Overview: revenue recognition steps per ASC 606

Principle: an entity should recognize revenue in an amount that reflects the consideration that the entity **expects to be entitled to** in exchange for goods or services.

Identify the contract(s) with a customer

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

Contract criteria:

- The contract must be approved by all parties to the contract and they must be committed to perform their obligations.
- Each party's rights regarding the goods and services to be transferred must be identifiable.
- The payment terms must be identifiable.
- The contract must have commercial substance.
- It must be probable that a vendor will collect the consideration to which it is entitled in exchange for the goods or services expected to be delivered.

1

Identify the separate performance obligations

A performance obligation is defined as a contractual promise with a customer to transfer a service or good to the customer.

Good or service is distinct if both criteria are met:

- The customer can benefit from the good or service either on a stand-alone basis or along with resources that are readily available to the customer (capable of being distinct).
- The entity's promise to transfer the good or service is separately identifiable from other promises in the contract (distinct within the context of the contract).

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Determine the transaction price

The transaction price is the amount that the entity expects to be entitled to as a result of transferring goods or services to the customer.

Several considerations:

- Variable consideration: contract consideration could be variable due to the existence of discounts, incentives, refunds, rebates, contingencies, price concessions, etc.
- Time value of money: may need to adjust the amount of consideration for the time value of money if the time between (1) when the entity provides the goods or services and (2) the customer makes the payment for these goods or services is more than one year.
- Noncash consideration
- Consideration payable: if an entity expects to pay a customer an amount in the form of cash, credit or other that can be applied to amounts owed to the entity.

3

Allocate the transaction price to the separate performance obligations

- If the contract has multiple performance obligations, then the transaction price should be allocated across the performance obligations
- Allocate based on standalone selling price
- If the standalone selling price is not available, estimate the standalone selling price.

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Recognize revenue when (or as) the entity satisfies a performance obligation

Transfer occurs when the customer obtains control of the asset.

At a point in time:

- Seller has a present right to payment.
- Customer has legal title to the asset.
- Seller has transferred physical possession of the asset to the customer.
- Customer has significant risks and rewards of ownership.
- Customer has accepted the asset.

Over time :

- Customer receiving/consuming benefits as the seller performs.
- Seller creates/enhances asset that the customer controls as it is created/ enhanced.
- Asset has no alternative use and the seller has a right to payment for performance completed to date.

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