although earlier application is permitted. Retrospective application is also permitted in accordance with ASC Subtopic 250-10, *Accounting Changes and Error Corrections > Overall*. In every case, an entity must adopt both sets of amendments in the same period using the same transition method and must make special transitional disclosures for each reporting period in the initial year of adoption.

As with all updates to U.S. GAAP, ASU Nos. 2009-13 and 2009-14 are available free in electronic format at www.fasb.org. **SF**

Bruce Pounder, CMA, CFM, Dip-IFR (ACCA), is president of Leveraged Logic, a provider of consulting and educational services to financial professionals. He is chair of IMA's Small Business Financial and Regulatory Affairs Committee and the liaison from that Committee to IMA's Financial Reporting Committee. You can reach Bruce at BPounder@LeveragedLogic.com.