

# Modifications to accounting for multiple-element revenue arrangements

## Separating elements becomes easier

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### Summary

The FASB recently issued Accounting Standards Update (ASU) 2009-13, *Multiple-Deliverable Revenue Arrangements – a consensus of the FASB Emerging Issues Task Force*, and ASU 2009-14, *Certain Revenue Arrangements That Include Software Elements – a consensus of the FASB Emerging Issues Task Force*, to amend the existing revenue recognition guidance. The ASUs codify consensus reached in September by the FASB Emerging Issues Task Force on Issues 08-1 and 09-3.

ASU 2009-13 amends *FASB Accounting Standards Codification*<sup>TM</sup> (ASC) 605, Revenue Recognition, 25, “Multiple-Element Arrangements” (formerly EITF Issue 00-21, “Revenue Arrangements with Multiple Deliverables”), as follows:

- Modifies criteria used to separate elements in a multiple-element arrangement
- Introduces the concept of “best estimate of selling price” for determining the selling price of a deliverable
- Establishes a hierarchy of evidence for determining the selling price of a deliverable
- Requires use of the relative selling price method and prohibits use of the residual method to allocate arrangement consideration among units of accounting
- Expands the disclosure requirements for all multiple-element arrangements within the scope of ASC 605-25

ASU 2009-14 amends the scope of ASC 985, Software, 605, “Revenue Recognition” (formerly AICPA Statement of Position 97-2, *Software Revenue Recognition*), to exclude certain tangible products and related deliverables from the scope of this guidance. Instead, the excluded products and related deliverables must be evaluated for separation, measurement, and allocation under the guidance of ASC 605-25, as amended by ASU 2009-13.

The amended guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. An entity may elect retrospective application to all revenue arrangements for all periods presented using the guidance in ASC 250, *Accounting Changes and Error Corrections*. Entities must adopt the amendments resulting from both of these ASUs in the same period using the same transition method, where applicable.



# ASU 2009-13: Multiple-deliverable revenue arrangements

## Introduction

ASU 2009-13, *Multiple-Deliverable Revenue Arrangements – a consensus of the FASB Emerging Issues Task Force*, amends the guidance in *FASB Accounting Standards Codification*<sup>TM</sup> (ASC or Codification) 605, *Revenue Recognition*, 25, “Multiple-Element Arrangements” (formerly EITF Issue 00-21, “Revenue Arrangements with Multiple Deliverables”) as follows:

- Modifies criteria used to separate elements in a multiple-element arrangement
- Replaces the term “fair value” with “selling price”
- Introduces the concept of “best estimate of selling price” for determining the selling price of a deliverable
- Establishes a hierarchy of evidence for determining selling price of a deliverable
- Requires the use of the relative selling price method and prohibits the use of the residual method to allocate arrangement consideration among units of accounting
- Expands the disclosure requirements for all entities with multiple-element arrangements within the scope of ASC 605-25

The scope of these amendments is the same as the scope of the pre-amended guidance in ASC 605-25.

## Background

Entities often provide multiple products or services to their customers under a single revenue arrangement or under multiple revenue arrangements that are accounted for as a single arrangement. But in the past, separating deliverables in a multiple-element arrangement under the requirements of ASC 605-25 was a challenge for many entities, especially when there was a lack of objective and reliable evidence of fair value for the undelivered item(s). The requirement to combine deliverables into a single unit of accounting because of a lack of such evidence often resulted in revenue recognition that did not reflect the economic substance of the arrangement. For instance, an entity might have been required to defer revenue for one or more delivered items.

In an effort to improve revenue recognition accounting and address certain practice issues, the FASB’s Emerging Issues Task Force (EITF) developed the guidance included in ASU 2009-13.

## Modifications to separation criteria

The following criteria must be met to separate elements in a multiple-element arrangement under the amended guidance in ASC 605-25:

- The delivered item(s) has stand-alone value to the customer.
- If a general right of return exists, delivery or performance of the undelivered item(s) is substantially in the control of the vendor and is considered probable.

ASU 2009-13 amends the guidance in ASC 605-25 to lessen the separation requirements by eliminating the criterion that requires an entity to have objective and reliable evidence of fair value for the undelivered item(s). Under the existing guidance in ASC 605-25, evidence of fair value includes either of the following:

- **Vendor-specific objective evidence (VSOE)**, which includes the price charged when the same element is sold separately or, for an element not yet sold separately, the price established by management with the relevant authority
- **Third-party evidence (TPE)**, such as competitors’ sales prices for the same or largely interchangeable products or services to similar customers in stand-alone sales, if VSOE is not available

## Modifications to accounting for multiple-element revenue arrangements

Although the amended guidance does not require VSOE or TPE for separation purposes, these concepts have been retained for purposes of determining how revenue will be measured and allocated among the units of accounting.

### Stand-alone value

The concept of “stand-alone value” is not changed by the amendments to ASC 605-25, but the elimination of the requirement that objective and reliable evidence of fair value exist for the undelivered element(s) in an arrangement in order for an entity to separate elements may cause more entities to evaluate whether stand-alone value for the delivered element(s) exists. Under the existing guidance of ASC 605-25, entities would often first evaluate whether objective and reliable evidence of fair value for the undelivered element(s) existed and if an entity concluded that it lacked the necessary evidence of fair value and therefore could not separate the deliverables, the entity did not evaluate whether the delivered item(s) had stand-alone value.

Under the amended guidance in ASC 605-25-5(a), an item has stand-alone value if either of the following conditions is met:

- It is sold separately by any vendor.
- The customer could resell the item on a stand-alone basis.

Determining whether stand-alone value exists will be relatively straightforward in certain circumstances, such as when the item being evaluated is sold separately by the entity. In other circumstances, the evaluation might be more complex, and an entity will be required to use significant judgment to determine whether stand-alone value for the delivered item exists.

### Separating elements: stand-alone value of delivered item

Company A is a manufacturer of office equipment. On February 15, 20X0, Company A enters into an arrangement with Company B for the delivery and installation of a state-of-the-art color copier/printer and ongoing maintenance for three years. The equipment is delivered and installed on February 28, 20X0. Currently no competitors offer comparable color copier/printers. However, there is an observable secondary market for these color copier/printers. Company A has a history of entering into maintenance agreements with secondary owners of its office equipment.

Even though there are currently no competitors, Company A concludes that the color copier/printer has stand-alone value because a secondary market exists. The fact that company A provides maintenance services to secondary owners of its equipment supports the position that the copier/printer has stand-alone value in this arrangement.

### Separating elements: no stand-alone value

Company A manufactures and installs specialty equipment for the manufacturing environment. Company A enters into an arrangement with Customer B for the delivery and installation of one of its specialized machines. The installation process is highly complex and requires a high degree of knowledge regarding the equipment. As a result, customers do not have the know-how to perform the installation and no other vendors provide the installation services. In addition, because Company A owns a patent used in manufacturing the equipment, no other vendor sells similar equipment.

Because Company A is the only vendor that can perform the installation services, it is unlikely that Customer B would have the ability to recover a substantial amount of its cost on resale of the equipment absent the installation services. As a result, the equipment does not have stand-alone value, and Company A should treat the arrangement as a single unit of accounting in determining the appropriate revenue recognition model to apply.

### Measurement

The amended guidance replaces the term “fair value” in ASC 605-25 with “selling price” to clarify that revenue is allocated based on entity-specific assumptions rather than on market participant assumptions.

The amendments in ASU 2009-13 also establish the following hierarchy of evidence for determining each unit’s selling price:

- VSOE
- TPE in the absence of VSOE
- Best estimate of selling price only in the absence of both VSOE and TPE

Consistent with the objective of determining VSOE, the amendments define the vendor’s “best estimate of selling price” as the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a stand-alone basis. To determine its best estimate of selling price, management should consider market conditions in addition to entity-specific factors.

Market conditions include factors such as the following:

- Overall economic conditions
- Customer demand for the deliverable(s)
- Impact of competition for the deliverable(s)
- Profit margins realized by entities in the industry

## Modifications to accounting for multiple-element revenue arrangements

An entity may consider the following entity-specific factors, among others, in developing its best estimate of selling price.

- The entity's pricing practices for the deliverable(s), including discounts (for example, volume discounts)
- Costs incurred by the entity to provide the deliverable(s)
- The entity's profit objectives for the deliverable(s)
- In a services arrangement, it may be practicable for a customer to perform certain services themselves. The potential costs savings by the customer would be considered by the entity in determining its gross profit margins.

Evaluating the evidence relating to selling price may require significant judgment. Management should consider all available evidence in developing its best estimate of selling price for each deliverable. An entity should not presume that contract prices are representative of VSOE, TPE, or its best estimate of selling price. In addition, an entity cannot ignore either VSOE or TPE of selling price if either one exists.

Under the amended guidance, consideration paid under an arrangement that falls within the scope of ASC 605-25 should be allocated to separate units of accounting based on their relative selling prices, unless other U.S. GAAP requires a unit of accounting to be recorded at fair value and marked to market each subsequent reporting period. In those situations, an amount equal to fair value should be allocated to that unit of accounting and the remainder of the arrangement consideration should be allocated based on the relative selling prices of the remaining units of accounting. We believe that it would be rare that the sum of the selling prices of each deliverable in an arrangement would be less than the total arrangement consideration.

An entity determines the selling price for each deliverable and allocates consideration only once, at the inception of the arrangement. Any subsequent evidence regarding changes to selling price is applied prospectively to new or materially modified arrangements. A change in selling price does not affect arrangements for which the selling price and allocation have been previously determined.

### Allocation methods

The guidance in ASU 2009-13 amends ASC 605-25 to require the use of the relative selling price method and prohibits the use of the residual method to allocate arrangement consideration. The relative selling price method requires the total arrangement consideration to be allocated to each unit of accounting on the basis of their relative selling prices.

