

# Revenue Recognition: Performance Obligations

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# Disclaimer

*The views or statements expressed herein are my own and do not necessarily reflect the views of Sobel & Co., LLC.*



# Agenda

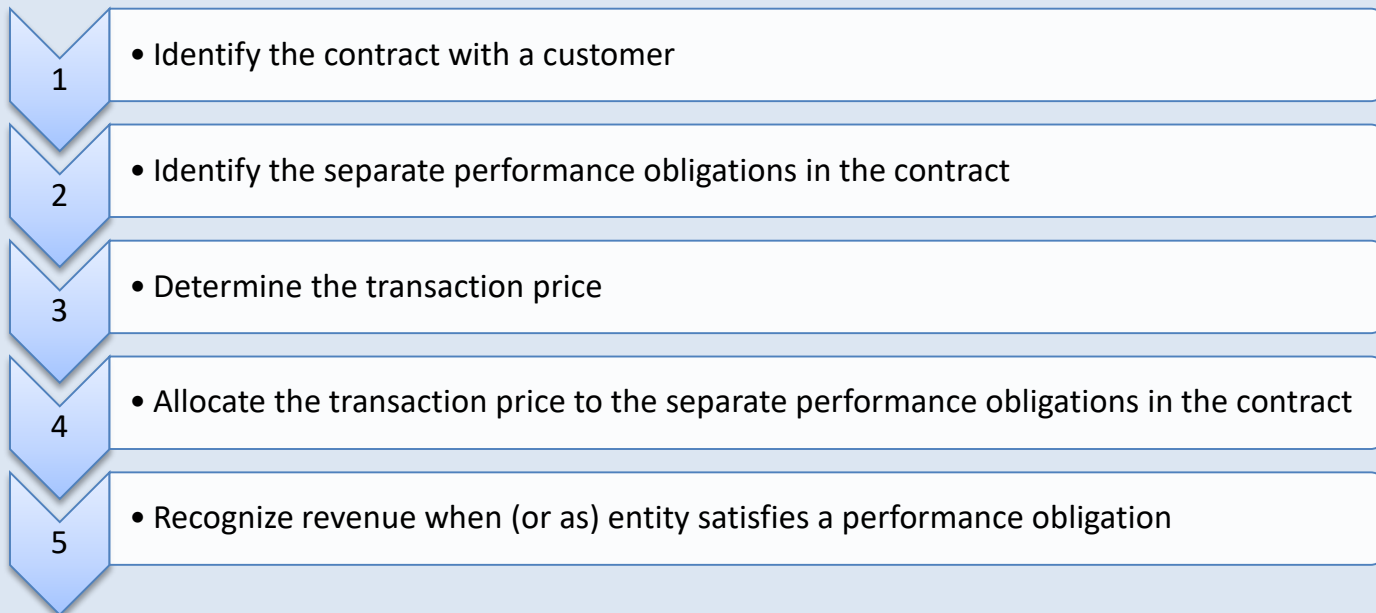
- Review of ASC Topic 606
- What is a Performance Obligation?
- Identifying Performance Obligations
- Disclosures



# The Core Principle of ASC Topic 606

- Recognize revenue when:
  - Promised goods or services are transferred to customers
  - In an amount that reflects the consideration a company expects to be entitled to in exchange for those goods and services
- Recognized when you transfer control

## 5 Steps for Revenue Recognition



# Transactions Scoped out of ASC 606

- Lease contracts under Topic 840/842
- Insurance contracts under Topic 944
- Financial instruments and other contractual rights under:
  - Topic 310 Receivables
  - Topic 320, 323, 325 Investment Topics
  - Topic 450 Liabilities
  - Topic 815 Derivatives and Hedging
  - Topic 825 Financial Instruments
  - Topic 860 Transfers and Servicing
  - Topic 958 Not-for-Profit Entities
- Guarantees Topic 460
- Nonmonetary exchanges between entities in the same line of business to facilitate customers or potential customers



# Effective Date

## Effective Date:

- Fiscal years, beginning after December 15, 2017 -  
Public business entities
- Fiscal years, beginning after December 15, 2018 -  
All other entities



# What is a Performance Obligation?

*Performance Obligation* - A promise in a contract with a customer to transfer to the *customer* either:

