FINANCIAL ACCOUNTING STANDARDS BOARD
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September 30, 2009

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the September 9–10, 2009 meeting of the FASB Emerging Issues Task Force and an inventory of open issues for the next EITF meeting. Also included is a confidential version of the minutes that has been marked for changes from the September 24, 2009 Fatal Flaw draft. After your review, please discard the confidential marked version of the minutes.

November Meeting
The next EITF meeting will be held on **November 19, 2009,** at the FASB offices in Norwalk, Connecticut. Please plan for the meeting to begin on Thursday, November 19, at 8:30 a.m. and conclude no later than 5:00 p.m. The meeting times are tentative and may change. Coffee will be available and lunch will be provided. As a reminder, the FASB will not be hosting a dinner for the November meeting.

Minutes
We plan to make minutes available **after 4:00 p.m.** on the following days:

Draft minutes available	**November 24, 2009**
Final minutes available	**December 8, 2009.**

Please call me at 203.956.5226 if you have any questions.

Sincerely,

Chad I. Bonn
Practice Fellow
cibonn@fasb.org

Emerging Issues Task Force
Meeting Minutes
September 9–10, 2009

0909FN

MINUTES OF THE SEPTEMBER 9–10, 2009 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Wednesday, September 9, 2009
Starting Time: 1:45 p.m.
Concluding Time: 5:00 p.m.

Thursday, September 10, 2009
Starting Time: 8:30 a.m.
Concluding Time: 2:15 p.m.

Task Force Members Present:
Russell G. Golden (Chairman)
Mark M. Bielstein
Mitchell A. Danaher
James G. Campbell
Jay D. Hanson[1]
Stuart H. Harden
Jan R. Hauser
Carl Kampel
Mark LaMonte
Carlo D. Pippolo
Matthew L. Schroeder
*R. Harold Schroeder
Ashwinpaul C. (Tony) Sondhi
Robert Uhl
*Lawrence E. Weinstock
James L. Kroeker (SEC Observer)

Task Force Members Absent:
None

*** For certain issues only.**

[1] Mr. Hanson also served as the AcSEC Observer.

Others at Meeting Table:
Leslie F. Seidman, FASB Board Member
Larry W. Smith, FASB Board Member
Marc A. Siegel, FASB Board Member
Shelly C. Luisi, SEC Senior Associate Chief Accountant
Chad I. Bonn, FASB Practice Fellow
* Kristofer E. Anderson, FASB Practice Fellow
* Kenneth B. Bement, FASB Project Manager
* Kevin W. Brower, FASB Practice Fellow
* Sriprasadh Cadambi, FASB Practice Fellow
* Trevor Farber, FASB Practice Fellow
* Bradley J. Homant, FASB Practice Fellow
* Diane C. Inzano, FASB Practice Fellow
* Adrian E. Mills, FASB Practice Fellow

* For certain issues only.

ADMINISTRATIVE MATTERS

- An FASB staff member announced that beginning with the September 9–10, 2009 EITF meeting, any consensus or consensus-for-exposure will no longer be issued in the form of an abstract or a draft abstract, but rather as an Accounting Standards Update (Update) or a proposed Accounting Standards Update (proposed Update). An EITF consensus is considered to be a generally accepted accounting principle when the FASB Accounting Standards Codification™ reflects the amendments set forth in the ASU. The FASB staff member noted that these documents are expected to be similar in appearance and content to all other ASUs issued by the FASB.

- An FASB staff member solicited objections to the final minutes of the June 18, 2009 meeting. No objections were noted.

- An FASB staff member noted that the following edit has been made to the final abstract for EITF Issue No. 09-1, "Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing," that was included with the final minutes of the June 18, 2009 EITF meeting to conform the transition guidance in the abstract (Appendix 09-1A) to the guidance in the final Codification Amendments (Appendix 09-1B) for that Issue.

  1<u>4</u>~~1~~. This Issue is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years<u> for arrangements outstanding as of the beginning of those fiscal years</u>. ~~Early adoption is not permitted.~~ This Issue requires retrospective application for all arrangements outstanding as of the beginning of fiscal year<u>s</u> <u>beginning on or after December 15, 2009</u>~~in which this Issue is initially applied~~. <u>This Issue is effective for interim or annual periods beginning on or after June 15, 2009, for share-lending arrangements entered into in those periods. Early application of this Issue is prohibited.</u>

- The SEC Observer stated that the SEC staff is currently updating several *EITF Abstracts*, D-Topics (SEC announcements made at EITF meetings and recorded in Appendix D of the *EITF Abstracts*). The SEC Observer stated that most changes are updates necessary to conform SEC guidance to the FASB Accounting Standards Codification™ format or modifications to SEC guidance needed as a result of recently issued accounting standards and do not represent new guidance. However, the SEC Observer announced a change to a previously held staff view, as documented in footnote 4 of Codification section 855-10-S99-2 (formerly Topic D-86), *Issuance of Financial Statements*. Previously, the staff considered posting of financial statements to a registrant's website not to be wide distribution to all shareholders and other financial statement users. Consistent with the Commission's interpretive guidance in Exchange Act Release No. 58288 (August 7, 2008), the staff now considers the posting of financial statements to a registrant's website to be wide distribution to all shareholders and other financial statement users if the registrant uses its website to disclose information to the public in a manner consistent with the requirements of Regulation FD.

- An FASB staff member announced that any consensuses-for-exposure reached at this meeting will be considered by the Board for ratification and exposure for public comment at the Board meeting on Wednesday, September 23, 2009. Any consensuses-for-exposure reached at prior meetings that are affirmed as consensuses at this meeting will also be considered by the Board for ratification at the Board meeting on Wednesday, September 23, 2009.

- November 2009 EITF meeting. An FASB staff member asked the Task Force to anticipate a one-day EITF meeting to be held on November 19, 2009. Subsequent to the meeting, the FASB staff determined that there would not be an extra EITF meeting held on October 15, 2009.

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 08-1

Title: Revenue Arrangements with Multiple Deliverables

Dates Discussed: March 12, 2008; June 12, 2008; September 10, 2008; November 13, 2008; March 19, 2009; June 18, 2009; September 9–10, 2009

References: FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*

FASB Accounting Standards Codification Topic 310, *Receivables*

FASB Accounting Standards Codification Topic 360, *Property, Plant, and Equipment*

FASB Accounting Standards Codification Topic 605, *Revenue Recognition*

FASB Accounting Standards Codification Topic 730, *Research and Development*

FASB Accounting Standards Codification Topic 840, *Leases*

FASB Accounting Standards Codification Topic 926, *Entertainment—Films*

FASB Accounting Standards Codification Topic 985, *Software*

FASB Statement No. 13, *Accounting for Leases* (now under Topic 840)

FASB Statement No. 45, *Accounting for Franchise Fee Revenue* (now under Topic 952)

FASB Statement No. 48, Revenue Recognition When Right of Return Exists (now under Topic 605)

FASB Statement No. 66, Accounting for Sales of Real Estate (now under Topic 360)

FASB Statement No. 68, Research and Development Arrangements (now under Topic 730)

FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (now under Topic 310)

FASB Statement No. 154, Accounting Changes and Error Corrections (now under Topic 250)

FASB Statement No. 157, Fair Value Measurements (now under Topic 820)

FASB Statement No. 162, The Hierarchy of Generally Accepted Accounting Principles

FASB Technical Bulletin No. 90-1, Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts (now under Topic 605)

FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises

AICPA Accounting Research Bulletin No. 45, Long-Term Construction-Type Contracts (now under Topic 605)

AICPA Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts (now under Topic 605)

AICPA Statement of Position 97-2, Software Revenue Recognition (now under Topic 985)

AICPA Statement of Position 98-9, Modification of SOP 97-2, Software Recognition, With Respect to Certain Transactions

AICPA Statement of Position 00-2, Accounting by Producers or Distributors of Films (now under Topic 926)

SEC Staff Accounting Bulletin No. 104, Topic 13, Revenue Recognition (now under Topic 605)

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" (now under Topic 605)

EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" (now under Topic 605)

EITF Issue No. 08-9, "Milestone Method of Revenue Recognition"

EITF Issue No. 09-3, "Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements"

Introduction

1. Entities often enter into revenue arrangements that provide for multiple payment streams. For example, a service provider may receive an up-front payment upon signing a service contract with a customer and then receive additional payments as services are provided to that customer. Other examples can be more complex, such as in biotechnology and pharmaceutical research and development arrangements, because they may involve multiple deliverables, up-front payments, payments for specific services, and payments upon achievement of certain clinical milestones. If delivery of a single unit of accounting spans multiple accounting periods or deliverables, an entity needs to determine how to allocate the multiple payment streams (arrangement consideration) attributable to that unit of accounting to those accounting periods.

2. The ultimate objective of attributing arrangement consideration to a single unit of accounting is to determine when the arrangement consideration should be recognized as revenue. The fundamental criteria for revenue recognition are set forth in Concepts Statement 5, paragraph 83, which states that "recognition involves consideration of two factors, (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important consideration." Generally, revenue is considered both realizable and earned when each one of the following four conditions is met:

a. Persuasive evidence of an arrangement exists
b. The arrangement fee is fixed or determinable
c. Delivery or performance has occurred
d. Collectibility is reasonably assured.

3. This Issue considers the determination of the unit of accounting for an arrangement with multiple deliverables and several other practice issues encountered relating to revenue attribution.

4. Revenue recognition for a single unit of accounting depends on the nature of the deliverable(s) composing that unit of accounting, the corresponding revenue recognition criteria, and whether those criteria have been met. Current guidance does not explicitly address many of the issues encountered by entities in practice. As a result, entities have adopted various accounting methods to attribute revenue in arrangements that have multiple payment streams that are accounted for as a single unit of accounting. Those practice issues can generally be arranged into two categories: those impacting the determination of the unit of accounting under Issue 00-21 and those related to revenue recognition attribution methods. The following issues have been encountered in practice when entities consider the appropriate attribution model for revenue with multiple payment streams:

Unit of Accounting:

1. Whether "access or standing ready to perform" can be a deliverable
2. Whether and how contingent deliverables should impact revenue recognition
3. Whether the fair value threshold requirement of Issue 00-21 needs to be revised

Revenue Recognition Attribution Methods:

4. Whether the milestone method is an acceptable attribution method of revenue recognition
5. How the proportional performance model should be applied to a single unit of accounting composed of multiple deliverables
6. Whether recognition of revenue on a straight-line basis is acceptable when the goods or services may not be delivered ratably over the period.

Prior EITF Discussion

5. At the March 12, 2008 EITF meeting, the Task Force discussed this Issue but was not asked to reach a conclusion. The issues presented at that meeting were:

Issue 1— Whether, under certain facts and circumstances, it may be acceptable to use a multiple attribution model to account for a single unit of accounting consisting of a single deliverable

Issue 2— Whether, under certain facts and circumstances, it may be acceptable to use a multiple attribution model to account for a single unit of accounting consisting of multiple deliverables.

The Task Force requested that the FASB staff perform additional research on the transactions that give rise to the practice concern addressed by this Issue.

6. At the June 12, 2008 EITF meeting, the Task Force was informed that a Working Group had been formed to provide recommendations to the Task Force on this Issue. The Task Force discussed the initial findings of the Working Group but was not asked to reach a conclusion. The Task Force instructed the staff to continue to develop this Issue with the assistance of the Working Group for discussion at a future Task Force meeting.

7. At the September 10, 2008 EITF meeting, the Task Force discussed the results of the Working Group meetings held on July 15, 2008, and August 7, 2008; the Working Group's recommendations; and the specific practice issues that had been identified and discussed by the Working Group. The Working Group made a recommendation that the Task Force not provide specific guidance on Issues 1–4 below and made specific recommendations on Issues 5 and 6 below.

8. The issues are:

Issue 1— Whether "access or standing ready to perform" can be a deliverable

Issue 2— Whether and how contingent deliverables should impact revenue recognition

Issue 3— How the proportional performance model should be applied to a single unit of accounting composed of multiple deliverables

Issue 4— Whether recognition of revenue on a straight-line basis is acceptable when the goods or services may not be delivered ratably over the period

Issue 5— Whether to modify the objective-and-reliable-evidence-of-fair-value threshold of Issue 00-21

Issue 6— Whether to issue guidance on the application of the milestone method of revenue recognition.