Under the existing guidance of ASC 605-25, the residual method is used if fair value exists for the undelivered element(s) but not for the delivered element(s). The residual method allows for deliverables within an arrangement to be separated, even though fair value does not exist for all deliverables. An amount equal to fair value is allocated to each of the undelivered element(s), and any consideration remaining is allocated to the delivered element(s).

In deliberating EITF Issue 08-1, the Task Force generally agreed that allocating consideration based on the relative selling price of each unit of accounting is conceptually preferable over applying the residual method. In addition, the EITF indicated that eliminating the residual method would simplify application of the amended guidance. As a result, the residual method is not allowed under the amended guidance in ASC 605-25.

### Implementation considerations: Estimating selling price

In order to develop its best estimate of selling price, management will likely need to obtain information from areas outside of the accounting department. Personnel from other areas of the business (for example, sales, marketing, and operations) may need to assist with the process of determining the best estimate of selling price.

Management should prepare robust documentation of the process it uses to determine its best estimate of selling price. Such documentation should include a discussion of management's consideration of the existence of VSOE or TPE of selling price, as well as a discussion of the various types of information evaluated in reaching its conclusion.

## Modifications to accounting for multiple-element revenue arrangements

### Implementation considerations: Impact on entities that use the residual method under the existing guidance

If an entity has been applying the residual method to separate deliverables in a multiple-element arrangement under the existing guidance of ASC 605-25, the entity will be required to change to the relative selling price method on adoption of the amendments to ASC 605-25. Consequently, an entity must establish appropriate method(s) to develop a selling price for each item in the arrangement, including the delivered item(s). In addition, an entity should consider the impact this change has on its processes, systems, and internal control structure.

### Impact on discounts and premiums

When applying the residual method under the existing guidance in ASC 605-25, an entity must allocate the full amount of the discount (premium) in the arrangement, if any, to the delivered element(s) in the arrangement. If the arrangement contains a discount, this method precludes the acceleration of revenue to the delivered element(s) for which the entity lacks objective and reliable evidence of fair value of under the existing guidance in ASC 605-25.

Under the relative selling price method, any discount or premium is allocated among all deliverables on a pro-rata basis. The elimination of the residual method and the requirement to use the relative selling price method supports accounting that is more reflective of the economic substance of the underlying transaction.

### Disclosure requirements

The amendments to ASC 605-25 place more reliance on judgment and estimates and, as a result, require more disclosures than under the existing guidance. ASC 605-25-50, as amended, includes a disclosure objective that requires an entity to disclose both qualitative and quantitative information about its revenue arrangements, including the following:

- Significant judgments made in applying the amended guidance ASC 605-25
- Changes in judgments or in the application of ASC 605-25, as amended, that may significantly affect either the timing or amount of revenue recognition

In light of this objective, the amended guidance prescribes specific information to be disclosed for similar types of multiple-element arrangements, including all of the following:

- The nature of the arrangements
- The significant deliverables included in the arrangements
- The timing of delivery of products or performance of services
- Provisions, such as performance, refund, cancellation, and termination
- The significant factors, inputs, assumptions, and methods used in determining the selling price for significant deliverables
- Whether significant deliverables can be accounted for separately and if not, why

- Revenue recognition timing for significant units of accounting
- The effect of significant changes in the selling price or in methods or assumptions used in determining the selling price for a unit of accounting if those changes result in a significant change in the allocation of consideration

### Transition and effective date

The amended guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. If an entity elects early application in a period that is not the first reporting period of its fiscal year, then the guidance must be applied retrospectively from the beginning of that fiscal year. An entity may elect retrospective application to all revenue arrangements for all periods presented using the guidance in ASC 250, *Accounting Changes and Error Corrections*. An entity must apply the amended guidance resulting from both ASU 2009-13 and ASU 2009-14, *Certain Revenue Arrangements That Include Software Elements – a consensus of the FASB Emerging Issues Task Force*, in the same period using the same transition method where applicable.

Next is a summary of the adoption method options, application requirements and related transitional disclosures required by the amended guidance in addition to the ongoing disclosures required as outlined in the section “Disclosure requirements” above.

## Modifications to accounting for multiple-element revenue arrangements

### Prospective application on the required effective date or at the beginning of a fiscal year

In the year of adoption, an entity must disclose information for financial statement users to understand the effects of the change in accounting principle, including, at minimum, the following qualitative information for similar types of arrangements:

- Description of changes in the units of accounting, if any
- Description of changes in methods used to allocate arrangement consideration to units of accounting in an arrangement
- Description of any changes in the pattern and timing of revenue recognition
- Whether adoption is expected to materially affect future periods

If adoption has a material effect, supplemental quantitative information must also be included for financial statement users to understand the effects of the change in accounting principle. ASU 2009-13 includes examples of methods that may be used, either individually or in combination, to meet this objective, such as:

- Disclosure of the amount of revenue that would have been recognized during the year of adoption for arrangements entered into or materially modified during the adoption period as if the pre-amended guidance of ASC 605-25 was applied

- Disclosure of the amount of revenue that would have been recognized in the year before adoption for arrangements originally accounted for under the pre-amended guidance of ASC 605-25, as if the amended guidance of ASC 605-25 was applied to those arrangements
- Disclosure of the amount of revenue recognized during the period and the amount of deferred revenue recorded as of the end of the reporting period for arrangements:
  - In existence during the period of adoption and accounted for under the pre-amended guidance of ASC 605-25
  - Entered into or materially modified during the period of adoption and accounted for under the amended guidance of ASC 605-25

### Retrospective application on the effective date or at the beginning of a fiscal year

- The entity must apply the guidance on changes in accounting principle in ASC 250-10-45-5 through 45-10
- The entity must disclose the information required in ASC 250-10-50-1 through 50-3

### Early adoption in a period that is not the first reporting period of the entity's fiscal year

If an entity early adopts during a period that is not the first reporting period of the entity's fiscal year, it must retrospectively apply the amended guidance to the beginning of its fiscal year and must disclose the amounts previously reported and the effect of the change in accounting principle for all prior interim periods in the fiscal year of early adoption, for the following captions, at minimum:

- Revenue
- Income before income taxes
- Net income
- Earnings per share

#### Implementation considerations: Retrospective application

An entity must satisfy the practicability conditions to retrospectively apply the amended guidance. As such, it must determine whether the information necessary to develop a selling price for all elements in its arrangements existed as of the retrospective application dates.

If an entity is considering retrospective application, it must do so using the information that would have been available at the time the arrangement was entered into. Hindsight information should not be used. For instance, if VSOE or TPE became available in a period subsequent to the date an arrangement was entered into, VSOE or TPE would not be used to measure and allocate arrangement consideration for that arrangement. The entity's best estimate of selling price would be used. In addition, in determining the best estimate of selling price for an arrangement entered into in a previous period, the entity should only consider the inputs regarding selling price that would have been known at that time. Subsequent changes in pricing or cost information would not be considered.

## Modifications to accounting for multiple-element revenue arrangements

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### Example

The following example compares the existing guidance to the amended guidance in various aspects of ASC 605-25. •

#### Example

Entity A, with a December 31, 2009 year-end, sells equipment Y and Z, both with stand-alone value, to Entity B. Total arrangement consideration is \$150,000. There are no return rights for Y and no refund rights if Z is not delivered. Equipment Y is delivered on December 15, 2009 and Z is delivered on April 15, 2010. Entity A has determined its best estimate of selling price for Y and Z is \$100,000 and \$50,000, respectively. Entity A has historically and continues to establish TPE of \$110,000 for equipment Y.

- Under the existing guidance in ASC 605-25, since Entity A lacks objective and reliable evidence of fair value for the undelivered element (Z), the arrangement is a single unit of accounting. Revenue of \$150,000 is deferred until Z is delivered in April 2010, assuming all other revenue recognition criteria are met.
- Under the amended guidance, the hierarchy requires that VSOE and then TPE, be considered first. Since TPE exists for equipment Y, that amount will be used for allocation. The discount is allocated ratably between equipment Y and Z under the relative selling price method. As such, \$103,125  $[(\$110,000/\$160,000) \times \$150,000]$  is recognized when Y is delivered in December 2009, and \$46,875  $[(\$50,000/\$160,000) \times \$150,000]$  is recognized when Z is delivered in April 2010, assuming all other revenue recognition criteria are met.

# ASU 2009-14: Certain revenue arrangements that include software elements

## Introduction

ASU 2009-14, *Certain Revenue Arrangements That Include Software Elements – a consensus of the FASB Emerging Issues Task Force*, amends the scope of arrangements that fall under the guidance in ASC 985, Software, 605, “Revenue Recognition” (formerly AICPA Statement of Position (SOP) 97-2, *Software Revenue Recognition*) to exclude tangible products containing software components and nonsoftware components that function together to deliver a product’s essential functionality.

## Background

SOP 97-2 was issued during an era when software was not as prevalent in many products as it is currently. Before the issuance of ASU 2009-14, the scope of ASC 985-605 included products or services that contain software that is more than incidental to the product or service as a whole. Since SOP 97-2 was issued, many technological advances have been made, and many products now contain embedded software and it is often a challenge for an entity to determine whether the software is more than incidental. Consequently, certain software-enabled devices that are sold with other deliverables fall within the existing scope of ASC 985-605.

An entity must have VSOE of fair value to separate deliverables in a multiple-element arrangement that is accounted for under the provisions of ASC 985-605. However, arrangements with software-enabled devices often include undelivered elements for which VSOE does not exist, which can result in revenue not always being recognized in a pattern that is consistent with the economic substance of the arrangement.

As a result of these practice issues and deliberations during the development of ASU 2009-13, the EITF added an item to its agenda to amend the scope of ASC 985-605 to exclude certain software-related products and allow for such products to be subject to the scope of the amended guidance of ASC 605-25.