- a) A good or service (or a bundle of goods or services) that is *distinct*
- b) A series of *distinct* goods or services that are substantially the same and that have the same pattern of transfer to the *customer*



# What is a Performance Obligation?

- A good or service is *distinct* if:
  - a) The good or service (GOS) is capable of being distinct,
  - b) Nature of the promise within the contract are for individual goods and services, and not for a combined item, and
  - c) Does the buyer infer the good or service as separate
  - d) A customer can benefit from a GOS if the customer can use the item, consume the item, sell the item for more than scrap value, or generates economic benefits from the GOS





# What is a Performance Obligation?

- GOS that are not distinct are bundled with other GOS in the contract until a bundle of GOS that is distinct is created. That bundle of GOS is a single performance obligation
- Entity is not required to separately account for promised GOS that are immaterial in the context of the contract



# Examples of Performance Obligations

- **Example of goods being promised:**
  - a) A good produced to be sold i.e. inventory for a manufacturer to be sold to a customer
  - b) A good bought to be resold i.e. retailer purchasing inventory to be sold to a customer



# Examples of Performance Obligations

- **Example of services being promised:**
  - a) Completing a task for a customer
  - b) Arrange for someone else to provide a GOS
  - c) Stand ready to provide a GOS available
  - d) Produce an asset for a customer
  - e) Grant a license for a customer



# Examples of Performance Obligations

- **Example of rights being promised:**
  - 1) A right to resell – i.e. distribution networks
  - 2) A right that was previously purchased – i.e. discount vouchers
  - 3) A right to purchase additional GOS that provides the customers with a material right



# Examples of Performance Obligations

- **Other examples of performance obligations:**
  - a) Warranties – services **beyond** providing assurance that a good or service meets contract specifications
  - b) Nonrefundable upfront fees
  - c) Marketing incentives and incidental obligations – additional GOS provided as a result of the sale of a different GOS
  - d) Preproduction activities – engineering or design work where the GOS is **transferred to the customer**



# Not Examples of Performance Obligations

- **Not examples of performance obligations:**
  - 1) A promise to provide a refund
  - 2) A promise to accept a returned good
  - 3) Consignment arrangement in which the consignee does not take control of the goods
  - 4) Warranty required by law
  - 5) Task to provide that a GOS meets contracts specifications
  - 6) Product liability
  - 7) Indemnification involving intellectual property
  - 8) Shipping and handling activities performed before a customer obtains control of GOS



# Example 1 – Manufacturer/Retail

- XYZ Company produces and distributes widgets for various customers. The terms for nearly all contracts are FOB shipping point. XYZ Company has a product guarantee that the product will not have any defects 18 months after purchase.

How many performance obligations are there?



# Example 2 – Contracting/Construction

- ABC Construction Company constructs various homes and apartments. The Company has a contract to construct four apartment buildings and provide monthly maintenance for five years after the construction is complete.

How many performance obligations are there in the contract?





# Example 3 - Technology

- Large Technology Company provides software as a service. In the contract, the Company will provide an annual subscription for the software, installation of software, provide training for the customer, and provide updates during the year.

How many performance obligations are there?



# Example 4 - Nonprofit

- Prestigious Boarding School provides education to middle and high school students. In addition to the excellent education, the School requires all students to live on campus which is included in the tuition cost.

How many performance obligations are there?



# Example 5 - Nonprofit

- Helpful Charity receives a gift from a private donor to open a homeless shelter.

How many performance obligations are there?



# Disclosures

**ASC 606 requires significant enhancement to disclosures, quantitative and qualitative, including:**

- Disaggregation of revenue (over-time -v- point-in-time)
- Contract balances and significant changes
- Information about performance obligations
- Remaining performance obligations
- Significant judgements, including input/output considerations
- Contract assets/liabilities
- Practical expedients



# Disclosures

## Performance Obligations disclosure should include:

1. When the company typically satisfies its performance obligations (e.g., at shipment, at delivery, as services rendered, etc.)
1. Significant payment terms
  - Terms, significant financing components, whether variable consideration is involved and constrained
2. Nature of goods/services to be transferred
  - Highlight performance obligations where company acts as agent
3. Return and refund obligations
4. Warranty obligations



ANY  
QUESTIONS  
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