9. The Task Force discussed Issues 1–4 and some members noted that in order to address those issues the Task Force may need to create a definition of a deliverable, which they believed would take longer than one year. The definition of a deliverable is currently being addressed in the Board's revenue recognition project. Task Force members also noted that a change to the objective-and-reliable-evidence-of-fair-value threshold in Issue 00-21 might reduce or resolve some of those issues without requiring additional standard setting. Therefore, the Task Force tentatively agreed not to provide guidance on Issues 1–4.

10. The Task Force discussed the Working Group recommendation on Issue 5 and considered whether the objective-and-reliable-evidence-of-fair-value threshold in Issue 00-21 should be modified to allow the use of an estimated selling price for the undelivered unit of accounting in

transactions in which vendor-specific objective evidence (VSOE) or acceptable third-party evidence (TPE) of the selling price for an undelivered unit of accounting are unavailable. Task Force members noted that the absence of objective and reliable evidence of fair value of the undelivered item in an arrangement is a common reason entities are unable to separate deliverables in an arrangement under Issue 00-21 and that this often results in accounting that constituents believe does not reflect the underlying economics of a transaction.

11. The Task Force discussed a model that would amend Issue 00-21 to require an entity to estimate the selling price of the undelivered unit(s) of accounting and allocate the arrangement consideration using the residual method when the entity does not have VSOE or acceptable TPE of the selling price for the undelivered unit(s) of accounting. When estimating the selling price for the undelivered unit of accounting, the Task Force discussed whether the following principle should be applied: the vendor's estimate of selling price shall be consistent with the objective of determining VSOE for the unit of accounting; that is, the price at which the entity would transact if the undelivered item(s) were sold regularly on a standalone basis. The entity must consider market conditions as well as entity-specific factors when estimating the selling price.

12. The Task Force also discussed whether Issue 00-21 should be amended to provide a principle for determining the estimated selling price of the undelivered unit of accounting and to include examples to demonstrate the application of that principle. The Task Force requested that the FASB staff update the existing examples in Issue 00-21 for discussion at the next Task Force meeting and include additional examples illustrating how an entity might develop the estimated selling price for the undelivered unit of accounting.

13. The Task Force also discussed whether the current fair value terminology in Issue 00-21 is intended to represent a fair value measurement consistent with the requirements of Statement 157. The Task Force agreed that the objective of that measurement is not a Statement 157 fair value measurement. The FASB staff notes that Statement 157, paragraph 3(a), excludes from its scope accounting pronouncements that permit measurements that are based on, or otherwise use, VSOE of fair value. Such pronouncements include Issue 00-21 and SOP 97-2, as noted in footnote 3 of Statement 157. The Task Force tentatively concluded that if a consensus on this Issue were to revise Issue 00-21, references to "fair value" should be replaced with references to "selling price" to avoid confusion with Statement 157. The Task Force noted that amendments that refer to selling price are not intended to have an impact on the determination of VSOE and TPE of fair value.

14. The Task Force discussed the Working Group recommendation that the scope of this Issue be limited to the proposed amendments to the fair value threshold of Issue 00-21 and not expanded to include other revenue recognition guidance that contains similar concepts (for example, SOP 97-2). The Task Force tentatively agreed with the Working Group recommendation but requested that the FASB staff seek user input on whether the scope of the proposed amendments to the fair value threshold of Issue 00-21 should be expanded to other revenue recognition guidance. In addition, the Task Force requested that the staff also seek user input on what, if any, additional disclosures should be required as a result of the proposed change in the fair value threshold.

15. The Task Force agreed with the FASB staff recommendation to address Issues 5 and 6 as two separate EITF Issues for discussion at a future EITF meeting since each of those issues has a separate scope. Issue 08-1 now focuses on Issue 5, that is, whether the fair value threshold requirement of Issue 00-21 needs to be revised. Further discussion of Issue 6 is now included in Issue 08-9.

16. At the November 13, 2008 EITF meeting, the Task Force discussed the following issues related to the fair value threshold of Issue 00-21, including consideration of comments received on this Issue:

Issue 1—Whether an entity should be allowed to use its best estimate of selling price for the undelivered item(s) in an arrangement when the deliverable(s) in that arrangement is within the scope of SOP 97-2

Issue 2— Whether an entity should be allowed to use a method other than the residual method of allocating arrangement consideration when the selling price of the undelivered unit(s) of accounting is based on the vendor's best estimate

Issue 3— Whether the Task Force agrees with the FASB staff's modifications to the application guidance of Issue 00-21

Issue 4— Whether the Task Force agrees with the FASB staff's modifications to the examples included in Exhibit 00-21B of the draft abstract.

The Task Force also considered a draft abstract prepared by the FASB staff marked to show proposed amendments to Issue 00-21 resulting from the Task Force's tentative conclusions reached at the September 10, 2008 EITF meeting.

17. On Issue 1, the Task Force discussed two comment letters (from entities that sell software-enabled devices accounted for under SOP 97-2) that recommended that the scope of Issue 08-1 be expanded to include transactions within the scope of SOP 97-2. The Task Force also considered the input received by the FASB staff from users of financial statements of software entities. Those users stated that they believed that contracts accounted for under SOP 97-2 should not require or allow deliverables to be accounted for as separate units of accounting based on an estimate of the selling price of undelivered elements when the company did not have VSOE. The Task Force considered whether to (a) expand the scope of Issue 08-1 to include transactions accounted for under SOP 97-2, (b) expand the scope of Issue 08-1 to specifically include revenue related to software-enabled devices, or (c) not expand the scope of Issue 08-1 but recommend a separate project to evaluate the scope of SOP 97-2 and the accounting for revenue arrangements with multiple deliverables within the scope of SOP 97-2. The Task Force reached a consensus-for-exposure that the scope of Issue 08-1 should be the same as the scope of Issue 00-21 and that the scope not be expanded to include deliverables within the scope of SOP 97-2. The Task Force also recommended to the FASB chairman that a separate Issue be added to the EITF agenda to consider changes to the accounting for multiple element arrangements under SOP 97-2. The FASB chairman was present at the meeting and after considering the input from Task Force and Board members, decided to add the Issue to the EITF agenda (refer to Issue 09-3). The Task Force noted that it would be preferable if any amendments arising from future Task Force deliberations on SOP 97-2 were to have an effective date that is consistent with Issue 08-1.

18. On Issue 2, the Task Force reached a consensus-for-exposure that an entity is required to use the residual method of allocating arrangement consideration when the selling price of the undelivered unit(s) of accounting is based on the vendor's best estimate. However, the amount allocated to the delivered unit(s) of accounting as a result of applying this methodology shall not exceed the selling price of the delivered unit(s) of accounting based on VSOE or TPE, if known.

19. On Issues 3 and 4, the Task Force reached a consensus-for-exposure that the draft abstract be modified to include guidance on disclosure, transition, and effective date, and to provide clarifying language to paragraph 17 of the draft abstract.

20. Amendments to Issue 00-21 as a result of the above decisions were provided in a marked format for Task Force consideration.

21. At the March 19, 2009 EITF meeting, the Task Force discussed 16 comment letters received on the draft abstract and the staff's analysis of those letters. The comment letters are summarized below.

Respondent Profile

Type of Respondent	**Number of Letters**
Preparers	7
Industry organizations	6
User group	1
Others	2
Total Number of Letters	16

22. The Task Force considered the following issues raised by respondents:

Issue 1— Whether the Task Force should continue discussion of this Issue and, if so, whether the Task Force should amend the draft abstract to provide an exception to the requirement that a vendor's best estimate of selling price be used in some circumstances in which VSOE or TPE of selling price do not exist

Issue 2— Whether the Task Force should provide additional guidance regarding the definition of standalone value in paragraph 9(a) of the draft abstract

Issue 3— Whether the Task Force should amend the draft abstract to require the use of the relative-selling-price method of allocation and allow for the use of a vendor's best estimate of selling price for the delivered unit(s) of accounting when VSOE or TPE of selling price do not exist. If not, whether the Task Force should retain the limitation of the amount of arrangement consideration that can be allocated to the delivered unit(s) of accounting when using the residual method and whether the Task Force should amend the draft abstract according to changes proposed by the staff to clarify the application of the residual method.

23. On Issue 1, the Task Force agreed to continue discussion of this Issue and not to provide an exception to the requirement to use a vendor's best estimate of selling price when VSOE or TPE of selling price do not exist. In making its decisions, the Task Force discussed the progress of the FASB and IASB joint project on revenue recognition. The Task Force observed that addressing this Issue would provide a short-term improvement for the uneconomic reporting that sometimes can result when applying the current revenue recognition model under Issue 00-21. One Task Force member expressed concern about the reliability of using management estimates in place of VSOE or TPE of selling price and whether entities may default to using an estimated selling price without applying a reasonable amount of effort to obtain VSOE or TPE. That Task Force member also questioned whether the Task Force had provided enough guidance regarding the level of effort that vendors should expend before concluding that VSOE or TPE of selling price could not be determined.

24. The Task Force acknowledged that there may be instances in which estimating the selling price of deliverables may be difficult either because of limited information available from the vendor's own transactions or because of the lack of similar transactions in the marketplace. However, the Task Force observed that separating deliverables into separate units of accounting to recognize revenue upon delivery of a product or performance of a service better reflects the economics of most transactions than not having that ability because the deliverables are required to be accounted for as one unit of accounting. The Task Force discussed an approach to mitigate concerns regarding the reliability of management estimates of selling price through disclosures.

25. On Issue 2, the Task Force observed that there is limited guidance provided on standalone value as that assessment requires judgment. Accordingly, the Task Force agreed not to provide any further clarification to the draft abstract on the issue of standalone value.

26. On Issue 3, the Task Force discussed the staff's recommendation to eliminate the residual method and require the use of the relative-selling-price method when an entity is unable to determine VSOE or TPE of selling price. Task Force members generally agreed that the relative-selling-price method may be a conceptually preferable approach to allocate arrangement consideration, and that the use of the relative-selling-price method would simplify the application of Issue 08-1. Some Task Force members expressed a concern that requiring entities that were previously using the residual method to adopt the relative-selling-price method may result in a significant change in practice for those companies that were previously able to separate deliverables under Issue 00-21.

27. Some Task Force members questioned why the use of a vendor's best estimate of selling price is a valid method for determining selling price only for undelivered products and services when applying the residual method. Those Task Force members indicated that if the use of the vendor's best estimate is a valid method for determining selling price, its use should not be restricted to the residual method.

28. After discussing Issue 3, the Task Force reached a tentative conclusion to eliminate the residual method and require vendors to allocate arrangement consideration using the relative-selling-price method. The Task Force also reiterated its commitment to address the need for enhanced disclosures of management estimates of selling price. Considering the decisions

reached at this meeting, the Task Force agreed that if a new consensus-for-exposure is reached on the application of the relative-selling-price method and enhanced disclosures, a revised draft abstract on Issue 08-1 should be re-exposed to provide constituents with the opportunity to comment on the elimination of the residual method and the proposed disclosures.

29. The Task Force discussed several possible disclosure proposals intended to provide users with sufficient information to understand the extent to which revenue was being recognized using a vendor's best estimate of selling price and the degree to which those estimates may change over time. Accordingly, the Task Force requested that the FASB staff develop a proposal for disclosures with the assistance of both users and preparers. The FASB staff agreed to meet with users and preparers to explore possible disclosures and to present the alternatives to the Task Force at a future meeting.

30. At the June 18, 2009 EITF meeting, the Task Force reached a consensus-for-exposure that the draft abstract previously exposed on December 1, 2008, be modified to include additional guidance on disclosure, transition, and effective date. In addition, the Task Force reaffirmed its decision from the March 19, 2009 meeting to eliminate the use of the residual method of allocation and require a vendor to allocate arrangement consideration at the inception of an arrangement to all deliverables in the arrangement using the relative-selling-price method. The consensus-for-exposure is included in the draft abstract in Appendix 08-1A.

31. The draft abstract contains the following key amendments to Issue 00-21:

a. A vendor is required to allocate arrangement consideration to all deliverables in an arrangement using the relative-selling-price method.
b. The selling price for each deliverable shall be determined using vendor specific objective evidence of selling price, if it exists, otherwise third-party evidence of selling price.
c. If neither vendor specific objective evidence nor third-party evidence of selling price exists for a deliverable, the vendor shall use its best estimate of the selling price for that deliverable when applying the relative-selling-price method.
d. A vendor's best estimate of selling price shall be consistent with the objective of determining vendor specific objective evidence of selling price for the deliverable; that is, the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a standalone basis. The vendor shall consider market conditions as well as entity-specific factors when estimating the selling price.
e. References to "fair value" are replaced with references to "selling price" to clarify that the selling price measure is not a Statement 157 marketplace participant measure.
f. The Task Force reached a consensus-for-exposure that the draft abstract be modified to include guidance on disclosure, transition, and effective date.