## Scope amendments to ASC 985-605

The amendments of ASU 2009-14 modify the scope of ASC 985-605 to exclude arrangements with tangible products which contain the following:

- Both software components and nonsoftware components that function together to deliver the tangible product’s essential functionality
- Undelivered elements that relate to software that is essential to the functionality of the tangible product

Under the amended scope of ASC 985-605, hardware components of a tangible product containing software components are always excluded from the scope of ASC 985-605. The amendments to ASC 985-605 provide guidance on how to determine which software, if any, related to the tangible product also would be excluded from the software revenue recognition guidance in ASC 985-605.

Software components that are either sold with or embedded within a tangible product and are essential to the product’s functionality are excluded from the scope of ASC 985-605. Also excluded are undelivered software elements that relate to the tangible product’s essential software.

The amended guidance requires entities to consider the following factors in determining whether software and nonsoftware components function together to deliver a tangible product’s essential functionality:

- If the entity infrequently sells the tangible product without the software components, there is a rebuttable presumption that software components are essential to the functionality of the tangible product.
- If an entity sells tangible products with similar functionality, such as different models, and the only substantive difference between the products is that one product includes software that the other product does not, the products are considered the same product for purposes of evaluating the factor in the first bullet.

## Modifications to accounting for multiple-element revenue arrangements

- If an entity sells a tangible product with software, but also sells the software on a stand-alone basis, the separate sale of the software does not affect the evaluation of whether the software is essential to the functionality of the tangible product.
- Software elements are not required to be embedded within a product to be considered essential to the product's functionality.
- Nonsoftware components must substantively contribute to the tangible product's essential functionality (in other words, the tangible product cannot just be a delivery mechanism for the software).

### Other amendments

If a multiple-element arrangement includes a tangible product with both essential and nonessential software components, the arrangement consideration should first be allocated to the software and nonsoftware components based on the relative selling price method in the amended guidance in ASC 605-25. An entity should then apply the amended separation, measurement, and allocation guidance in ASC 605-25 to determine whether the nonsoftware items can be further separated and if so, how to allocate the nonsoftware consideration to those units of accounting. An entity should apply the guidance in ASC 985-605 to determine whether the software components can be further separated and if so, how to allocate and recognize revenue for the units of accounting.

### Implementation considerations: ASC 985-605 scope amendments

Management must exercise judgment when evaluating a multiple-element arrangement that includes a tangible product with software to determine whether the software is subject to ASC 985-605 or to ASC 605-25, as amended. If more than one software component is delivered with the tangible product, management must evaluate each software component to determine whether it is essential to the functionality of the tangible product. Software components that are essential to the functionality of the tangible product are subject to the amended measurement and allocation guidance in ASC 605-25, while software components that are not essential to the functionality of the tangible product are subject to the guidance in ASC 985-605.

If a single undelivered element relates to software components that are both within and outside the scope of ASC 985-605, the undelivered element must be bifurcated into a software deliverable and a nonsoftware deliverable using the amended guidance in ASC 605-25. The resulting software deliverable is accounted for under the guidance of ASC 985-605 and the nonsoftware deliverable is accounted for under other appropriate revenue guidance.

### Disclosure requirements

The disclosures prescribed by ASC 605-25, as amended, apply to arrangements with tangible products and software components that are excluded from the amended scope in ASC 985-605.

### Transition and effective date

The transition requirements and effective date are consistent with the amended guidance in ASC 605-25. The amended guidance in 985-605 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 (January 1, 2011 for a calendar year-end entity). Early adoption is permitted. If an entity elects early application in a period that is not the first reporting period of its fiscal year, then the guidance must be applied retrospectively from the beginning of that fiscal year. An entity may elect retrospective application to all revenue arrangements for all periods presented using the guidance in ASC 250.

The amended guidance in ASC 985-605 must be adopted in the same period using the same transition method as the amended guidance in ASC 605-25.

### Implementation considerations: Transition

An entity has flexibility regarding when and how to adopt the provisions of the amended guidance. As a result, an entity should carefully consider the facts and circumstances applicable to its situation to determine which adoption method to apply.

In addition, an entity should consider whether it is impracticable for it to retrospectively apply the guidance to any prior period. To retrospectively apply the amended guidance, an entity must be able to identify objective information that existed at the retrospective application dates to support the required estimates.

## Modifications to accounting for multiple-element revenue arrangements

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### Examples

Included below are examples illustrating the amended provisions of ASC 985-605. •

#### Example 1

Entity A sells a PC with an operating system that, along with the hardware, provides the PC's essential functionality. Entity A never sells the PC and the operating system separately. Also included in the arrangement is a specified upgrade right for the next version of the operating system and postcontract customer support (PCS), including a right to when-and-if-available upgrades of the operating system.

- Since the hardware (nonsoftware component) and operating system (software component) function together to deliver the tangible product's essential functionality, these components are excluded from the scope of ASC 985-605.
- In addition, because the PCS and the specified upgrade right relate to the software that is essential to the PC's functionality, they are also excluded from the scope of ASC 985-605.
- The entire arrangement is assessed for separation, measurement, and allocation in accordance with the amended guidance in ASC 605-25.

#### Example 2

Entity A sells a PC with an operating system that, along with the hardware, provides the PC's essential functionality. Entity A also sells customized productivity software with and separately from the PC. Entity A provides PCS that covers both the operating system and the productivity software.

- Because the hardware (nonsoftware component) and operating system (software component) function together to deliver the PC's essential functionality, these components are excluded from the scope of ASC 985-605.
- The productivity software is a software deliverable that is not considered essential to the PC's functionality and therefore is within the scope of ASC 985-605.
- Since the PCS relates to components both within (productivity software) and outside (operating system) the scope of ASC 985-605, it must be bifurcated into a software and nonsoftware component using the amended measurement and allocation guidance in ASC 605-25.

This Grant Thornton LLP bulletin provides information and comments on current accounting issues and developments. It is not a comprehensive analysis of the subject matter covered and is not intended to provide accounting or other advice or guidance with respect to the matters addressed in the bulletin. All relevant facts and circumstances, including the pertinent authoritative literature, need to be considered to arrive at conclusions that comply with matters addressed in this bulletin.

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# Appendix A

## FAQs on new guidance for separating deliverables in multiple-deliverable revenue arrangements

The questions and answers in this appendix provide implementation guidance and examples illustrating the amendments under Accounting Standards Update (ASU) 2009-13, *Multiple-Deliverable Revenue Arrangements – a consensus of the FASB Emerging Issues Task Force*.

### Stand-alone value

**A-1: What does it mean for a delivered item to have “stand-alone value”? Do the amendments to ASC 605-25 in ASU 2009-13 impact this determination?**

*FASB Accounting Standards Codification*<sup>TM</sup> (ASC or Codification) 605, *Revenue Recognition*, 25, “Multiple-Element Arrangements,” 25-5 states that an item has “stand-alone value” if it is sold separately by any vendor or if the customer can resell the delivered item on a stand-alone basis. It further indicates that an observable market for the item does not need to exist to conclude that a customer has the ability to resell the item. ASU 2009-13, *Multiple-Deliverable Revenue Arrangements – a consensus of the FASB Emerging Issues Task Force*, amends the separation criteria in ASC 605-25, but does not change the meaning of “stand-alone value” as described in ASC 605-25.

In evaluating whether any vendor sells the item separately, an entity should consider whether it or any other entity can sell that item on a stand-alone basis. If competing or similar products have features and functionality that allow them to be used in place of the item sold by the entity, then the entity would conclude that stand-alone value exists for that item. In addition, if the customer can either use the delivered item for its intended purpose absent the delivery of the other items or immediately resell the item at an amount that would substantially recover the purchase price, an entity would conclude that the delivered item has stand-alone value. The ability to sell the item solely for scrap does not meet the stand-alone value criterion.

The amendments to ASC 605-25 may cause some entities to consider whether stand-alone value exists in situations where they previously did not evaluate the stand-alone value criterion. Under the existing guidance in ASC 605-25, some entities may not have assessed whether the delivered item in a multiple-element arrangement had stand-alone value to a customer because they did not have objective and reliable evidence of fair value for the undelivered item, which is required to separate the delivered item into a unit of accounting. The

amendments in ASU 2009-13 eliminate the requirement in ASC 605-25-5 for an entity to have objective and reliable evidence of fair value of the undelivered item(s) in order to separate the delivered item as a unit of accounting, but retain the requirement for the delivered item to have stand-alone value to the customer. As a result, entities that previously did not assess whether the delivered item in a multiple-element arrangement had stand-alone value to a customer may need to do so upon adoption of the amendments to ASC 605-25. If a delivered item does not have stand-alone value to a customer, it does not qualify as a separate unit of accounting.

### Measurement

**A-2: What is meant by the concept of “best estimate of selling price”?**

Consistent with the objective of determining vendor-specific objective evidence (VSOE), the amendments to ASC 605-25 define the vendor’s “best estimate of selling price” as “the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a stand-alone basis.” To determine its best estimate of selling price, management should consider all reasonably available information, including market data and entity-specific factors discussed under question A-5.

## Modifications to accounting for multiple-element revenue arrangements

### A-3: When would an entity be permitted or required to develop a best estimate of selling price?

ASC 605-25 was amended to allow entities to separate deliverables in multiple-element arrangements that lack VSOE or third-party evidence (TPE) if both of the following separation criteria are met:

- The delivered item(s) has stand-alone value to the customer.
- If a general right of return exists, delivery or performance of the undelivered item(s) is substantially in the control of the vendor and is considered probable.

The amendments in ASC 605-25 establish the following hierarchy of evidence for determining a unit's selling price:

- VSOE
- TPE
- Best estimate of selling price

Therefore, an entity must first determine if it has VSOE of selling price for any deliverables in a multiple-element arrangement. In accordance with the amended guidance in ASC 605-25-30-6A,

VSOE of selling price is limited to either of the following:

- The price charged for a deliverable when it is sold separately by the entity
- The price established by management having the relevant authority for a deliverable that is not yet sold separately; however, it must be probable that the price will not change before the separate introduction of the deliverable into the marketplace.

If an entity determines that it does not have VSOE of selling price for any or all of the deliverables in a multiple-element arrangement, it must assess the specific facts and circumstances to determine whether TPE exists for those deliverable(s). TPE of selling price is the price of the entity's or another vendor's largely interchangeable products or services in stand-alone sales to similarly situated customers.

An entity would develop its best estimate of selling price for a deliverable only in the absence of both VSOE and TPE.

### A-4: How much effort must an entity expend to determine if it has VSOE or TPE?

An entity cannot ignore evidence that is reasonably available without undue cost and effort in determining whether it has either VSOE or TPE for a deliverable. Cost and effort will vary, depending on the specific facts and circumstances of each situation. For instance, less cost and effort might be expended to determine whether VSOE or TPE exists for deliverables that are never sold separately by the entity or any other vendor because separate sales are required for VSOE or TPE. We believe an arrangement that contains deliverables that the entity sells separately will require an analysis to determine if VSOE exists. We also believe that if an entity has established VSOE or TPE for a deliverable under the pre-amended guidance, and if no significant change in facts and circumstances results in a change in pricing practices, it should continue to perform its VSOE or TPE analysis. This analysis would be performed even if the effort and cost of that analysis is considered greater than the effort and cost of developing a best estimate of selling price.

#### Example 1 – When to use a best estimate of selling price

On January 1, 20X0, Entity E, an equipment manufacturer, enters into a multiple-element arrangement to manufacture and deliver equipment A, B, and C on July 1, 20X0, October 1, 20X0, and January 1, 20X1, respectively, for total consideration of \$760,000. All of the deliverables meet the separation criteria in ASC 605-25, and as a result, Entity E would account for each element in this arrangement as a separate unit of accounting. Entity E has VSOE for equipment A and TPE for equipment B, but does not have VSOE or TPE for equipment C.

Because Entity E does not have VSOE or TPE for an element that meets the other separation criteria in ASC 605-25, management must determine its best estimate of selling price for equipment C.

## Modifications to accounting for multiple-element revenue arrangements

### A-5: How can an entity determine its best estimate of selling price for a deliverable?

The amendments to ASC 605-25 do not require any specific approach to estimate selling price when VSOE or TPE does not exist. However, guidance is provided in ASC 605-25-55 in the form of examples to illustrate one method that an entity might use to estimate selling price. The examples all utilize a cost plus margin approach, some of which take into consideration various factors in determining the appropriate margins. Using a cost plus margin approach to estimate selling price may not be appropriate in certain situations, such as when costs consist primarily of research and development and the payments do not correlate to the costs incurred.

The amended guidance in ASC 605-25 requires an entity to consider market conditions in addition to entity-specific factors to determine its best estimate of selling price. Market conditions include factors such as the following:

- Overall economic conditions
- Customer demand for the deliverable(s)
- Impact of competition for the deliverable(s)
- Profit margins realized by entities in the industry
- Impact of geographic areas

An entity may consider the following entity-specific factors, among others, in developing its best estimate of selling price:

- The entity's pricing practices for the deliverable(s), including discounts or pricing strategies such as
  - Volume discounts
  - Price reductions to gain market share or lower inventory levels due to obsolescence or an improved model
- Costs incurred by the entity to provide the deliverable(s)

- The entity's profit objectives for the deliverable(s)
- Expected life of the product
- How the type or size of customer impacts pricing
- Market share goals for products
- Stand-alone sales of the deliverable when VSOE is not achieved

In a services arrangement, it may be practicable for a customer to perform certain services themselves. The potential costs savings by the customer would be considered by the entity in determining its gross profit margin for those services.

### Example 2 – Best estimate of selling price: equipment

On January 1, 20X0, Entity E, an equipment manufacturer, enters into a multiple-element arrangement to manufacture and deliver equipment A, B, and C on July 1, 20X0, October 1, 20X0, and January 1, 20X1, respectively, for total consideration of \$760,000. Stated contract prices are \$185,000 for equipment A, \$265,000 for equipment B, and \$310,000 for equipment C. The deliverables all meet the separation criteria in ASC 605-25, and as such, Entity E would account for each element in this arrangement as a separate unit of accounting. Because Entity E does not have VSOE or TPE for any of these products, it must estimate the selling price for each deliverable.

Entity E considered the following factors in determining its best estimate of selling price for equipment A, B, and C.

#### Equipment A

Entity E's cost to manufacture equipment A is \$160,000. Demand for equipment A has decreased due to a comparable and modernized model recently introduced by a competitor. The competitor's product list price is \$240,000. Entity E's profit margin on this equipment has historically been 30 percent. Entity E is in the process of modernizing equipment A and expects the new model to be ready for sale and distribution by July 1, 20X1. Entity E estimates it has approximately two years of equipment A inventory on hand.

After weighing all the available evidence, Entity E estimates the stand-alone selling price for equipment A is \$177,700. The selling price was determined based on the \$160,000 cost to manufacture plus an estimated gross margin of 10 percent. The entity ignored historic profit margins and used a 10 percent gross margin due to the superiority of its competitor's new product and the entity's strategy to clear its own inventory of existing equipment A in time for the introduction of its new equipment A model on July 1, 20X1.

#### Equipment B

Entity E's cost to manufacture equipment B is \$160,000. Profit margins on this equipment have historically averaged 41 percent. Entity E is the industry leader in equipment B, with the highest rated product and the highest market share for that product. Equipment B has been on the market for only 2 years, while its competitors' comparable equipment has been on the market for 2.5 years or longer. Entity E is not aware of any competitive threats to equipment B and believes equipment B will continue to be the market leader in the foreseeable future.

After weighing all the available evidence, Entity E estimates the stand-alone selling price for equipment B is \$271,000. The selling price was determined based on the \$160,000 cost to manufacture plus an estimated gross margin of 41 percent. The entity used a 41 percent gross margin due to historical trends and its position in the market place.

## Modifications to accounting for multiple-element revenue arrangements

### Example 2 – Best estimate of selling price: equipment (continued)

#### Equipment C

Entity E recently introduced equipment C to the market. Entity E's cost to manufacture equipment C is \$190,000. As part of equipment C's research and development, studies indicated that its price could be set at \$340,000 (44.1 percent margin). The pricing studies considered the fact that equipment C is in high demand and that there is limited competition. Entity E also considered that if the price was set appropriately for equipment C, it would be able to access markets and customers it historically has not accessed, while also providing exposure of its full product listing to this new customer base.

After weighing all the available evidence, Entity E estimates the stand-alone selling price for equipment C is \$330,000. The selling price was determined based on the \$190,000 cost to manufacture plus an estimated gross margin of 42.4 percent. Entity E used a 42.4 percent gross margin rather than the 44.1 percent gross margin indicated in its pricing study because of its strategy to attract a new customer base.

Arrangement consideration would be allocated to the deliverables using the relative selling price method. The table below summarizes the allocation results.

Equipment	Selling price	Ratio*	Arrangement consideration allocation*
A	\$177,700	23%	\$174,800
B	271,000	35%	266,000
C	330,000	42%	319,200
	<b>\$778,700</b>	<b>100%</b>	<b>\$760,000</b>

\*Ratio is computed as the individual selling price for each deliverable divided by the sum of the selling prices for all the deliverables. The ratio is then multiplied by the total arrangement consideration to compute the allocation of arrangement consideration for equipment A, as follows:

$$[\$177,700 \div \$778,700 = 23\%] \times \$760,000 = \$174,800$$

### Example 3 – Best estimate of selling price: consulting services

On January 1, 20X0, Entity Z, a provider of consulting services, enters into a multiple-element arrangement to provide the following services for total consideration of \$725,000.

Service	Date service will be provided	Contract price
A	During year 20X0	\$150,000
B	During years 20X0 and 20X1	200,000
C	During year 20X1	75,000
D	During years 20X0 through 20X2	300,000
		<b>\$725,000</b>

Payments of \$300,000, \$150,000, \$150,000, and \$125,000 are due and payable on January 1, 20X0, January 1, 20X1, January 1, 20X2, and January 31, 20X2, respectively. All of the services meet the separation criteria in ASC 605-25, and as such, each is considered a separate unit of accounting. Entity Z does not have VSOE or TPE for any of its services and therefore must estimate selling price for each service.

Entity Z determines pricing for its services based on an estimate of expected hours, using standard billing rates. Gross standard billing rates are set annually, based on Entity Z's annual budget. In setting the standard billing rates, Entity Z considered overall economic conditions, customer demand, competition, and cost incurred to deliver services. Entity Z typically provides discounts from its standard billing rates, depending on various factors, including headcount, timing and type of work, geographic location, number of services purchased, leverage in contract negotiations, and other general market forces. Although the entity may occasionally receive 100 percent of its gross billing rates for services included in certain arrangements, an analysis of historic data indicates realization of approximately 60 percent for services A and B and 65 percent for services C and D.

Based on the facts and circumstances of this arrangement, the entity determined that realization is an appropriate measure to determine estimated selling price. The budgeted hours and rates for each of the consulting projects were obtained from the project managers to determine the gross billable amounts. The gross billable amounts were then multiplied by the appropriate realization for the type of work performed to determine the estimated selling price. Arrangement consideration would be allocated to the deliverables using the relative selling price method

## Modifications to accounting for multiple-element revenue arrangements

### Example 3 – Best estimate of selling price: consulting services (continued)

The table below summarizes the results.