Current EITF Discussion

32. At the September 9–10, 2009 EITF meeting, the Task Force discussed the 34 comment letters received on the draft abstract and the staff's analysis of those letters. The Task Force discussed the following issues relating to the comments received on the draft abstract:

Issue 1— Whether the Task Force should continue discussion of this Issue separate from the FASB and IASB joint revenue recognition project.

Issue 2, Question 1— Whether the Task Force should specify that "reasonable estimates" must exist in order to apply either the relative selling price method or the residual method.

Issue 2, Question 2— Whether to affirm its consensus-for-exposure to eliminate the residual method of allocation and require the use of the relative selling price method.

Issue 2, Question 3— If the answer to Issue 2, Question 2, is no and the Task Force decides to retain the residual method, whether the Task Force agrees with the staff's recommended revisions to clarify the application of the residual method?

33. On Issue 1, the Task Force agreed to continue discussion of this Issue separate from the FASB and IASB joint revenue recognition project after considering the support from a majority of respondents (including users).

34. On Issue 2, Question 1, the Task Force reached a consensus not to specify that "reasonable estimates" must exist in order to apply this Issue. Task Force members observed that the comments raised by respondents who favored including such a provision had previously been considered by the Task Force, and did not include any new information that would warrant a change to its previous decision.

35. On Issue 2, Question 2, the Task Force affirmed as a consensus the elimination of the residual method of allocation and the requirement to use the relative selling price method when allocating revenue in a multiple deliverable arrangement. Some Task Force members observed that the comments raised by respondents who favored retaining the residual method had previously been considered by the Task Force. Those Task Force members noted that the relative selling price method is expected to result in a better reflection of the economics of transactions.

36. Some Task Force members questioned whether there should be an option to apply either the relative selling price method or the residual method. Those Task Force members believed that providing such an option may address the cost/benefit concerns raised by some respondents. Other Task Force members observed that providing optionality would impair comparability between entities. Still, other Task Force members did not support the elimination of the residual method because they believed that the ability to reasonably estimate all deliverables would be limited. Those Task Force members believed that the rigor associated with developing VSOE or TPE of selling price results in more reliable financial reporting than allowing estimated selling prices. After discussion, the Task Force decided not to provide an option to use the residual method.

Disclosure

37. The Task Force discussed and reached a consensus not to provide additional guidance on defining *similar arrangements* in determining when information can be aggregated in making certain disclosures. Some respondents had requested such a clarification. Task Force members observed that determining when similar arrangements exist will require judgment and consideration of the significance and relevance of the arrangements to the overall financial statements.

38. The Task Force also discussed a comment repeated by several respondents that the ongoing disclosures included in the draft abstract may be burdensome to preparers and may not provide useful information for users. The FASB staff noted that the staff sought out additional feedback from users on whether they believed that those disclosures would provide them with useful information. The FASB staff noted that of the eight users who provided feedback on this matter, a majority believed that the disclosures would provide useful information and allow them to better understand the timing of an entity's revenue recognition practices and the effect that significant changes in a vendor's business will have on revenue trends. After some discussion, the Task Force reached a consensus to affirm the ongoing disclosure requirements included in the draft abstract.

39. The Task Force also discussed whether the disclosure requirements should be the same for both public and private entities. The Task Force decided that the disclosures should not be different for those entities.

Effective Date, Transition Method, and Transition Disclosures

40. The Task Force affirmed as a consensus that this Issue shall be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier application permitted. However, if a vendor elects earlier application and the period of adoption is not the first reporting period in the vendor's fiscal year, the guidance in this Issue must be applied through retrospective application from the beginning of the vendor's fiscal year. The vendor must disclose the effect of the change to those previously reported periods in the year of adoption.

41. The Task Force also reached a consensus to provide entities with the option of applying this Issue on a retrospective basis in accordance with the guidance in paragraphs 250-10-45-9 and 45-10 on the presentation of accounting changes and error corrections. Task Force members observed that the guidance in Subtopic 250-10 does not permit retrospective application of a new accounting principle to a prior period if it is impracticable to apply it retrospectively to that period.

42. The Task Force reached a consensus on the transition disclosure requirements that an entity shall disclose information that enables users to understand the effect of the change in accounting principle on revenue trends. To satisfy that objective, an entity is required at a minimum to disclose qualitative information by similar types of arrangements. If the effect of adopting this Issue is material, the qualitative information shall be supplemented with quantitative information to satisfy the objective.

Board Ratification

43. At the September 23, 2009 meeting, the Board ratified the consensus reached by the Task Force in this Issue. The draft amendments to the FASB Accounting Standards Codification™ to be included in the Accounting Standards Update are included as Appendix 08-1A.

Status

44. No further EITF discussion is planned.

Appendix 08-1A

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™

Introduction

A1. The Accounting Standards Codification is amended as described in paragraphs 2–31. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u> and deleted text is ~~struck out~~.

Amendments to Subtopic 605-25

A2. Amend paragraphs 605-25-05-1 through 05-2, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-05-1 This Subtopic addresses ~~certain~~ <u>some</u> aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, this Subtopic addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, and how arrangement consideration ~~should~~ <u>shall</u> be measured and allocated to the separate units of accounting in the arrangement.

605-25-05-2 ~~Many entities offer multiple solutions to~~ <u>To meet</u> their customers' ~~needs.~~<u>needs, vendors often provide</u> ~~Those solutions may involve the delivery or performance of~~ multiple products, services, ~~or~~ rights to use assets, <u>or any combination thereof. These vendors transfer the deliverables to the customer</u> and performance may occur at different times or over different periods of ~~time.~~<u>time, and the customer's</u> ~~In some cases, the arrangements include initial installation, initiation, or activation services and involve consideration in the form of a fixed fee or a fixed fee coupled with a continuing payment stream. The continuing payment stream generally corresponds to the continuing performance, and the amount of the~~ payments <u>for these deliverables</u> may be fixed, variable ~~based on future performance~~, or a combination of fixed and variable ~~payment amounts~~.

A3. Amend paragraph 605-25-15-3A, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-15-3A Those Topics may provide guidance with respect to whether and how to allocate consideration of a multiple-deliverable arrangement. Whether deliverables are within the scope of those other Topics is determined by the scope provisions of those Topics, without regard to the order of delivery of that item in the arrangement. The following describes the three categories into which the other Codification Topics fall and the application of this Subtopic or the other Topics in determining separate units of accounting and allocating arrangement consideration:

a. Other ~~Topic addresses~~ Topics address both separation and allocation. If another Topic provides guidance regarding the determination of separate units of accounting and how to allocate arrangement consideration to those separate units of accounting, the arrangement or the deliverables in the arrangement that is within the scope of that Topic shall be accounted for in accordance with the relevant provisions of that Topic rather than the guidance in this Subtopic.

b. Other ~~Topic addresses separation~~ Topics address separation, but not allocation. If another Topic provides guidance requiring separation of deliverables within the scope of that Topic from deliverables not within the scope of that Topic, but does not specify how to allocate arrangement consideration to each separate unit of accounting, such allocation shall be ~~performed~~ based on the ~~a~~ relative selling price of the deliverables ~~fair value basis~~ ~~using the entity's best estimate of the fair value of the deliverables~~ within the scope of that Topic and the deliverables not within the scope of that Topic. For example, leased assets are required to be accounted for separately under the guidance in Subtopics 840-20 and 840-30. See paragraph 605-25-55-3. (~~Solely for~~For purposes of the allocation between deliverables within the scope of another Topic and deliverables not within the scope of that other Topic, ~~an entity's best estimate of fair value is not limited to vendor-specific objective evidence of fair value or third-party evidence of fair value, as those concepts are~~ the selling price shall be determined using the guidance as discussed in paragraphs ~~605-25-30-6B~~605-25-30-6A through 30-6B~~30-9~~.) Subsequent ~~accounting (identification~~identification of separate units of accounting and allocation of arrangement consideration ~~value thereto) for the value allocated~~

to the deliverables not subject to that other Topic would be governed by the provisions of this Subtopic.

c. Other ~~Topic addresses~~ Topics address neither separation nor allocation. If another Topic provides no guidance regarding the separation of the deliverables within the scope of that Topic from those deliverables that are not or the allocation of arrangement consideration to deliverables within the scope of that Topic and to those that are not, then the guidance in this Subtopic shall be followed for purposes of such separation and allocation. (For example, Subtopic 605-35 provides separation and allocation guidance [segmentation provisions] for deliverables within its scope. However, that Subtopic does not provide separation and allocation guidance ~~between~~ for deliverables within its scope and ~~other~~ deliverables not within its scope.) In such circumstances, it is possible that a deliverable subject to the guidance of another Topic does not meet the criteria in paragraph 605-25-25-5 to be considered a separate unit of accounting. In that event, the arrangement consideration allocable to such deliverable shall be combined with the amount allocable to the other applicable undelivered items within the arrangement. The appropriate recognition of revenue then shall be determined for those combined deliverables as a single unit of accounting.

A4. Amend paragraph 605-25-15-4, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-15-4 The guidance in this Subtopic does not address when the criteria for revenue recognition are met or provide revenue recognition guidance ~~on the appropriate revenue recognition convention~~ for a given unit of accounting. For example, this Subtopic does not address when revenue attributable to a unit of accounting shall be recognized based on proportional performance. The timing of revenue recognition for a given unit of accounting ~~will depend~~depends on the nature of the deliverable(s) composing that unit of accounting ~~(and the corresponding revenue recognition convention)~~ and on whether the applicable criteria ~~general conditions~~ for revenue recognition have been met.

A5. Amend paragraph 605-25-25-2, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-25-1 In an arrangement with multiple deliverables, the principles in paragraph 605-25-25-2 and application guidance in Section 605-25-30 and paragraphs 605-25-25-4 through 25-6 shall be used to determine both of the following:

a. Units of accounting, that is, whether the arrangement should be divided into separate units of accounting

b. Measurement and allocation of arrangement consideration, that is, how the arrangement consideration should be measured and allocated among the separate units of accounting.

605-25-25-2 The principles applicable to this Subtopic are as follows:

a. Revenue arrangements with multiple deliverables shall be divided into separate units of accounting if the deliverables in the arrangement meet the criteria in paragraph 605-25-25-5.

b. Arrangement consideration shall be allocated among the separate units of accounting based on their relative selling prices ~~fair values~~ (or as otherwise provided in paragraph~~paragraphs~~ 605-25-30-4 ~~through 30-3~~). The amount allocated to the delivered unit of accounting ~~items~~ is limited as discussed in paragraph 605-25-30-5.

c. Applicable revenue recognition criteria shall be considered separately for separate units of accounting.

A6. Amend paragraphs 605-25-25-5 through 25-6, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-25-3 In applying the guidance in this Subtopic, separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and shall, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary.

605-25-25-4 A vendor shall evaluate all deliverables in an arrangement to determine whether they represent separate units of accounting. That evaluation shall be performed at the inception of the arrangement and as each item in the arrangement is delivered.

605-25-25-5 In an arrangement with multiple deliverables, the delivered item or items shall be considered a separate unit of accounting if both ~~all~~ of the following criteria are met:

a. The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).

b. Subparagraph superseded by Accounting Standards Update 2009-XX.~~There is objective and reliable evidence of the fair value of the undelivered item(s).~~

c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor.

See the flowchart in paragraph 605-25-55-1 for an illustration of these criteria. The criteria for dividing an arrangement into separate units of accounting shall be applied consistently to arrangements with similar characteristics and in similar circumstances.

605-25-25-6 ~~The arrangement consideration allocable to the~~ A delivered item or items that do not qualify as a separate unit of accounting within the arrangement shall be combined with the ~~amount allocable to the~~ other applicable undelivered item(s) within the arrangement. The allocation of arrangement consideration and the ~~appropriate~~ recognition of revenue then shall be determined for those combined deliverables as a single unit of accounting.

A7. Amend paragraphs 605-25-30-2 , with a link to a transition paragraph 605-25-65-1, as follows:

605-25-30-1 The amount of total arrangement consideration must be fixed or determinable other than with respect to the impact of either of the following:

a. Any refund rights or other concessions (collectively referred to as refund rights) to which the customer may be entitled

b. Performance bonuses to which the vendor may be entitled.