Service	Hours	Blended hourly rate	Estimated billings at standard rates	Realization	Selling price	Ratio	Arrangement consideration allocation
A	1,500	\$200	\$300,000	60%	\$180,000	21%	\$152,250
B	2,125	\$200	425,000	60%	255,000	30%	217,500
C	500	\$250	125,000	65%	81,250	10%	72,500
D	2,000	\$250	500,000	65%	325,000	39%	282,750
			<b>\$1,350,000</b>		<b>\$841,250</b>	<b>100%</b>	<b>\$725,000</b>

#### A-6: Can an entity default to contract prices in determining its best estimate of selling price?

No. ASC 605-25-30-7 clearly states that contractually stated prices in a multiple-element arrangement are not presumed to represent VSOE, TPE, or an entity's best estimate of selling price for an individual product or service. An entity must develop its best estimate of selling price by considering market conditions and entity-specific factors. Once the best estimate of selling price is developed and compared to stated contract prices, an entity with strict pricing policies that prevent significant pricing fluctuations may conclude that contractually stated prices approximate estimated selling prices. However, we believe that an entity should document its assessment of its best estimate of selling price, even when contract prices are believed to represent estimated selling price. See additional discussion in question A-10.

#### A-7: Can a range of prices be utilized to approximate an entity's best estimate of selling price?

Yes. As noted in ASC 605-25-30-6C, an entity's best estimate of selling price should be consistent with the objective of determining VSOE, which is "the price at which an entity would transact if the deliverable were sold by the entity regularly on a stand-alone basis." The widely accepted bell-shaped curve method, used for testing VSOE, indicates that a range is sufficient for the purpose of establishing VSOE. Consequently, we believe that establishing a range of estimated selling price may also be acceptable. However, we also believe that the range used for estimated selling price should be narrower than the range used for VSOE, as described below, since estimated selling price, unlike VSOE, is not based on actual transactions.

Under the bell-shaped curve method used for establishing VSOE, the entire population of transactions is evaluated to determine whether the range of prices is sufficiently narrow to provide evidence of VSOE of fair value. Although judgment is required in assessing whether the range of prices is sufficiently narrow for establishing VSOE, we believe that at least 80 percent of the transactions in the population should fall within a range of  $\pm 15$  percent of the midpoint of the range. In calculating the range for VSOE, the relative percent is applied to the change from the midpoint of the range. For example, if \$100 is the midpoint of the range, a range of  $\pm 15$  percent would be \$85 to \$115.

## Modifications to accounting for multiple-element revenue arrangements

In establishing a range for an entity's best estimate of selling prices, an entity would first determine its best estimate of selling price for each deliverable using the guidance included in question A-5 above. The entity would then calculate a narrow range of estimated selling prices for each deliverable that represents the price it would accept if the deliverable were sold regularly on a stand-alone basis. If the contract prices for the deliverable(s) within the multiple-element arrangement are within the applicable ranges established, then the contract prices would be considered to approximate the entity's best estimate of selling price. If the arrangement contains deliverables with contractually stated prices that are not within the range of estimated selling price, then the entity would not be able to use the stated contract price as the estimated selling price, and would instead use a price within the range. The entity would need to establish a policy for using prices within a range and to apply that policy consistently. Appropriate policies would include using the midpoint of the range or using the endpoint of the range nearest the stated contract price. For example, if the contractually stated price for a deliverable is above the established range of estimated selling price, then the entity would use the high end of the range as its estimated selling price for that deliverable.

### Example 4 – Range of best estimate of selling price

Assume the same facts in Example 2, except that the entity determined a narrow range of estimated selling prices, based on its facts and circumstances, as follows.

Equipment	Contract price	Range of estimated selling prices	
		High	Low
A	\$185,000	\$182,000	\$173,000
B	265,000	278,000	264,000
C	310,000	338,000	322,000

The entity adopted a policy to use the midpoint of the range of estimated selling prices for deliverables with stated contract prices that fall outside the range.

The table below summarizes the results of the relative selling price allocation.

Equipment	Contract price	Selling price	Ratio	Arrangement consideration allocation
A	\$185,000	\$177,500	23%	\$174,800
B	265,000	265,000	34%	258,400
C	310,000	330,000	43%	326,800
		<b>\$772,500</b>	<b>100%</b>	<b>\$760,000</b>

### A-8: When and how often would an entity allocate arrangement consideration to deliverables in a multiple-element arrangement?

An entity determines the selling price for each deliverable and allocates consideration only once: at the inception of the arrangement. Any subsequent evidence regarding changes to selling price is applied prospectively to new or materially modified arrangements. A subsequent change in selling price does not affect arrangements for which the selling price and allocation have been previously determined. For instance, if an entity allocates consideration based on the best estimate of selling price at inception, but subsequently establishes VSOE or TPE for a deliverable included in that arrangement, the initial allocation would not be modified, even though a higher level of evidence was subsequently established.

### A-9: When developing its best estimate of selling price, are there certain factors an entity should consider to assess in determining whether it has developed a reasonable estimate?

Most pricing strategies provide for a discount, rather than a premium, when stand-alone deliverables are sold as part of a bundled arrangement. In our view, the sum of the selling prices of each deliverable in a multiple-element arrangement would rarely be less than the total arrangement consideration. In such instances, we believe the entity should reassess whether it has identified all deliverables and has considered all available evidence in determining the selling price for each deliverable.

## Modifications to accounting for multiple-element revenue arrangements

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### A-10: What documentation should an entity maintain to support its best estimate of selling price?

An entity is required to consider all available evidence, including market conditions and entity-specific factors, in developing its best estimate of selling price for each deliverable. Consequently, management should document, in sufficient detail, the considerations relating to these conditions, as well as other factors and pertinent data points used in the analysis. In addition, consideration should also be given to documenting the reason why a certain factor or data point did not have an impact on the selling price determination.

### Other

### A-11: Is separating deliverables optional under the amended guidance of ASC 605-25?

No. Deliverables included in a multiple-element arrangement that meet the separation criteria in ASC 605-25-25-5 must be separated and accounted for as separate units of accounting.

### A-12: How is accounting for hosting arrangements that include multiple-element arrangements impacted by the amendments to ASC 605-25?

The proper accounting for multiple-element software hosting arrangements depends on whether the arrangement falls within the scope of ASC 985, Software, 605, “Revenue Recognition” (formerly AICPA Statement of Position 97-2, Software Revenue Recognition), or ASC 605-25. Hosting arrangements are within the scope of ASC 985-605 if both of the following criteria included in ASC 985-605-55-121 are met:

- The customer has a contractual right to take possession of the software at any time during the hosting period without incurring a significant penalty.
- The customer has the ability either to run the software on its own hardware or to contract with a party unrelated to the vendor to host the software without incurring a significant penalty.

Multiple-element hosting arrangements that are excluded from the scope of ASC 985-605 are accounted for using the guidance in ASC 605-25. The impact of the amendments to ASC 605-25 on multiple-element hosting arrangements within the scope of ASC 605-25 is similar to the impact on nonhosting arrangements within the scope of ASC 605-25. In summary, hosting arrangements are impacted by the adoption of the amended guidance in ASC 605-25 in the following areas:

- Less restrictive criteria for separating elements in a multiple-element arrangement due to the elimination of the criterion that requires an entity to have objective and reliable evidence of fair value for the undelivered element(s)
- Requirement to use the relative selling price method, and prohibition of the residual method, to allocate arrangement consideration among units of accounting
- Expanded disclosure requirements

As previously mentioned, the concept of “stand-alone value” is not changed by the amendments to ASC 605-25, but consistent with the impact on nonhosting multiple-element arrangements, the elimination of the fair value criterion may cause more entities with hosting arrangements to evaluate whether stand-alone value exists for the delivered element(s) than the previous guidance. The determination of stand-alone value could be a new focus for entities with multiple-element hosting arrangements that include professional services, such as set-up or implementation, in addition to the hosting service.

In general, meeting the criterion for stand-alone value for certain professional services is often difficult in hosting arrangements. To conclude that the set-up or implementation services have stand-alone value, the entity must sell the services independent of the hosting services, or it must have evidence that another vendor can sell the services. However, the nature of hosting arrangements generally makes it unlikely that the entity would provide the implementation services separate from the hosting services or that another vendor would be able to provide the implementation services to the customer.

## Modifications to accounting for multiple-element revenue arrangements

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Some hosting arrangements include elements the customer can reasonably expect to benefit from over the entire hosting relationship period. These elements, which include implementation, activation, and consulting services that directly relate to the hosted software, usually can be provided only by the entity due to the knowledge required to perform the services, as well as the complexity of the services and the related hosting application. As a result, such services often do not have stand-alone value because the customer obtains value from those services only through the hosted software and only the entity alone can generally provide. The customer derives value from these hosting-related elements through its entire hosting relationship with the entity. As a result, if an entity is unable to separate these services from the hosting services, it should recognize revenue from the up-front payment over the estimated customer relationship period, which could be longer than the initial hosting contract period.

### **A-13: Are optional future purchases considered deliverables under the amended guidance to ASC 605-25?**

The amendments to ASC 605-25 do not change the accounting for optional future purchases. If a multiple-element arrangement contains an option to purchase additional goods or services that are necessary for the intended use of the delivered good or service, the additional goods or services are considered deliverables in the arrangement and are subject to the amended separation and measurement guidance in ASC 605-25. The fact that such additional goods or services are necessary for the intended use of the delivered good or service, however, may call into question whether they can be separated from the delivered item under the stand-alone value criterion in ASC 605-25. If the additional goods or services are not necessary for the intended use of the delivered goods or services, such optional future purchases would not be considered deliverables in the arrangement because the customer can make a decision about future purchases independent of the delivered items; however, discounts on such purchases may be considered a separate deliverable in the original arrangement, as discussed in the next question. Optional future purchases that are not deliverables would be considered separate arrangements when and if the customer exercises the option to purchase the item.

### **A-14: Are future discounts a deliverable under the amended guidance?**

Discounts on future purchases, including optional purchases, may be deliverables subject to the separation and measurement guidance included in ASC 605-25, as amended by ASU 2009-13. Determining whether a discount is a deliverable in a multiple-element arrangement requires the use of judgment. Existing guidance for software arrangements under ASC 985-605-15-3d requires that significant incremental discounts on customers' future purchases be allocated to those future deliverables. Although this guidance specifically applies to arrangements within the scope of ASC 985-605, entities may analogize to this guidance for arrangements within the scope of ASC 605-25.

Under ASC 985-605-15-3d, a discount may be considered a deliverable if it is (1) incremental to the range of discounts reflected in the pricing of the other elements in the arrangement, (2) incremental to the range of discounts typically given in comparable transactions, and (3) significant when compared to the total arrangement consideration.

## Modifications to accounting for multiple-element revenue arrangements

### Example 5 – Discounts on future purchases

Entity A enters into an arrangement with Entity B to sell a piece of equipment and installation services. The equipment and installation services are separate units of accounting because the equipment has stand-alone value to the customer and the deliverables otherwise meet the amended separation criteria in ASC 605-25. The total arrangement consideration is \$2,000. Entity A has determined that the estimated selling prices for the equipment and installation services are \$1,500 and \$900, respectively. The arrangement terms also indicate that Entity A will discount the installation services by 75 percent on a future purchase of any model of equipment at list price for the remainder of the year.

Entity A determines that the discount on future installation services is a separate deliverable under the arrangement because of the significance of the discount. As a result, Entity A would allocate a portion of the arrangement consideration to the future discount using the relative selling price method. If the estimated selling price of the discount was \$600 (based on an average cost to install any equipment model, while considering other entity-specific and market factors), then \$1,000 would be allocated to the equipment, \$600 would be allocated to the installation services, and \$400 would be allocated to the future discount on installation services. The table below summarizes the allocation results.

Deliverable	Selling price	Ratio	Arrangement consideration allocation
Equipment	\$1,500	50%	\$1,000
Installation service	900	30%	600
Discount on future installation service	600	20%	400
	<b>\$3,000</b>	<b>100%</b>	<b>\$2,000</b>

### Effective date and transition

#### A-15: What are the adoption options and key requirements for the amendments to ASC 605-25?

Entities have flexibility in how they adopt the amendments to ASC 605-25. The amended guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010; however, early adoption is permitted. If an entity elects early application in a period that is not the first reporting period of its fiscal year, then the guidance must be applied retrospectively from the beginning of that fiscal year. An entity may also elect retrospective application to all revenue arrangements for all periods presented using the guidance in ASC 250, *Accounting Changes and Error Corrections*. The following table summarizes the requirements of the various adoption options.

Adoption date	Application method	Requirements
If adopted <ul style="list-style-type: none"> <li>• Early and during the first reporting period of the fiscal year, or</li> <li>• On the required effective date</li> </ul>	Prospective	<ul style="list-style-type: none"> <li>• Disclose qualitative and quantitative (if material) information to allow financial statement users to understand the effect of the change in accounting principle, as described in ASC 605-25-65-1c and 65-1d</li> </ul>
If adopted <ul style="list-style-type: none"> <li>• Early and during the first reporting period of the fiscal year, or</li> <li>• On the required effective date</li> </ul>	Retrospective	<ul style="list-style-type: none"> <li>• Apply the guidance on changes in accounting principle in ASC 250-10-45-5 through 45-10</li> <li>• Disclose the information required in ASC 250-10-50-1 through 50-3</li> </ul>
If adopted <ul style="list-style-type: none"> <li>• Early and during an interim period of the fiscal year</li> </ul>	Prospective or retrospective	<ul style="list-style-type: none"> <li>• Use the guidance in ASC 250-10-45-5 through 45-10 to retrospectively apply the amended guidance in ASC 605-25 from the beginning of the fiscal year</li> <li>• Disclose the amounts previously reported, and the effect of the change in accounting principle for all prior interim periods in the fiscal year of adoption, for the following captions at a minimum:                             <ul style="list-style-type: none"> <li>– Revenue</li> <li>– Income before income taxes</li> <li>– Net income</li> <li>– Earnings per share</li> </ul> </li> </ul>

## Modifications to accounting for multiple-element revenue arrangements

### A-16: How does the amended guidance in ASC 605-25 apply to undelivered elements included in multiple-element arrangements entered into before adoption of the amended guidance?

The amendments to ASC 605-25 apply only to arrangements entered into or materially modified after the amended guidance is adopted. The amended guidance does not impact the determination of whether elements (including undelivered elements) are separate units of accounting or of how much consideration is allocated to undelivered elements included in arrangements entered into before the entity adopted the amended guidance, unless the arrangement terms are materially modified after applying the amended guidance. If an entity materially modifies an arrangement after adopting the provisions of the amended guidance of ASC 605-25, it should apply the amended separation and allocation provisions of ASC 605-25 to all undelivered elements in the arrangement. See question A-17 below.

### A-17: What does it mean to “materially modify” an arrangement?

The amended guidance in ASC 605-25 is effective for arrangements entered into or materially modified in fiscal years beginning after June 15, 2010. Because the guidance in ASC 605-25 does not define what it means for an arrangement to be “materially modified,” determining whether an arrangement is materially modified and, as a result, whether it should be accounted for under the amended guidance in ASC 605-25 will require judgment.

### Example 6 – Accounting for existing arrangements upon adoption

On December 1, 2009, Entity A, a calendar year-end entity, entered into an agreement to manufacture and deliver equipment Y and Z on January 31, 2010 and January 31, 2011, respectively. Payment of \$100 for equipment Y is due on delivery. The deliverables have stand-alone value and the arrangement does not contain any refund rights. Entity A has established VSOE for equipment Y, but does not have VSOE or TPE for equipment Z. Entity A adopted the amended guidance in ASC 605-25 on January 1, 2010.

Because the arrangement was entered into before the adoption of the amended guidance in ASC 605-25 and since it was not materially modified, the amended guidance would not apply to this arrangement. Therefore, the entity would continue to follow the pre-amended separation and allocation guidance in ASC 605-25 for the undelivered elements after the January 1, 2010 adoption date. As a result, since objective and reliable evidence of fair value does not exist for the undelivered element (equipment Z), revenue for equipment Y (\$100) would be deferred, and revenue for both equipment Y and Z would be recognized upon delivery of equipment Z on January 31, 2011.

Modifications that could be considered material include the following:

- Significant changes to arrangement consideration
- The addition or removal of deliverables
- Significant extension of the term of an arrangement

There must be a substantive business reason for the modification to be considered material. For example, if the purpose of a modification is to get a specific accounting treatment, that modification would not be considered material.

In addition, changing the delivery date of an item in a multiple-element arrangement that existed before the effective date of the amended guidance is generally not a material modification that would require, or allow, the arrangement to be accounted for under the amended guidance of ASC 605-25.

Judgment is also required to determine whether a modification applies to the existing arrangement or comprises a new arrangement. For example, a promise by a vendor to deliver additional units of a product to a customer at the same price as the original contract would generally be considered a new arrangement rather than a material modification of an existing arrangement.

### A-18: How are existing multiple-element arrangements that are materially modified accounted for under the amended guidance in ASC 605-25?

The amended guidance applies to arrangements entered into or materially modified after adoption of the amendments. An arrangement whose inception precedes the adoption of the amended guidance in ASC 605-25 continues to be accounted for under the existing guidance, unless the arrangement is materially modified after adoption.

## Modifications to accounting for multiple-element revenue arrangements

The amended guidance in ASC 605-25 does not address how an entity should account for deferred revenue related to a multiple-element arrangement that is materially modified after an entity has prospectively adopted that guidance. In this situation, we believe that the deferred revenue balance should be adjusted to reflect the amendments to ASC 605-25 using Approach A, described as follows:

- **Approach A:** Allocate the total modified arrangement consideration to all deliverables in the modified arrangement using the relative selling price method as though the amended guidance in ASC 605-25 existed at the inception of the original contract. The estimated selling prices for the delivered items should be based on the information that would have been known at the time of inception, if practicable. If it is not practicable to estimate selling prices using the information that would have been known at inception, current information at the time of arrangement modification may be used. Any resulting differences in deferred revenue as a result of the adoption of the amendments in ASC 605-25 should be recognized as revenue upon the date of modification. We believe Approach A is the preferred approach if it is practicable to obtain that information. Alternatively, Approach B below could be used.

- **Approach B:** Allocate the modified arrangement consideration and any deferred revenue from the existing arrangement to the remaining undelivered elements based on the estimated selling prices of the undelivered elements at the time of the arrangement modification.

Any difference in deferred revenue as a result of the adoption of the amendments to ASC 605-25 would be recognized as revenue at the date of modification.

The following example illustrates the two approaches discussed above.

### Example 7 – Materially modified arrangement

On January 1, 2008, Entity A entered into an agreement to manufacture and deliver equipment X, Y, and Z on December 31, 2008, December 31, 2009, and December 31, 2010, respectively. Total arrangement consideration was \$1,600, with \$500, \$600, and \$500 due and payable on delivery of equipment X, Y, and Z, respectively.

All of the deliverables have stand-alone value and the arrangement does not contain any refund rights. Entity A did not have VSOE or TPE for any of the deliverables. Therefore, Entity A could not account for equipment X, Y, and Z as separate units of accounting under the pre-amended guidance of ASC 605-25. The entity delivered equipment X and received \$500, as scheduled, on December 31, 2008 and recorded \$500 of deferred revenue as of December 31, 2008. Entity A prospectively adopted the amended guidance in ASC 605-25 in December 2009.

On December 31, 2009, at the request of the customer, the contract was modified for Entity A to provide significant enhancements to equipment Z. Additional consideration of \$100 in connection with the modifications was received on December 31, 2009, and an additional \$700 was due and payable on delivery of enhanced equipment Z on December 31, 2010. Total modified arrangement consideration was \$2,400, including \$500 paid in 2008, \$700 paid in 2009 on delivery of equipment Y, and \$1,200 payable in 2010 on delivery of modified equipment Z. Entity A believes these changes to the arrangement terms represent a material modification.