605-25-30-2 ~~If there is objective and reliable evidence of fair value (as discussed in paragraphs 605-25-30-7 through 30-9) for all units of accounting in an arrangement, the arrangement consideration shall be allocated to the separate units of accounting based on their relative fair values (the relative fair value method), except as specified in paragraph 605-25-30-4. However, there may be cases in which there is objective and reliable evidence of the fair value(s) of the undelivered item(s) in an arrangement but no such evidence for the delivered item(s). In those cases, the residual method shall be used to allocate the arrangement consideration.~~ Arrangement consideration shall be allocated at the inception of the arrangement to all deliverables on the basis of their relative selling price (the relative selling price method), except as specified in paragraphs 605-25-30-4 through 605-25-30-5. When applying the relative selling price method, the selling price for each deliverable shall be determined using vendor-specific objective evidence of selling price, if it exists; otherwise, third-party evidence of selling price (as discussed in paragraph 605-25-30-6B). If neither vendor-specific objective evidence nor third-party evidence of selling price exists for a deliverable, the vendor shall use its best estimate of the selling price for that deliverable (as discussed in paragraph 605-25-30-6C) when applying the relative selling price method. In deciding whether the vendor can determine vendor-specific objective evidence or third-party evidence of selling price, the vendor shall not ignore information that is reasonably available without undue cost and effort.

A8. Supersede paragraph 605-25-30-3 , with a link to a transition paragraph 605-25-65-1, as follows:

605-25-30-3 Paragraph superseded by Accounting Standards Update 2009-XX.~~Under the residual method, the amount of consideration allocated to the delivered item(s) equals the total arrangement consideration less the aggregate fair value of the undelivered item(s). The reverse residual method (that is, using a residual method to determine the fair value of an undelivered item) is not an acceptable method of allocating arrangement consideration to the separate units of accounting, except as described in the following paragraph.~~

A9. Amend paragraphs 605-25-30-4 through 30-5, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-30-4 To the extent that any separate unit of accounting in the arrangement ~~(including a delivered item)~~ is required by guidance included in another Topic ~~under generally accepted accounting principles (GAAP)~~ to be recorded at fair value (and marked to market each reporting period thereafter), the amount allocated to that unit of accounting shall be its fair value. Under those circumstances, the remainder of arrangement consideration shall be allocated to the other units of accounting in accordance with the requirements in ~~paragraphs~~paragraph 605-25-30-2 ~~through 30-3~~.

605-25-30-5 The amount allocable to ~~a~~ the delivered ~~item or items~~ unit or units of accounting is limited to the amount that is not contingent upon the delivery of additional items or meeting other specified performance conditions (the noncontingent amount). That is, the amount allocable to the delivered ~~item or items~~ unit or units of accounting is the lesser of the amount otherwise allocable in accordance with paragraphs 605-25-30-2 and ~~through 30-4~~605-25-30-4, or the noncontingent amount. Additionally, although Subtopic 605-15 may affect the amount of revenue recognized, the allocated amount is not adjusted for the impact of a general right of return pursuant to that Subtopic. See the Example in paragraphs 605-25-55-13 through 55-18.

605-25-30-6 The measurement of revenue per period shall be limited to the measurement that results from assuming that cancellation of the arrangement will not occur. The amount recorded as an asset for the excess of revenue recognized under the arrangement over the amount of cash or other consideration received from the customer since the inception of the arrangement shall not exceed all amounts to which the vendor is legally entitled, including cancellation fees (in the event of customer cancellation). However, whether a vendor intends to enforce its contractual rights in the event of customer cancellation shall be considered in determining the extent to which an asset should be recorded.

A10. Add paragraphs 605-25-30-6A through 30-6C, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-30-6A Vendor-specific objective evidence of selling price is limited to either of the following:

a. The price charged for a deliverable when it is sold separately

b. For a deliverable not yet being sold separately, the price established by management having the relevant authority (it must be probable that the price, once established, will not change before the separate introduction of the deliverable into the marketplace).

605-25-30-6B Third-party evidence of selling price is the price of the vendor's or any competitor's largely interchangeable products or services in standalone sales to similarly situated customers.

605-25-30-6C The vendor's best estimate of selling price shall be consistent with the objective of determining vendor-specific objective evidence of selling price for the deliverable; that is, the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a standalone basis. The vendor shall consider market conditions as well as entity-specific factors when estimating the selling price.

A11. Amend paragraph 605-25-30-7, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-30-7 Contractually stated prices for individual products or services in an arrangement with multiple deliverables shall not be presumed to be representative of vendor-specific objective evidence, third-party evidence or a vendor's best estimate of selling price~~fair value~~. ~~The best evidence of fair value is the price of a deliverable when it is regularly sold on a standalone basis.~~

A12. Supersede paragraphs 605-25-30-8 through 30-9, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-30-8 Paragraph superseded by Accounting Standards Update 2009-XX.~~Fair value evidence often consists of entity-specific or vendor-specific objective evidence of fair value. As discussed in paragraphs 985-605-25-6 through 25-7, vendor-specific objective evidence of fair value is limited to the following:~~

a. ~~The price charged for a deliverable when it is sold separately~~

b. ~~For a deliverable not yet being sold separately, the price established by management having the relevant authority (it must be probable that the price, once established, will not change before the separate introduction of the deliverable into the marketplace).~~

605-25-30-9 Paragraph superseded by Accounting Standards Update 2009-XX.~~The use of vendor-specific objective evidence of fair value is preferable in all circumstances in which it is available. Third-party evidence of fair value (for example, prices of the vendor's or any competitor's largely interchangeable products or services in sales to similarly situated customers) is acceptable if vendor-specific objective evidence of fair value is not available.~~

A13. Amend paragraph 605-25-50-1, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-50-1 ~~A vendor shall disclose both of the following:~~ The objective of the disclosure guidance in this Section is to provide both qualitative and quantitative information about a vendor's revenue arrangements and about the significant judgments made about the application of this Subtopic and changes in those judgments or in the application of this Subtopic that may significantly affect the timing or amount of revenue recognition. Therefore, in addition to the required disclosures, a vendor shall also disclose other qualitative and quantitative information as necessary to comply with this objective.

~~a. Its accounting policy for recognition of revenue from multiple-deliverable arrangements (for example, whether deliverables are separable into units of accounting)~~

~~b. The description and nature of such arrangements, including performance-, cancellation-, termination-, or refund-type provisions.~~

A14. Add paragraph 605-25-50-2, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-50-2 A vendor shall disclose all of the following information by similar type of arrangement:~~.~~

a. The nature of its multiple-deliverable arrangements

b. The significant deliverables within the arrangements

c. The general timing of delivery or performance of service for the deliverables within the arrangements

d. Performance-, cancellation-, termination-, and refund-type provisions

e. A discussion of the significant factors, inputs, assumptions, and methods used to determine selling price (whether vendor-specific objective evidence, third-party evidence, or estimated selling price) for the significant deliverables

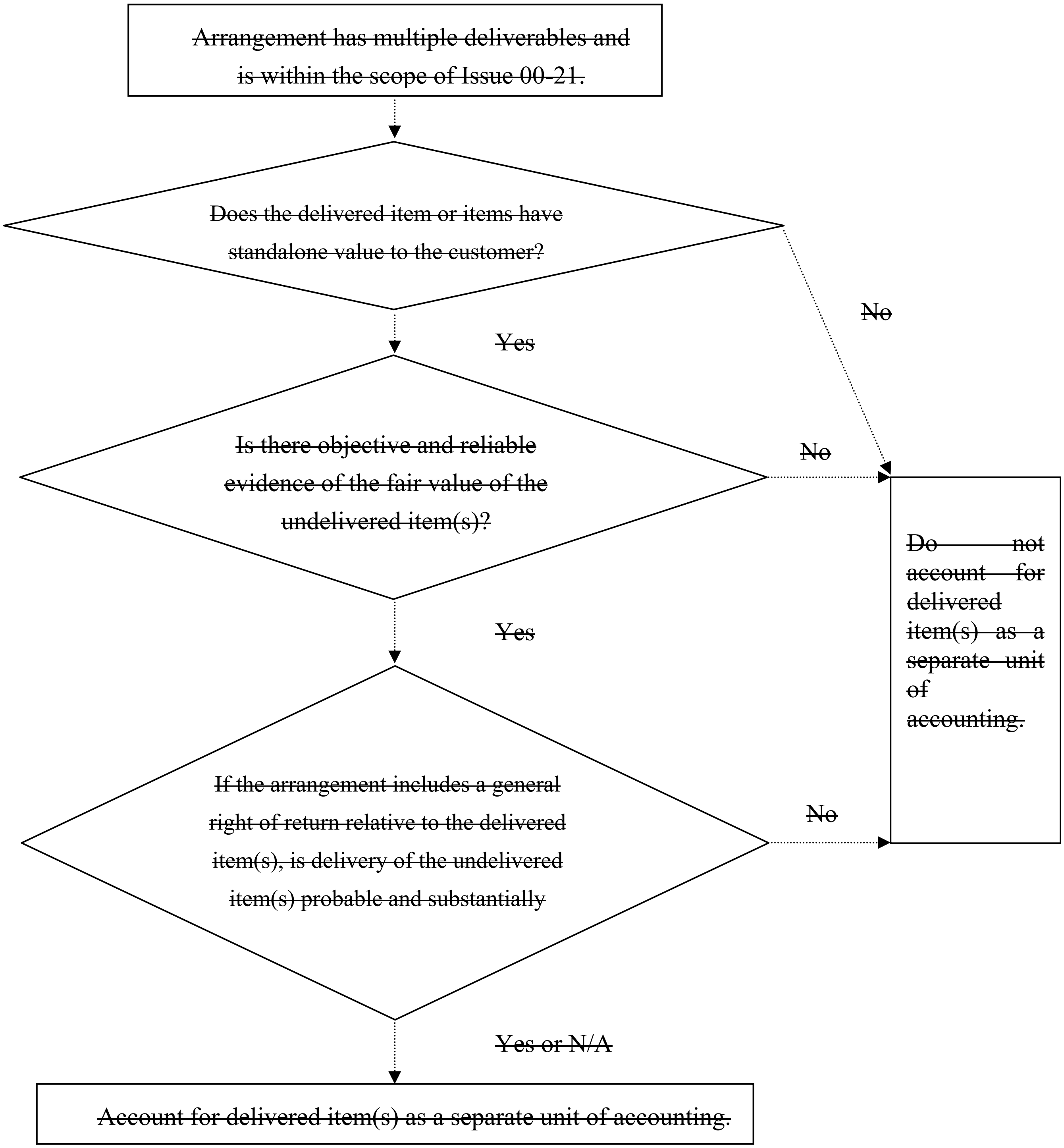
f. Whether the significant deliverables in the arrangements qualify as separate units of accounting~~,~~ and the reasons that they do not qualify as separate units of accounting, if applicable

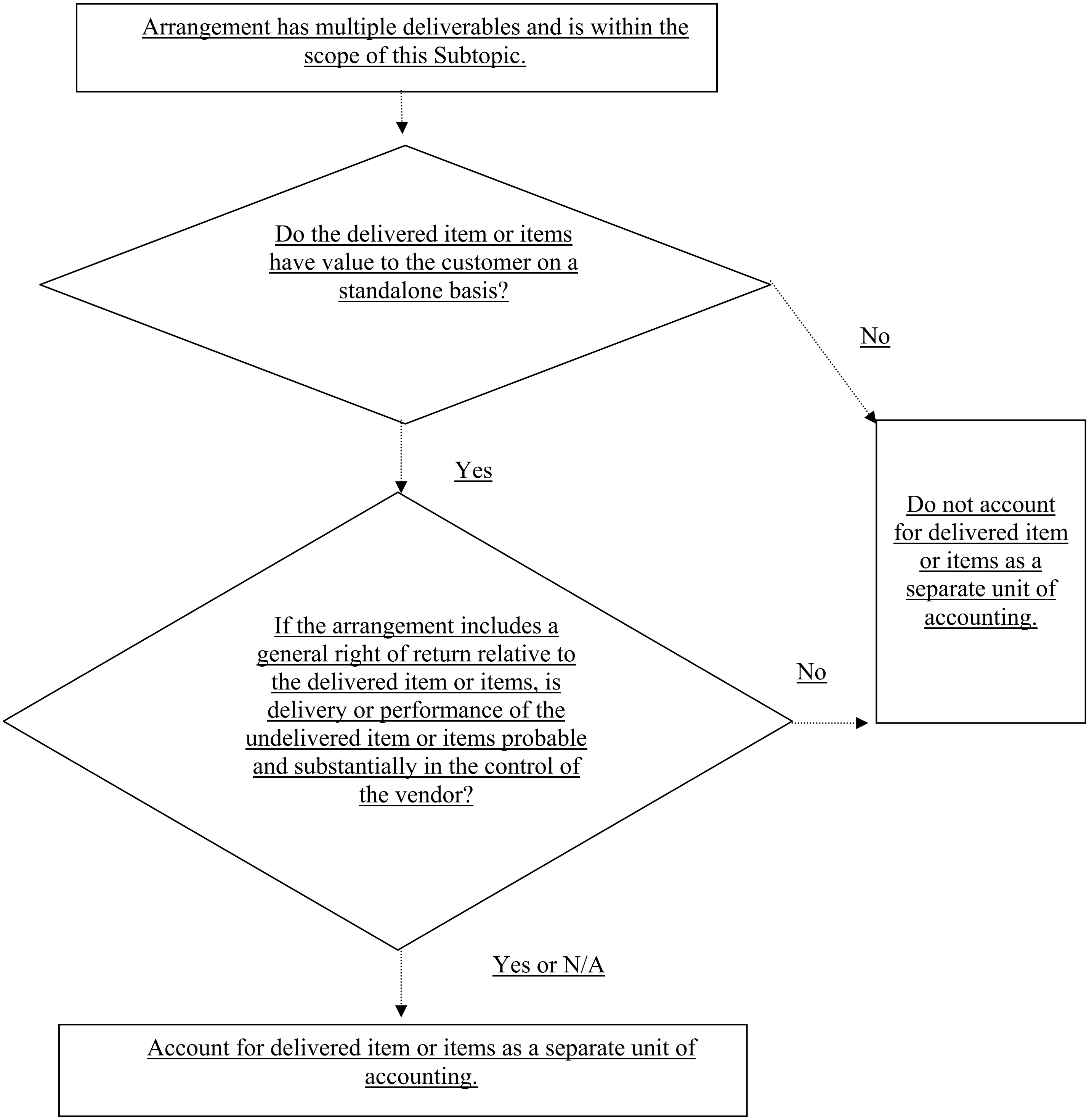
g. The general timing of revenue recognition for significant units of accounting

h. Separately, the effect of changes in either the selling price or the method or assumptions used to determine selling price for a specific unit of accounting if either one of those changes has a significant effect on the allocation of arrangement consideration.

A15. Amend paragraph 605-25-55-1, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-1 This diagram represents an overview of the provisions of this Subtopic with respect to determining the separate units of accounting in an arrangement and should, therefore, be reviewed in conjunction with the guidance in the entire Subtopic.


~~Arrangement has multiple deliverables and is within the scope of Issue 00-21.~~
~~Does the delivered item or items have standalone value to the customer?~~
~~No~~
~~Yes~~
~~Is there objective and reliable evidence of the fair value of the undelivered item(s)?~~
~~No~~
~~Do not account for delivered item(s) as a separate unit of accounting.~~
~~Yes~~
~~If the arrangement includes a general right of return relative to the delivered item(s), is delivery of the undelivered item(s) probable and substantially~~
~~No~~
~~Yes or N/A~~
~~Account for delivered item(s) as a separate unit of accounting.~~


Arrangement has multiple deliverables and is within the scope of this Subtopic.
Do the delivered item or items have value to the customer on a standalone basis?
No
Yes
Do not account for delivered item or items as a separate unit of accounting.
If the arrangement includes a general right of return relative to the delivered item or items, is delivery or performance of the undelivered item or items probable and substantially in the control of the vendor?
No
Yes or N/A
Account for delivered item or items as a separate unit of accounting.

A16. Amend paragraphs 605-25-55-2 through 55-3, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-2 The following provides implementation guidance on how to allocate arrangement consideration to each separate unit of accounting when a ~~multiple element~~ multiple-deliverable arrangement contains deliverables that are within the scope of other ~~Codification~~ Topics and those Topics only provide guidance on how to separate the deliverables (see paragraph 605-25-15-3A(b)).

605-25-55-3 For example, leased assets are required to be accounted for separately under the guidance in Subtopics 840-20 and 840-30. Consider an arrangement that includes the lease of equipment under an operating lease, the maintenance of the leased equipment throughout the lease term (executory cost), and the sale of additional equipment unrelated to the leased equipment. The arrangement consideration should be allocated between the deliverables subject to the guidance in Subtopic 840-20 and the other deliverables using the ~~on a~~ relative selling price method. ~~fair value basis using the entity's best estimate of fair value of the deliverables.~~ (Although ~~that Subtopic~~ Topic 840 does not provide guidance regarding the accounting for executory costs, it does provide guidance regarding the allocation of arrangement consideration between the lease and the executory cost elements of an arrangement. Therefore, this example refers to the leased equipment and the related maintenance as deliverables subject to the guidance in that ~~Subtopic~~ Topic.) The guidance in ~~that Subtopic~~ Topic 840 would then be applied to separate the maintenance from the leased equipment and to allocate the related arrangement consideration to those two deliverables. This ~~Subtopic~~ Topic would be applied to further separate any deliverables not subject to the guidance in ~~that Subtopic~~ Topic 840 and to allocate the related arrangement consideration.

A17. Amend paragraphs 605-25-55-7 through 55-12, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-7 The following Examples provide guidance only with respect to determining whether a multiple-deliverable revenue arrangement contains more than one unit of accounting and, if so, how to measure and allocate the arrangement consideration to the separate units of accounting. As discussed in paragraph 605-25-15-4, this Subtopic (including the Examples) does not address (for any unit of accounting) when the criteria for revenue recognition are met or provide revenue recognition guidance~~ on the appropriate revenue recognition convention~~. The examples illustrate potential application of this Subtopic based on the limited facts presented. The evaluations and disclosures following each of the example fact patterns are not intended to represent the only manner in which the guidance in this Subtopic could be applied. Additional facts would most likely be required to fully evaluate the deliverables, units of accounting, and presentation issues related to these arrangements.

605-25-55-8 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the ~~fair value~~ allocation and contingencies guidance in paragraphs 605-25-30-2 through 30-5.

605-25-55-9 CellularCo runs a promotion in which new customers who sign a two-year contract receive a free phone. ~~The contract requires the customer to pay a cancellation fee of $300 if the customer cancels the contract.~~ There is a one-time activation fee of $50 and a monthly fee of $40 for the ongoing service. The same monthly fee is charged by CellularCo regardless of whether a free phone is provided. The phone costs CellularCo $100. Further, assume that CellularCo frequently sells the phone separately for $120. CellularCo is not required to refund any portion of the fees paid for any reason. CellularCo is a sufficiently capitalized, experienced, and profitable business and has no reason to believe that the two-year service requirement will not be met.

605-25-55-10 CellularCo is considering whether the phone and the phone service (that is, the airtime) are separable deliverables in the arrangement. The activation fee is simply considered additional arrangement consideration to be allocated. The phone and activation are delivered first, followed by the phone service, which is provided over the two-year period of the arrangement.

605-25-55-11 Based on an evaluation of the circumstances, the first condition for separation is met for the phone. That is, the phone has value on a standalone basis because it is sold separately by CellularCo. The second condition is also met because ~~for separation also is met because objective and reliable evidence of fair value exists for the phone service. Finally,~~ there are no general rights of return in this arrangement. Therefore, the phone and the phone service should be accounted for as separate units of accounting.

605-25-55-12 The total arrangement consideration is $1,010. The ~~fair value~~ selling price of the phone service is $960 ($40 ×~~$40x~~ 24 months), the price charged by CellularCo when sold separately. The ~~fair value~~ selling price of the phone is $120, the price of the phone when sold separately by CellularCo. Without considering whether any portion of the amount allocable to the phone is contingent upon CellularCo's providing the phone service, CellularCo would allocate the arrangement consideration on a relative ~~fair value~~ selling price basis as follows: $112.22 [$1,010 ×~~x~~ ($120 ÷ [$120 + $960])] to the phone and $897.78 [$1,010 ×~~x~~ ($960 ÷ [$120 + $960])] to the phone service. However, because a free phone is provided in the arrangement and the customer has no obligation to CellularCo if phone service is not provided, $62.22 (assuming the customer has paid the nonrefundable activation fee) is contingent upon CellularCo's providing the phone service. Therefore, the amount allocable to the phone is limited to $50 ($112.22 −~~-~~ $62.22), and the amount allocable to the phone service is increased to $960.

A18. Amend paragraphs 605-25-55-15 and 605-25-55-17, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-13 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and contingencies guidance in paragraph 605-25-30-5.

605-25-55-14 Entity C sells high-speed aerosol can manufacturing equipment. Entity C sells a complete manufacturing process, which consists of Equipment X, Y, and Z. Entity C does not sell Equipment X, Y, and Z separately; however, other entities do sell the same equipment separately and there is a market for used equipment. Installation is not considered in this Example.

605-25-55-15 Entity C is evaluating ~~revenue recognition~~ whether Equipment X, Y, and Z are separate units of accounting under the following scenario.

605-25-55-16 Entity C delivered Equipment X and Z on March 27, but did not deliver Equipment Y until April 6. Without Equipment Y, the customer does not have use of Equipment X and Z. However, there is an active market for new Equipment X, Y, and Z on a separate basis, as the equipment is often bought separately from other vendors as replacements become necessary. The contract provides that if all pieces of equipment are not delivered, the customer may return Equipment X and Z and have no liability to Entity C. The contract requires delivery of all equipment prior to June 1, and Entity C has sufficient production capacity and inventory to deliver all of the equipment prior to that contractual deadline.

605-25-55-17 Based on an evaluation of the circumstances, the first condition for separation is met for Equipment X and Z. Equipment X and Z have value on a standalone basis because they are sold separately by other vendors. The second condition ~~for separation~~ is also ~~is~~ met because ~~sufficient objective and reliable evidence of the fair value exists for Equipment Y based on the prices charged for the separate pieces of equipment by other unrelated vendors. Finally,~~ there is no general right of return in the arrangement.

605-25-55-18 Therefore, Equipment X, Y, and Z should be accounted for as separate units of accounting. However, even though accounted for as separate units of accounting, the arrangement consideration allocable to both Equipment X and Z is $0 because the full amount otherwise allocable to those separate deliverables is contingent upon the delivery of Equipment Y.

A19. Amend paragraph 605-25-55-19, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-19 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and allocation guidance in paragraph~~paragraphs~~ 605-25-30-2 ~~through 30-3~~.

A20. Amend paragraphs 605-25-55-23 through 55-29, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-20 Entity E is an experienced manufacturer of equipment used in the construction industry. Entity E's products range from small to large individual pieces of automated machinery to complex systems containing numerous components. Unit selling prices range from $200,000 to $2.5 million. Unit selling prices are quoted inclusive of installation.

605-25-55-21 Each equipment model has standard performance specifications and is not otherwise customized for the specific needs of a buyer. Entity E extensively tests the equipment against those specifications prior to shipment. The installation process does not involve changes to the features or capabilities of the equipment and does not require proprietary information about the equipment in order for the installed equipment to perform to specifications.

605-25-55-22 While there are others in the industry with sufficient knowledge about the installation process for the equipment, as a practical matter, most purchasers engage Entity E to perform the installation services. However, some customers choose not to have the equipment installation performed by Entity E for various reasons (for example, their proprietary use of the equipment, their preference that installation be performed by their own employees or other vendors with whom the customers have established relationships, or for their own convenience). If a potential customer wishes to purchase equipment without installation, Entity E will not reduce the quoted selling price for the commensurate value of the installation. If a customer chooses to purchase equipment without installation, there is only one deliverable.

605-25-55-23 Assume that a customer enters into an arrangement to purchase equipment with a price of $200,000 (the price at which Entity E regularly sells the equipment without installation) from Entity E and chooses to have Entity E perform the installation for that equipment. The customer is obligated to pay Entity E the arrangement consideration upon delivery of the equipment. The price of the installation service when it is performed by vendors other than Entity E is $8,000 (third-party evidence of selling price). There are no refund rights (general or otherwise) in the arrangement. Entity E is considering whether the equipment and the installation service are separable units of accounting in the arrangement.