## Modifications to accounting for multiple-element revenue arrangements

### Example 7 – Materially modified arrangement (continued)

#### Approach A

Entity A would allocate the modified arrangement consideration to all the deliverables using the relative selling price method. Entity A determined the estimated selling price for equipment X to be \$500, using pricing data and other evidence from January 1, 2008. Entity A determined the estimated selling prices of equipment Y and modified equipment Z to be \$700 and \$1,400, respectively, at the date of the arrangement modification, using the information that would have been known at contract inception, January 1, 2008. The table below summarizes the results of the re-allocation, the related deferred revenue balances, and the amount of revenue recognized (or to be recognized) each year.

Equipment	Deliverable delivery and reporting period	Selling price	Ratio	Arrangement consideration allocation	Deferred revenue before modification*	Deferred revenue after modification	Revenue recognized
X	2008	\$ 500	19%	\$ 456	\$ 500	\$ 0	\$ 0
Y	2009	700	27%	648	1,100	96	1,104
Z	2010	1,400	54%	1,296	N/A	N/A	1,296
		<b>\$2,600</b>	<b>100%</b>	<b>\$2,400</b>			<b>\$2,400</b>

\* Represents the cumulative amount of deferred revenue that would have been recorded based on the original arrangement terms.

Any excess deferred revenue in existence as of the arrangement modification date would be recognized as revenue at that date. Based upon the estimated selling price re-allocation, Entity A should recognize revenue of \$1,104 and record \$96 of deferred revenue as of the December 31, 2009 modification date. The modified deferred revenue balance of \$96 is computed based on the revised cumulative amount of total arrangement consideration of \$1,200 allocated to equipment X and Y delivered in 2008 and 2009, less \$1,104, which is the cumulative amount of revenue that should be recognized through December 31, 2009 after the arrangement modification and prospective adoption of the amended guidance in ASC 605-25.

#### Approach B

Entity A would allocate the remaining modified arrangement consideration and deferred revenue only to the undelivered elements. Entity A determined the estimated selling price of equipment Y and modified equipment Z to be \$700 and \$1,400, respectively, on the date of the arrangement modification. The table below summarizes the results of the re-allocation, the related deferred revenue balances, and the amount of revenue recognized (or to be recognized) each year.

Equipment	Deliverable delivery and reporting period	Selling price	Deferred revenue before modification	Deferred revenue after modification	Revenue recognized
X	2008	N/A	\$ 500	\$ 0	\$ 0
Y	2009	\$700	1,100	200	1,000
Z	2010	1,400	N/A	N/A	1,400
					<b>\$2,400</b>

The deferred revenue balance as of the arrangement modification date, plus the remaining consideration related to the undelivered items as of that date, will be allocated to the undelivered items based on their respective estimated selling price. After allocating \$1,400 of \$2,400 total consideration to equipment Z, the remaining \$1,000, which includes a deferred revenue adjustment of \$900, would be recognized during 2009.

#### A-19: What is the transition guidance for an entity that uses the residual method under the pre-amended guidance in ASC 605-25?

Under the amended guidance of ASC 605-25, all entities must use the relative selling price method to allocate arrangement consideration to all elements that meet the separation criteria. The residual method is no longer allowed. As a result,

an entity that has historically used the residual method to allocate arrangement consideration because it had objective and reliable evidence for the undelivered (but not for the delivered) element(s) in its arrangements will need to develop a selling price for all elements in new or materially modified arrangements after it prospectively adopts the amended guidance in ASC 605-25. The entity will be required

to use the relative selling price method to allocate arrangement consideration to the units of accounting in both new and materially modified arrangements. The amended guidance in ASC 605-25 does not impact an arrangement whose inception date is before adoption, unless the arrangement is materially modified after the adoption date.

## Modifications to accounting for multiple-element revenue arrangements

### Example 8 – Transition from the residual method

On January 1, 2009, Entity A, a calendar year-end entity, entered into an agreement to manufacture and deliver equipment Y and Z on January 31, 2010 and December 31, 2010, respectively. All of the deliverables have stand-alone value and the arrangement does not contain any refund rights. Entity A has established VSOE for equipment Z, but does not have VSOE or TPE for equipment Y. Under the existing guidance in ASC 605-25, since Entity A did not have objective and reliable evidence of fair value for the delivered item but did for the undelivered item, it followed the residual method to allocate the arrangement consideration at inception.

Assuming Entity A prospectively adopts the amended guidance in ASC 605-25 on January 1, 2010 and the arrangement is not materially modified, Entity A would continue to account for the arrangement under the existing guidance in ASC 605-25. No change would be made to the original allocation.

Alternately, if Entity A both adopts the amended guidance and materially modifies the arrangement on January 1, 2010, it would use VSOE for the selling price for equipment Z and would develop its best estimate of selling price for equipment Y at the contract modification date. Entity A would allocate the arrangement consideration to equipment Y and Z using the relative selling price method. Under the relative selling price method, any discount would be allocated to both elements. Thus, the amount allocated to equipment Z using the relative selling price method may differ from the amount initially allocated to equipment Z using the residual method if a discount exists in the arrangement.

### A-20: What should an entity consider if it is early adopting the amendments to ASC 605-25 during an interim period or electing retrospective application?

As previously noted, an entity that is considering adopting the amendments to ASC 605-25 early and during an interim period would be required to apply the amended guidance from the beginning of the fiscal year. An entity should retrospectively apply the guidance using the information that would have been available at the time the arrangement was entered into. As such, it must determine whether the information necessary to develop a selling price for all elements in its arrangements existed at the arrangement inception dates. Hindsight information should not be used. For instance, if VSOE or TPE did not exist at the arrangement's inception, but became available in a later period, then VSOE or

TPE would not be used to measure and allocate arrangement consideration for that arrangement. Instead, the entity must use its best estimate of selling price. In addition, in determining the best estimate of selling price for an arrangement entered into in a previous period, the entity should consider only inputs regarding selling price that would have been known at that time. Subsequent changes in pricing or cost information should not be considered.

Similarly, if an entity is considering early retrospective adoption during the first reporting period of the fiscal year, it would be required to satisfy the practicability conditions in ASC 250. If it is practicable for an entity to determine estimated selling prices for all elements for all periods presented, it may elect full retrospective application of the amended guidance as of the earliest

period presented. If it is impracticable to determine estimated selling prices for all arrangements outstanding during each period presented, the cumulative effect of the change should be reflected as of the beginning of the earliest period the new principle can be applied. The transition disclosures outlined in ASC 250 for changes in accounting principle would be required.

# Appendix B

## FAQs on the amendments to the scope of the software revenue recognition guidance

The questions and answers in this appendix provide implementation guidance and examples illustrating the amendments under Accounting Standards Update (ASU) 2009-14, *Certain Revenue Arrangements That Include Software Elements – a consensus of the FASB Emerging Issues Task Force*.

### Determining whether software is essential

#### B-1: What factors should an entity consider when determining whether a software deliverable in a tangible product is essential to the product's functionality?

The amended guidance in *FASB Accounting Standards Codification*<sup>TM</sup> (ASC or Codification) ASC 985, *Software*, 605 "Revenue Recognition" (formerly AICPA Statement of Position 97-2, *Software Revenue Recognition*), lists the following factors to consider in determining whether software in a tangible product is essential to the product's functionality:

- If an entity infrequently sells the tangible product without the software components, there is a rebuttable presumption that the software components are essential to the tangible product's functionality.
- If an entity sells tangible products with similar functionality, such as different models, and the only substantive difference between the similar products is that one product includes software that the other product does not, the products are considered the same product for purposes of the evaluation in the first bullet.
- If an entity sells a tangible product with software, but also sells the software on a stand-alone basis, the separate sale of the software does not affect the evaluation of whether the software is essential to the functionality of the tangible product.
- Software elements are not required to be embedded within a product to be considered essential to the product's functionality.
- Nonssoftware components must substantively contribute to the tangible product's essential functionality (in other words, the tangible product cannot just be a delivery mechanism for the software).

Determining whether software in a tangible product is essential to its functionality requires management to exercise judgment. If software in a tangible product is essential to its functionality, the entire product, including the software, is outside the scope of ASC 985-605 and is instead within the scope of ASC 605-25. Each software deliverable in an arrangement must be evaluated to determine if it is essential to the functionality of the product. Some arrangements include both software deliverables that are essential to the product's functionality that are within the scope of ASC 605-25 and nonessential software deliverables that are within the scope of ASC 985-605.

#### Example 9 – Essential software

Entity A sells a medical device with diagnostic software. The diagnostic software, along with the device, provides the device's essential functionality. The entity does not sell the device without the diagnostic software.

Entity A concludes that the medical device and diagnostic software function together to deliver the tangible product's functionality. Both elements would be outside the scope of ASC 985-605.

**Modifications to accounting for multiple-element revenue arrangements**

**Example 10 – Essential software sold separately**

Using the facts from the example above, assume that Entity A sells the diagnostic software separately, but that it does not sell the medical device without the diagnostic software.

Entity A concludes that the diagnostic software is essential to delivering the functionality of the medical device and that the medical device with the embedded diagnostic software is outside the scope of ASC 985-605. However, an arrangement to sell the diagnostic software without the medical device would be within the scope of ASC 985-605 because the amendments to ASC 985-605 provide a scope exception only for software sold with a tangible product.