605-25-55-24 Based on an evaluation of the circumstances, the first condition for separation is met for the equipment. The equipment has standalone value as it is sometimes sold separately ~~by Entity E~~. The second condition for separation is also ~~met.~~met because ~~Objective and reliable evidence of the fair value for the installation exists. There is sufficient evidence of the fair value of the installation on a separate component basis (as evidenced by the amount charged by independent third parties). Finally,~~ there are no general refund rights. Therefore, the equipment and the installation are considered separate units of accounting in the arrangement.

605-25-55-25 Regardless of whether the installation is performed, the total arrangement consideration is $200,000. Entity E has either vendor-specific objective evidence or third-party evidence of selling price for all units of accounting in the arrangement. ~~Therefore, consideration in the arrangement would be allocated on a relative fair value basis. In this case, the~~The arrangement consideration of $200,000 ~~would~~ should be allocated to the separate units of accounting using the ~~based on their~~ relative selling price method ~~fair values~~. Thus, allocation of the arrangement consideration would be $192,308 [$200,000 × ($200,000 ÷ [$200,000 + $8,000])] to the equipment and $7,692 [$200,000 × ($8,000 ÷ [$200,000 + $8,000])] to the installation service. Additionally, none of the amount allocable to the equipment is contingent upon performing the installation.

605-25-55-26 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the allocation guidance in paragraph 605-25-30-2.~~residual method allocation in paragraph 605-25-30-3.~~

605-25-55-27 Entity A is an established auto dealer. Entity A's service center provides all scheduled maintenance services (including oil changes) at no additional charge (other than for parts) for any customer who purchases an automobile from Entity A for the period that the customer owns the automobile. The customer also may choose to have the maintenance services performed by others without affecting the vehicle warranty, but most customers utilize Entity A's maintenance services unless they move to a distant location. Neither Entity A nor any other dealer sells the automobile without the lifetime maintenance services. However, Entity A sells maintenance services separately to customers who did not purchase their vehicles from Entity A. The automobiles are sold subject to a limited warranty and there are no refund rights in the arrangement. Customers are obligated to Entity A for all arrangement consideration upon taking delivery of the automobile. Since lifetime maintenance services are not ~~sold~~ separately priced when a customer purchases an automobile from ~~by~~ Entity A, they are not within the scope of Subtopic 605-20.

605-25-55-28 Based on an evaluation of the circumstances, the first condition for separation is met for the automobile because, even though the automobile is not sold separately by any vendor, it is considered to have standalone value because the customer could resell the automobile on a standalone basis. The second condition for separation also is met because~~met. There is sufficient evidence of the fair value of the maintenance services on a separate component basis (as evidenced by the amount charged on a standalone basis by Entity A for maintenance services and data available from which to estimate the volume and types of maintenance services provided during a typical customer's ownership of the vehicle). Finally,~~

there are no refund rights (general or otherwise) in the arrangement. Therefore, the automobile and the maintenance services should be considered separate units of accounting in the arrangement.

605-25-55-29 Because no entity sells the automobile separately, neither vendor-specific objective evidence nor third-party evidence of selling price exists for the automobile. However, there is vendor-specific objective evidence of selling price of the maintenance services (as evidenced by the amount charged on a standalone basis by Entity A for maintenance services and data available from which to estimate the volume and types of maintenance services provided during a typical customer's ownership of the vehicle). As a result, when applying the relative selling price method, Entity A should use its best estimate of selling price for the automobile and vendor-specific objective evidence of selling price for the maintenance. ~~Consideration in the arrangement should be allocated using the residual method. The fair value of the maintenance services should be determined as described in the preceding paragraph. The remaining arrangement consideration should be allocated to the automobile.~~ Additionally, none of the amount allocable to the automobile is contingent upon providing the maintenance services.

A21. Amend paragraphs 605-25-55-30. 605-25-55-32, and 605-25-55-34 through 55-36, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-30 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the interplay between the accounting for a separately priced maintenance agreement in Subtopic 605-20 and the allocation guidance in paragraph 605-25-30-2.~~paragraphs 605-25-30-2 through 30-3.~~

605-25-55-31 Entity S is an experienced home appliance dealer. Entity S also offers a number of services together with the home appliances that it sells. Assume that Entity S regularly sells Appliance W on a standalone basis. Entity S also sells installation services and maintenance services for Appliance W. However, Entity S does not offer installation or maintenance services to customers that buy Appliance W from other vendors. Pricing for Appliance W is as follows:

a. Appliance W only: $ 800

b. Appliance W with installation service: $ 850

c. Appliance W with maintenance services: $ 975

d. Appliance W with installation and maintenance services: $1,000.

605-25-55-32 In each instance in which maintenance services are provided, the maintenance service is separately priced within the arrangement at $175. Additionally, ~~Note also that~~ the incremental amount charged by Entity S for installation of $50 approximates the amount charged by independent third parties.

605-25-55-33 Appliance W is sold subject to a general right of return. If a customer purchases Appliance W with installation and/or maintenance services, and Entity S does not complete the services satisfactorily, the customer is entitled to a refund only of the portion of the fee that exceeds $800.

605-25-55-34 Assume that a customer purchases Appliance W with both installation and maintenance services for $1,000. Based on its experience, Entity S believes that it is probable that installation of the equipment will be performed satisfactorily to the customer. The maintenance services are priced separately and should be accounted for based on the guidance in Subtopic 605-20. Entity S is evaluating whether Appliance W and the installation service represent separate units of accounting. ~~(The maintenance services are separately priced at $175 and should be accounted for based on the guidance in Subtopic 605-20.)~~

605-25-55-35 Based on an evaluation of the circumstances, the first condition for separation is met for Appliance W because it sometimes is sold separately by Entity S. The second condition for separation is also met~~. There is objective and reliable evidence of the fair value of the installation on a separate component basis (as evidenced by the amount charged by independent third parties). The third condition for separation is met~~ because, even though a general right of return exists, performance of the appliance installation is probable and within the control of Entity S. Therefore, Appliance W and installation should be accounted for as separate units of accounting.

605-25-55-36 Entity S would allocate $175 of the arrangement consideration to the maintenance services based on the guidance in Subtopic 605-20. Without considering whether any of the amount otherwise allocable to Appliance W is contingent upon the performance of the installation, Entity S would allocate the remainder of the arrangement consideration ($825) to

Appliance W and the installation service using the relative selling price method. ~~in proportion to their fair values.~~ The ~~fair value~~ vendor-specific objective evidence of selling price of Appliance W is its price when sold separately ($800), and the ~~fair value~~ third-party evidence of selling price of the installation service is the amount charged by independent third parties, which approximates $50. Therefore, the amounts ~~otherwise~~ allocable to Appliance W and to the installation services are $776 [$825 × ($800 ÷ [$800 + $50])] and $49 [$825 × ($50 ÷ [$800 + $50])], respectively. Since the customer is entitled to a refund only of the portion of the fee that exceeds $800 if the installation is not performed, no portion of the amount allocable to Appliance W is contingent upon that installation.

A22. Amend paragraphs 605-25-55-37 through 55-47 and their related headings, with a link to a transition paragraph 605-25-65-1, as follows:

> > Example 6: Human Resources Outsourcing Services ~~Biotech License, Research and Development, and Contract Manufacturing Agreement~~

605-25-55-37 This Example illustrates an approach to estimating the selling price of deliverables under paragraph 605-25-30-6C when neither vendor-specific objective evidence nor third-party evidence of selling price exists. The approach in this Example should not be considered the only appropriate approach to estimating the selling price of the deliverables. ~~This Example illustrates the combined unit of accounting method in paragraph 605-25-25-6 and the residual method of allocation in paragraph 605-25-30-3.~~

605-25-55-38 Entity HR provides its customers with human resource solutions (for example, support and guidance in areas such as employee relations, payroll and taxes, health benefits administration, 401(k) administration). Customers may do one of the following:

- ~~a.~~ Choose a prepackaged bundle of services.
- ~~b.~~ Customize an existing bundle of services.
- ~~c.~~ Select the individual services they require.

Because of the many services provided by Entity HR and its customers' varying needs, no two arrangements are exactly alike. Entity HR prices its arrangements on the basis of the unique bundle of services to be provided. As a result, Entity HR does not have vendor-specific objective evidence of selling price for any individual service that it provides. Although each service is sold separately by other vendors, and while Entity HR has some information about its competitors' pricing, it is unable to obtain third-party evidence of selling price for any individual service. ~~Biotech Company (Biotech) enters into an agreement with Pharmaceutical Company (Pharma). The agreement includes all of the following:~~

a. Subparagraph superseded by Accounting Standards Update 2009-XX.~~Biotech licensing certain rights to Pharma~~

b. Subparagraph superseded by Accounting Standards Update 2009-XX.~~Biotech providing research and development services to Pharma~~

c. Subparagraph superseded by Accounting Standards Update 2009-XX.~~Biotech contract manufacturing product for Pharma.~~

605-25-55-39 Assume that on January 1, 20X1, Entity HR begins providing human resource solution services to Customer Y under a three-year arrangement. Under the arrangement, Entity HR agrees to provide Customer Y with payroll processing, three periodic training events, employee handbook development, and an executive compensation assessment. The executive compensation assessment and employee handbook development are expected to be completed by June 30, 20X1, and 20X2, respectively. Entity HR expects to provide one training event annually. Total compensation under the arrangement is $1,275,000. Entity HR receives compensation under the arrangement as follows: an upfront payment of $375,000 and monthly payments of $25,000. There are no general refund rights included in the arrangement. ~~Additional details on each of those aspects of the agreement are as follows:~~

~~a. License. Biotech licenses certain rights on an exclusive basis to Pharma for a period of 10 years. The license gives Pharma the exclusive right to market, distribute, and manufacture Drug B as developed using Technology A. Biotech retains all ownership rights to Technology A and Drug B. There are no when-and-if-available clauses or other performance obligations associated with the license, except as described in this paragraph.~~

~~b. Research and development. Biotech agrees to provide research and development services on a best-efforts basis to Pharma. Biotech agrees to devote four full-time equivalents to the research and development activities, and Pharma expects to devote several full-time equivalents to the research and development activities as well. The objective of the research~~

~~and development services is to develop Drug B using Technology A. The ultimate objective is to receive Food and Drug Administration approval on Drug B.~~

~~c. Contract manufacturing. If successfully developed, Biotech agrees to manufacture Drug B for Pharma for a period of five years.~~

605-25-55-40 Entity HR is evaluating whether all of the following represent separate units of accounting and how to allocate arrangement consideration to the separate units of accounting:

a. Payroll processing

b. Periodic training

c. Employee handbook development

d. Executive compensation assessment. ~~Compensation under the arrangement is as follows:~~

~~a. Biotech receives $5 million up-front upon signing the agreement.~~

~~b. Biotech receives $2 million upon meeting each of 4 defined milestones ($8 million in total if all 4 defined milestones are met).~~

~~c. Biotech receives $250,000 per year for each full-time equivalent that performs research and development activities.~~

~~d. Biotech receives cost plus 30 percent for manufacturing Drug B (that is, Biotech will receive compensation for its direct costs plus a 30 percent margin for manufacturing Drug B).~~

~~None of these payments, once received, are refundable, even if Food and Drug Administration approval is never received. In addition, while Biotech must perform on a best-efforts basis, it is not obligated to achieve the milestones.~~

605-25-55-41 Based on an evaluation of the circumstances, Entity HR concludes that there are no units of accounting at inception of the arrangement because no item in the arrangement has been delivered at that date. However, Entity HR will reassess whether a delivered item should be considered a separate unit of accounting each time it performs under the arrangement. ~~While Biotech has licensed certain rights related to Technology A to other parties, Biotech has not~~

~~licensed Technology A to others for use in the development of Drug B. Likewise, Biotech has not licensed the marketing, distribution, or manufacturing rights of Drug B to any other party.~~

605-25-55-42 Entity HR determines that each of the deliverables in the arrangement has standalone value. Because Entity HR does not have either vendor-specific objective evidence or third-party evidence of selling price for the deliverables in the arrangement, Entity HR must use its best estimate of selling price for each deliverable when allocating arrangement consideration under the relative selling price method. ~~Pharma must use Biotech to perform the research and development activities necessary to develop Drug B using Technology A because the know-how and expertise related to Technology A is proprietary to Biotech. In other words, Biotech is the only party capable of performing the level and type of research and development services required by Pharma under the agreement. Biotech has determined that the fees charged for the research and development services (that is, the $250,000 per year for each full-time equivalent that performs research and development activities) are competitive with what other third-party vendors charge for similar research and development services (that is, they represent the fair value of those services). In addition, Biotech regularly provides similar research and development services to other customers for comparable fees. The fees earned by Biotech if it reaches the milestones represent performance bonuses that are contingent only on performance of the research and development services (that is, they are unrelated to the contract manufacturing deliverable and are not part of the fair value of the research and development services).~~

605-25-55-43 In estimating the selling price for the deliverables, Entity HR considered all of the following:

a. Its internal costs

b. Its profit objectives

c. The pricing practices it used to establish the bundled price for its services

d. Whether any market constraints exist that may limit its selling price (for example, whether competitors could charge a lower price for the same service or whether the price for the service exceeds the cost savings to its customers). Entity HR believes that as the price for its service begins to exceed the customers' internal cost, the customers will be less likely to purchase the service. ~~Assuming that the contract manufacturing provided by Biotech could be provided by other contract manufacturers (who would not be dependent on Biotech for critical ingredients), the license agreement gives Pharma the right to manufacture the drug; no proprietary information related to the manufacturing process would preclude other parties from being able to manufacture Drug B. Biotech has determined that cost plus 30 percent is competitive with what other third-party contract manufacturers charge for manufacturing drugs similar to Drug B (that is, it represents the fair value of those services). In addition, Biotech regularly provides similar contract manufacturing services for other customers for comparable fees.~~

605-25-55-44 When determining the price for its bundled services, Entity HR typically applies a gross profit margin to the cost (primarily labor and other time and expenses) it will incur in providing the contracted services. The profit margin varies with the types of services to be provided and generally includes a discount based on the number of services being purchased. For example, Entity HR typically includes the following gross profit margins, which have been developed over time (by a relevant, authorized level of management) on the basis of available market data and demand for the services:

a. A 26 percent gross profit margin on its payroll processing services

b. A 15 percent gross profit margins on its employee handbook development services and executive compensation assessments

c. A 22 percent gross profit margin on its training services before considering any discount on the total arrangement.

Entity HR believes that these returns are consistent with the gross margins sought by its competitors. In addition, Entity HR has no information that would indicate that a competitor would charge a price that could affect the price Entity HR could charge for its service, either by limiting the price that Entity HR could charge or by allowing Entity HR to increase its price. In addition, Entity HR's analysis also indicates that the price of the individual services calculated using its internal gross profit margins would be in a range in which the service would still be attractive to its customers (that is, the cost of the service would be less than the internal costs for the same service if the customers had to provide the service themselves). ~~Based on an evaluation~~

~~of the circumstances, there are three deliverables in this arrangement that should be considered for separation:~~

~~a. License~~

~~b. Research and development activities~~

~~c. Contract manufacturing.~~

605-25-55-45 Using its internal gross profit margins and the total estimated costs it will incur to deliver the remaining units of accounting and after considering market constraints, Entity HR estimates the selling price for the undelivered units of accounting as follows.

Costs to be incurred for payroll processing for 3 years	$976,250
(1 − Payroll processing gross profit margin of 26 percent)	÷ .74
Estimated selling price for payroll processing	1,319,257
Cost to be incurred for executive compensation assessment	45,223
(1 − executive compensation assessment gross profit margin of 15 percent)	÷ .85
Estimated selling price for executive compensation assessment	53,204
Costs to be incurred for employee handbook	56,113
(1 − Employee handbook gross profit margin of 15 percent)	÷ .85
Estimated selling price for employee handbook	66,015
Costs to be incurred for 3 training events	40,706
(1 −Training event gross profit margin of 22 percent)	÷ .78
Estimated selling price for training events	52,187
Total estimated selling price of all deliverables	$1,490,663

~~The efforts expended by Biotech to reach each of the four defined milestones are considered part of the research and development activities and are not evaluated on a standalone basis. The fees earned by Biotech if it reaches the milestones represent performance bonuses that are contingent only on performance of the research and development services (that is, they are unrelated to the contract manufacturing deliverable).~~

605-25-55-46 Therefore, at January 1, 20X1, Entity HR allocates the arrangement consideration ($1,275,000) as follows (before determining whether any individual deliverable should be considered a separate unit of accounting).

Payroll processing	[1,275,000 × (1,319,257 ÷ 1,490,663)]	$1,128,392
Executive compensation	[1,275,000 × (53,204 ÷ 1,490,663)]	45,507
Employee handbook	[1,275,000 × (66,015 ÷ 1,490,663)]	56,464
3 training events	[1,275,000 × (52,187 ÷ 1,490,663)]	44,637
Total consideration		$1,275,000

~~The license deliverable does not meet the first criterion for separation. The license does not have standalone value to Pharma. Because Drug B has not yet been developed, the license is of no value to Pharma without the ensuing research and development activities using Technology A, which is proprietary to Biotech. Likewise, Pharma could not sell the license to another party (that is, without Biotech's agreeing to provide the research and development activities for that other party).~~

605-25-55-47 At the inception of the arrangement and as each item in the arrangement is delivered, Entity HR must perform an evaluation to determine whether the delivered item represents a separate unit of accounting. If the delivered item does not qualify as a separate unit of accounting, the arrangement consideration allocable to the delivered item shall be combined with the amount allocable to the other applicable undelivered item(s) within the arrangement. ~~On a combined basis, however, the license and research and development activities have value on a standalone basis. That is, in similar arrangements, Biotech has sold the license and research and development separately from the manufacturing process. Additionally, Pharma could sell that combined unit of accounting to another party.~~

A23. Supersede paragraphs 605-25-55-48 through 55-50, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-48 Paragraph superseded by Accounting Standards Update 2009-XX.~~The combined unit of accounting (license and research and development activities) also meets the second criterion for separation from the contract manufacturing because Biotech has objective and~~

~~reliable evidence of the fair value of the contract manufacturing (based on what it and other third parties charge for that type of service).~~

605-25-55-49 Paragraph superseded by Accounting Standards Update 2009-XX.~~Finally, there are no general rights of return in the arrangement. Therefore, the combined unit of accounting should be considered a separate unit of accounting in the arrangement.~~

605-25-55-50 Paragraph superseded by Accounting Standards Update 2009-XX.~~Biotech has not entered into any other agreements in which it has licensed the marketing, distribution, and manufacturing rights to Technology A for use in the development of Drug B and agreed to perform research and development activities to develop Technology A into Drug B. In addition, given the unique nature of Technology A, third-party fair value evidence for the combined unit of accounting also does not exist. As such, Biotech does not have objective and reliable evidence of the fair value of the combined unit of accounting. Based on that analysis, the method of allocating the arrangement consideration would be the residual method because fair value evidence exists for the contract manufacturing, but not the combined unit of accounting. Because the contract manufacturing deliverable is priced at its fair value, none of the other arrangement consideration should be allocated to the contract manufacturing deliverable.~~

A24. Amend paragraphs 605-25-55-51 through 55-56, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-51 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the allocation guidance in paragraph 605-25-30-2.~~residual method of allocation in paragraph 605-25-30-3.~~

605-25-55-52 Entity M manufactures and sells complex medical equipment to physicians and hospitals for medical scanning purposes. Prior to shipment, each piece of equipment is tested extensively to meet entity and Food and Drug Administration specifications. The equipment is shipped fully assembled, but some installation and setup is required. No other entities sell the same or largely interchangeable equipment.

605-25-55-53 Installation is a standard process, outlined in the owner's manual, consisting principally of uncrating, calibrating, and testing the equipment. A purchaser of the equipment could complete the process using the information in the owner's manual, although it would probably take significantly longer than it would take Entity M's technicians to perform the tasks. Although ~~While the process is not complex and does not involve proprietary information,~~ other vendors do not ~~provide the service.~~install Entity M's equipment, other vendors do provide largely interchangeable installation services for $25,000. Historically, Entity M has never sold the equipment without installation. ~~most~~Most installations are performed by Entity M ~~and are completed~~ within 7 to 24 days of shipment. Installation is included in the overall sales price of the equipment ~~(that is, Entity M does not sell the equipment on a noninstalled basis) and has an estimated fair value of $20,000 (based on per diem rates for technician time)~~.

605-25-55-54 In addition, the customer must pay for cartridges that record images. ~~The retail price of each cartridge is $250. Company~~ Entity M is the only manufacturer of the cartridges ~~but also~~ and it only sells them on a standalone basis to wholesalers ~~wholesale basis~~ through a wide network of distributors. The distributors' retail price for each cartridge is $250. Each cartridge can handle only a specific number of scans. Once a cartridge is exhausted, a new one must be purchased in order to use the equipment. Entity M always sells its equipment with a starter supply of 20 cartridges.

605-25-55-55 The sales price of the arrangement that consists of the equipment, installation, and 20 cartridges is $400,000. The customer is obligated to pay in full upon delivery of the equipment. The customer is entitled to a refund of $25,000 if ~~Company~~ Entity M does not perform the installation or if the 20 cartridges are not delivered. On March 15, Entity M delivers the equipment and on April 5 delivers the 20 cartridges and performs the installation. Entity M is evaluating whether delivery of the equipment represents a separate unit of accounting.

605-25-55-56 Based on an evaluation of the circumstances, the first condition for separation is met for the equipment because, even though Entity M has never sold the equipment without the cartridges, a customer could resell the equipment (in a primary or secondary market). The second condition for separation also is met because ~~objective and reliable evidence of fair value exists for the cartridges and the installation based on third-party evidence and Entity M's entity-specific evidence of fair value. The third condition for separation is met because~~ there are no general rights of return involved in this arrangement. Therefore, the equipment should be accounted for as a separate unit of accounting.

A25. Add paragraphs 605-25-55-56A through 55-56B, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-56A Entity M does not have vendor-specific objective evidence of selling price for the equipment because it does not sell the equipment separately (without installation services and cartridges). In addition, third-party evidence of selling price does not exist as no vendor separately sells the same or largely interchangeable equipment. Therefore, Entity M must use its best estimate of selling price when allocating arrangement consideration. For the cartridges, Entity M uses third-party evidence of the price charged when sold separately by its distributors ($5,000 = 20 × $250). In addition, Entity M has third-party evidence of selling price for the installation ($25,000).

605-25-55-56B In estimating its selling price for the equipment, Entity M considered its cost to produce the equipment, its profit margin for similar arrangements, customer demand, effect of competitors on Entity M's equipment, and other market constraints. After weighing the relevance of the available data points, Entity M estimates its standalone selling price for the equipment to be $385,000. Total selling price for all deliverables in the arrangement on a standalone basis is $415,000.

A26. Amend paragraph 605-25-55-57, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-57 When applying the relative selling price method, Entity M should use its best estimate of selling price for the equipment, third-party evidence of selling price for the cartridges, and third-party evidence of selling price for the installation.~~The residual method should be used to allocate the arrangement consideration.~~ Accordingly, without considering whether any portion of the amount allocable to the equipment is contingent upon delivery of the other items, the amount ~~otherwise~~ allocable to the equipment, cartridges, and installation ~~would be~~ is as follows:

a. ~~$375,000 to the equipment ($400,000 – [$250 × 20] – $20,000)~~ $371,084 to the equipment ($400,000 × [$385,000 ÷ 415,000])

b. ~~$5,000 to the cartridges ($250 × 20)~~ $4,819 to the cartridges ($400,000 × [$5,000 ÷ 415,000])

c. ~~$20,000 to the installation.~~ $24,097 to the installation ($400,000 × [$25,000 ÷ 415,000]).

Additionally, no portion of the amount allocable to the equipment is contingent upon the delivery of the cartridges or performance of the installation. That is, if the cartridges are not delivered and the installation is not performed, Entity M would be entitled to $375,000.

A27. Amend paragraphs 605-25-55-58 through 55-61, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-58 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5, the ~~fair value~~ allocation guidance in paragraph~~paragraphs~~ 605-25-30-2~~ through 30-3~~, and the limitation in paragraph 605-25-30-5 to noncontingent amounts.