**Allocation**

**B-2: How does an entity allocate consideration to deliverables that function together to provide a tangible product’s essential functionality if the arrangement contains other deliverables included in the scope of ASC 605-25?**

The tangible product, which includes the essential software component, is considered a single unit of accounting under the amended guidance of ASC 605-25. All other deliverables in the arrangement would be assessed for separation using the amended guidance in ASC 605-25. If the separation criteria in ASC 605-25 are met, the relative selling price method must be used to allocate arrangement consideration to the tangible product, which includes the software component, and to the other deliverables within the scope of ASC 605-25.

**Example 11 – Tangible product and PCS**

On January 1, 20X0, Entity A enters into an arrangement to sell a medical device with diagnostic software that, along with the hardware, provides the device’s essential functionality. Entity A never sells the device and the diagnostic software separately. Also included in the arrangement is postcontract customer support (PCS), including a right to when-and-if-available upgrades of the software. Total arrangement consideration is \$1,000. The PCS does not qualify as separately-priced extended warranty under ASC 605-20, “Services,” 25-3 (formerly FASB Technical Bulletin 90-1 *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*).

The deliverables, which include the device and PCS, have stand-alone value, and the arrangement does not contain any refund rights. Since the hardware (nonsoftware component) and software (software component) function together to deliver the tangible product’s essential functionality, these components are both excluded from the amended scope of ASC 985-605. In addition, because the PCS relates to software that is essential to the device’s functionality, it is also excluded from the scope of ASC 985-605. The entity does not have VSOE or TPE for the device, but does have VSOE of \$100 for the PCS. The entire arrangement is assessed for separation, measurement, and allocation in accordance with the amended guidance in ASC 605-25.

Entity A would allocate the arrangement consideration to the deliverables using the relative selling price method. Entity A determined the estimated selling price for the device is \$1,000. The table below summarizes the relative selling price allocation.

Unit of account	Selling price	Ratio	Arrangement consideration allocation
Medical device	\$1,000	91%	\$10
PCS	100	9%	90
	<b>\$1,100</b>	<b>100%</b>	<b>\$1,000</b>

**Modifications to accounting for multiple-element revenue arrangements**

**Example 12 – Tangible product, PCS, and specified upgrade**

In addition to the facts included in Example 11 above, assume the arrangement also includes a specified upgrade right related to the software. Entity A does not have VSOE or TPE for the specified upgrade right. Because the specified upgrade right relates to software that is essential to the device's functionality, it is excluded from the scope of ASC 985-605. Under the amended guidance in ASC 605-25, Entity A determined the estimated selling price for the specified upgrade to be \$50.

Entity A would allocate the arrangement consideration to the deliverables using the relative selling price method.

Unit of account	Selling price	Ratio	Arrangement consideration allocation
Medical device	\$1,000	87%	\$870
PCS	100	9%	90
Specified upgrade	50	4%	40
	<b>\$1,150</b>	<b>100%</b>	<b>\$1,000</b>

**B-3: How does an entity allocate consideration to software and nonsoftware deliverables in a multiple-element arrangement that includes a tangible product?**

If a multiple-element arrangement includes a tangible product with both essential and nonessential software components, the arrangement consideration should first be allocated to the nonsoftware and software component groups, based on the relative selling price method in the amended guidance in ASC 605-25. An entity should then apply the amended separation, measurement, and allocation guidance in ASC 605-25 to determine whether the nonsoftware items can be further separated and, if so, how to allocate the nonsoftware consideration to those separate units of accounting. An entity should apply the guidance in ASC 985-605 to determine whether the software components can be further

separated and, if so, how to allocate the software consideration and recognize revenue for those units of accounting.

If a single undelivered element relates to software components that are both within and outside the scope of ASC 985-605, that undelivered element must be bifurcated into a software deliverable and a nonsoftware deliverable using the amended guidance in ASC 605-25. The resulting software deliverable is accounted for under the guidance of ASC 985-605, and the nonsoftware deliverable is accounted for under other appropriate revenue guidance.

The following examples illustrate how arrangement consideration is allocated among deliverables in an arrangement containing a tangible product and both essential and nonessential software components, including PCS that covers both the essential and nonessential software.

## Modifications to accounting for multiple-element revenue arrangements

### Example 13 – Essential and nonessential software (no VSOE)

On January 1, 20X0, Entity A enters in an arrangement to sell a medical device with diagnostic software that, along with the hardware, provides the device's essential functionality. Entity A never sells the device and the software separately. The device also includes pre-installed advanced reporting and analysis software (collectively, the "reporting software"), which is sold both installed on the device and separately from the device. The reporting software enables users to manipulate data, prepare customized reports, and interface data with other software. The arrangement also includes one year of PCS covering both the diagnostic software and the reporting software. The reporting software is never sold without one year of PCS when it is sold separately from the medical device. Total arrangement consideration is \$1,200. The PCS does not qualify as a separately-priced extended warranty under ASC 605-20-25-3.

Because the hardware (nonsoftware component) and diagnostic software (software component) function together to deliver the device's essential functionality, these components (collectively the "nonsoftware component") are excluded from the scope of ASC 985-605. The reporting software is a software deliverable that is not considered essential to the device's functionality and therefore is within the scope of the software guidance in ASC 985-605.

All of the deliverables have stand-alone value and the arrangement does not contain any refund rights. Due to significant fluctuations in renewal pricing, Entity A does not have VSOE or TPE for PCS sold in any of its arrangements. Because the PCS in this arrangement relates to components both within (reporting software is not essential to the medical device's functionality) and outside (diagnostic software is essential to the device's functionality) the scope of ASC 985-605, it must be bifurcated between the software and nonsoftware components using the relative selling price method in the amended guidance in ASC 605-25. Entity A determined that the estimated selling prices for the nonsoftware and software components, each, as a group, are \$975 and \$325, respectively. The nonsoftware group is comprised of the medical device (including the diagnostic software) and the related PCS. The software group includes the reporting software and the related PCS.

Entity A would allocate the arrangement consideration to the software and nonsoftware component groups using the relative selling price method. The table below summarizes the results of the relative selling price allocation.

Group	Deliverables	Selling price	Ratio	Arrangement consideration allocation
Nonsoftware Software	Medical device* and related PCS	\$975	75%	\$900
	Reporting software and related PCS	325	25%	300
		<b>\$1,300</b>	<b>100%</b>	<b>\$1,200</b>

\*including essential diagnostic software

Entity A would assess the appropriate guidance in ASC 605-25 and ASC 985-605 for the nonsoftware and software components, respectively, to determine whether further separation of deliverables within the groups should be made.

The nonsoftware components fall within the scope of ASC 605-25. Entity A determined that the medical device (including the essential software) and the related PCS meet the separation criteria. Entity A also determined that its best estimate of selling price for the device (including the essential software) and for the related PCS that was bifurcated to the essential diagnostic software is \$885 and \$90, respectively.

Entity A would allocate the arrangement consideration to the nonsoftware deliverables using the relative selling price method in the amended guidance in ASC 605-25. The table below summarizes the results of the relative selling price allocation.

Deliverables	Selling price	Ratio	Arrangement consideration allocation
Medical device*	\$885	91%	\$819
Related PCS	90	9%	81
	<b>\$975</b>	<b>100%</b>	<b>\$900</b>

\*including diagnostic software

Assuming all other revenue criteria have been met, Entity A would recognize \$819 upon delivery of the medical device and \$81 ratably over the one-year PCS service period.

Since the software group falls within the scope of ASC 985-605, it is held to the VSOE threshold for separating elements. Entity A does not have VSOE for the PCS related to the reporting software. As a result, it would account for the reporting software and the related PCS as a single unit of accounting. Assuming all other revenue criteria have been met, Entity A would recognize revenue of \$300 for the software components ratably over the one-year PCS service period.

## Modifications to accounting for multiple-element revenue arrangements

### Example 14 – Essential and nonessential software (VSOE)

Assume the same facts in Example 13 above, except that Entity A previously established VSOE for PCS based on renewals (stand-alone sales), as follows.

Arrangement	VSOE
PCS for medical device and essential diagnostic software	\$85
PCS for reporting software	\$50

Also assume Entity A determined that its best estimate of selling price for the medical device (and essential diagnostic software), without PCS, is \$900.

Entity A would allocate the arrangement consideration to the software and nonsoftware component groups using the relative selling price method. The table below summarizes the relative selling price allocation.

Group	Deliverables	Selling price*	Ratio	Arrangement consideration allocation
Nonsoftware	Medical device** and related PCS	\$985	75%	\$900
Software	Reporting software and related PCS	325	25%	300
		<b>\$1,310</b>	<b>100%</b>	<b>\$1,200</b>

\*Selling price for the nonsoftware component is computed as \$900 for the medical device (including essential diagnostic software) based on the entity's best estimate of selling price, plus \$85 VSOE for the PCS related to the essential diagnostic software. Selling price for the software component was determined to be \$325 based on the entity's best estimate of selling price.

\*\*including diagnostic software

Entity A would further allocate the nonsoftware arrangement consideration of \$900 between the medical device and the related PCS using the relative selling price method.

The table below summarizes the relative selling price allocation.

Deliverables	Selling price	Ratio	Arrangement consideration allocation
Medical device*	\$900	91%	\$819
Related PCS	85	9%	81
	<b>\$985</b>	<b>100%</b>	<b>\$900</b>

\*including essential diagnostic software

Assuming all other revenue criteria have been met, Entity A would recognize \$819 upon delivery of the medical device and \$81 ratably over the one-year PCS service period.

The \$300 of consideration relating to the software component falls within the scope of ASC 985-605 and is allocated based on that guidance. Since Entity A has VSOE for the undelivered element—that is, PCS related to the reporting software—it would allocate arrangement consideration to the software component deliverables using the residual method. Under the residual method, \$50 representing VSOE of the PCS related to the productivity software is allocated to the \$300 software component. The remaining \$250 is allocated to the productivity software.

Assuming all other revenue criteria have been met, Entity A would recognize \$250 upon delivery of the medical device, which includes the reporting software, and \$50 for the related PCS ratably over the one-year service period.