605-25-55-59 Entity B sells computer systems. On April 20, a customer purchases a computer system from Entity B for $1,000. The system consists of a central processing unit, a monitor, and a keyboard. Solely for purposes of simplifying this illustration of the application of the guidance in this Subtopic, it is assumed that the provisions of Subtopic 985-605 do not apply. On April 30, Entity B delivers the central processing unit to the customer without the monitor or keyboard. Each of the items is regularly sold ~~can be purchased~~ separately at a ~~cost~~ price of $700 for the central processing unit, $300 for the monitor, and $100 for the keyboard. The central processing unit could function with monitors or keyboards manufactured by others, who have them readily available. The customer is entitled to a refund equal to the separate price of any item composing the system that is not delivered. The arrangement does not include any general rights of return. Entity B is evaluating whether delivery of the central processing unit represents a separate unit of accounting.

605-25-55-60 Based on an evaluation of the circumstances, the first condition for separation is met for the central processing unit, as it is sold separately by Entity B. The second condition for separation is met because ~~the fair values of the undelivered items (keyboard and monitor) are objectively and reliably determined based on the price of that equipment when sold separately by Entity B. The third condition for separation is met because~~ there are no general rights of return. Therefore, the central processing unit would be accounted for as a separate unit of accounting.

605-25-55-61 Entity B has vendor-specific objective evidence of selling price for all deliverables in the arrangement as each is sold regularly on a standalone basis. Without considering whether any portion of the amount allocable to the central processing unit is contingent upon delivery of the other items, Entity B would allocate the arrangement consideration ~~on a~~ using the relative selling price method. ~~fair value basis.~~ Therefore, the portion of the arrangement fee otherwise allocable to the CPU is \$636.36 (\$1,000 × [\$700 ÷ \$1,100]), of which \$36.36 (\$636.36 − [\$1,000 − \$300 − \$100~~\$400~~]) is subject to refund if the monitor and keyboard are not delivered. Therefore, the amount allocable to the central processing unit is limited to \$600, which is the amount that is not contingent upon delivery of the monitor and keyboard.

A28. Amend paragraphs 605-25-55-68 through 55-69, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-62 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the limitation in paragraph 605-25-30-6 to all amounts to which the vendor is entitled, including cancellation fees.

605-25-55-63 Entity D sells fabric for use in manufacturing clothing. Customers may purchase fabric from Entity D in individual 50-yard bolts or in bulk lots consisting of multiple bolts. One of Entity D's customers (Customer A) is a manufacturer of band uniforms that prefers to purchase the fabric in bulk because it needs the fabric to have a high level of consistency in color and quality. Customer A enters into an arrangement with Entity D to purchase a 12-bolt bulk lot of fabric that is to be delivered by Entity D in 3 4-bolt installments over a period of 3 months.

605-25-55-64 At Customer A's request, Entity D provides a customer satisfaction guarantee that it will refund double the price (up to a maximum of the total arrangement fee) for each bolt of fabric that is not delivered or not delivered from the same dye lot as the initial installment. That is, the double-money-back guarantee provides that, in addition to having no obligation for bolts of fabric not delivered or not delivered from the appropriate dye lot, the customer will receive a refund for (or will not be obligated to pay for) an equal number of bolts.

605-25-55-65 There are no general rights of return included in the arrangement. The price for an individual 50-yard bolt of fabric is \$160, and the price for a 12-bolt bulk lot is \$1,824.

605-25-55-66 In determining the units of accounting under the arrangement, Entity D considered the following.

605-25-55-67 Entity D sold the 12-bolt bulk lot of fabric to Customer A on November 1, 20X2. Entity D will deliver the first of three four-bolt installments of fabric on November 15 and will deliver the remaining installments on December 15, 20X2, and January 15, 20X3. Customer A is obligated to Entity D for the full price of the fabric on November 15, 20X2, subject to the money-back guarantee. Entity D has sufficient production capacity and inventory to deliver all of the fabric in accordance with the installment provisions of the arrangement and, therefore, believes that it will do so. In addition, Entity D has entered into similar arrangements with many other customers in the past and rarely has failed to deliver fabric from the appropriate dye lot under its bulk-sale arrangements.

605-25-55-68 Based on an evaluation of the circumstances, the first condition for separation is met for the delivered fabric because Entity D also sells bolts of fabric individually. The second condition for separation is also met because ~~objective and reliable evidence of fair value exists based on Entity D's vendor-specific evidence of fair value. Arrangement consideration would be allocated evenly among the 12 bolts of fabric because each has an identical fair value (based on Entity D's vendor-specific evidence of fair value). The third condition for separation is met because~~ there are no general rights of return in the arrangement. Therefore, the delivered fabric should be accounted for as a separate unit of accounting.

605-25-55-69 <u>Without considering whether any portion of the amount allocable to the individual bolts of fabric are contingent upon delivery of the other bolts of fabric, Entity D would allocate the arrangement consideration evenly among the 12 bolts of fabric using the relative selling price method because each bolt has an identical selling price. Therefore, the portion of the arrangement fee otherwise allocable to each bolt of fabric is $152 ($1,824 ÷ 12).</u> However, in allocating the arrangement consideration, no amount is allocable to the initial delivered fabric because the arrangement provides the customer with a double-money-back guarantee for each bolt of fabric not delivered from the same dye lot as the initial installment. However, upon delivery of the second four-bolt installment (assuming that installment is delivered from the same dye lot as the initial installment), the amount allocable to that installment would be the amount related to four bolts of ~~fabric.~~<u>fabric, $608 ($152 × 4 bolts of</u>

fabric). That is, if the third installment was not delivered or was not delivered from the same dye lot as the initial installment, Entity D would be entitled only to the price charged for four bolts of fabric.

A29. Amend paragraph 605-25-55-73, with a link to a transition paragraph 605-25-65-1, as follows:

605-25-55-70 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the limitation in paragraph 605-25-30-5 to noncontingent amounts.

605-25-55-71 PainterCo is a contractor that provides painting services for commercial and private residences. PainterCo contracts with a customer to paint the customer's house for $3,000. The price is inclusive of all paint, which is obtained by PainterCo at a cost of $800. The customer is given the right to purchase paint separately if so desired (although the customer did not opt to do so in this Example). The paint would have cost the customer $900 if purchased from a hardware store. The painting service would have cost $2,150 if purchased without the paint.

605-25-55-72 All paint necessary to complete the project is delivered to the customer's house prior to the beginning of the work. The customer has a general right of return with respect to any unopened can of paint. Further, the customer may receive a full refund of the sales price for all of the paint (whether or not the cans were opened) if PainterCo does not paint the house. PainterCo has always completed the painting service in accordance with contract terms and, therefore, believes that performance of the painting service in this arrangement is probable. PainterCo does not sell paint without providing the painting service.

605-25-55-73 Based on an evaluation of the circumstances, the first condition for separation is met because the paint is sold separately by other vendors. The second condition for separation is also met ~~for the painting service because objective and reliable evidence of fair value exists as PainterCo sells the painting service separately. The third condition for separation is met~~ because, even though a general right of return exists, performance of the painting service is probable and within the control of PainterCo. Therefore, the paint and the painting service are considered separate units of accounting.

605-25-55-74 However, in allocating the arrangement consideration, no amount would be allocated to the paint because, in the event that PainterCo does not perform the painting service, the customer may return all of the paint for a full refund.

A30. Add paragraphs 605-25-55-75 through 55-93, with a link to a transition paragraph 605-25-65-1, as follows:

> > Example 11: Agricultural Equipment

605-25-55-75 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and an approach to estimating the selling price of deliverables under paragraph 605-25-30-6C when neither vendor-specific objective evidence nor third-party evidence of selling price exists. The approach in this Example should not be considered the only appropriate approach to estimating the selling price of the deliverables.

605-25-55-76 Entity A, a public entity, engages in the manufacture and distribution of farm equipment and related service parts, including tractors, harvesters, integrated agricultural management systems technology, and precision agricultural irrigation equipment. Each product has standard performance specifications but can be customized to meet the specific needs of any buyer. Entity A extensively tests the equipment against the standard and customer specifications before shipment.

605-25-55-77 On December 29, 20X8, Entity A enters into an arrangement to deliver a tractor and customized irrigation equipment to Customer M for a fee of $270,000. For purposes of this example, the irrigation equipment is accounted for in accordance with Section 605-10-S99. The customer is obligated to pay $100,000 upon delivery of the tractor and the remainder of the arrangement consideration upon delivery of the irrigation equipment. On December 31, 20X8, Entity A delivers the tractor, and on April 5, 20X9, Entity A delivers the irrigation equipment. Neither product requires installation.

605-25-55-78 The tractor in this arrangement is often sold separately by Entity A for a price of $100,000, which is considered vendor-specific objective evidence of selling price. The irrigation equipment is also sold separately; however, because of the customized nature of the product, Entity A has neither vendor-specific objective evidence nor third-party evidence of selling price.

605-25-55-79 Entity A is considering whether the tractor is a separate unit of accounting and, if so, how to allocate the arrangement consideration at December 31, 20X8.

605-25-55-80 Based on an evaluation of the circumstances, the first condition for separation is met for the tractor. The tractor has standalone value as it is sold separately by Entity A. The second condition for separation is also met as there are no general rights of return. Therefore, the tractor should be accounted for as a separate unit of accounting.

605-25-55-81 Entity A has vendor-specific objective evidence of selling price for the tractor but has neither vendor-specific objective evidence nor third-party evidence of selling price for the irrigation equipment. Therefore, Entity A must estimate the selling price for the irrigation equipment.

605-25-55-82 Entity A considered all of the following in estimating the standalone selling price for the irrigation equipment:

a. Entity A's cost to produce the customized irrigation equipment is $110,000.

b. The division of Entity A that produces the irrigation equipment and other similar products earns an average gross profit margin of approximately 30 percent. The range of profit margins within the irrigation product line varies from 10 to 45 percent. Entity A generally receives a higher profit margin on the more specialized or customized products.

c. When selling noncustomized irrigation equipment, Entity A averages, on a worldwide basis, a selling price of approximately $140,000, which includes a gross profit margin of 25 percent.

d. Customer M is located in Asia where high demand has resulted in Entity A being able to command 10 to 15 percent higher prices for its irrigation product line than it commands in other markets it serves. This pricing is also consistent with Entity A's ongoing marketing strategy in Asia.

e. Direct competitors to Entity A's irrigation product line, Entity D and Entity E, earn average gross profit margins in Asia of 30 percent and 32 percent, respectively, based on a review of their periodic filings.

f. The customized irrigation equipment includes enhanced functionality that Entity A does not believe its competitors can provide. Entity A believes that this enhanced functionality has additional value in the marketplace.

g. Entity A's price list provided to prospective customers lists the price for irrigation equipment before customization at $155,000.

605-25-55-83 After weighing the relevance of the available data points, Entity A estimates its standalone selling price for the irrigation equipment to be $185,000. The determination of that estimated selling price was based on the cost of the irrigation equipment of $110,000 plus an estimated gross profit margin of 40 percent. The 40 percent gross profit margin is management's best estimate based on the margin they would expect to earn on the irrigation equipment if sold separately in Asia. The estimated margin of 40 percent is higher than the 30 percent average margin of the division because the 30 percent average margin includes lower margin products. Entity A also notes that it could command higher margins in Asia than the average margin due to the high demand in that market and the recent history combined with its ongoing pricing strategy. Entity A also considered the margins reported by its competitors and believes its estimated 40 percent margin is reasonable in relation to the competitor margins considering the enhanced functionality it believes the irrigation equipment has over its competitors' products.

605-25-55-84 Entity A did not rely on the $170,000 price of the irrigation equipment that was stated in the arrangement because the stated prices were negotiated to provide for more cash consideration earlier in the arrangement rather than to reflect the standalone selling price of the products. In addition, the arrangement prices are net of any discount embedded in the bundled arrangement rather than standalone selling prices of the products. Considering the customized nature of the irrigation equipment, Entity A did not consider the estimated selling price of $185,000 to be inconsistent with the list price of $155,000 for uncustomized irrigation equipment.

605-25-55-85 Accordingly, at December 31, 20X8, using the relative selling price method, Entity A would allocate $94,736 ($270,000 × [$100,000 ÷ $285,000]) to the tractor and $175,264 ($270,000 × [$185,000 ÷ $285,000]) to the irrigation equipment. Additionally, none of the amount allocable to the tractor is limited by the amount of payment contingent upon delivery of the irrigation equipment.

> > Example 12—Biotech License and Research and Development Agreement

605-25-55-86 This Example illustrates the accounting for deliverables combined into one unit-of-accounting required by paragraph 605-25-25-6.

605-25-55-87 The entity, Biotech, enters into an agreement with a pharmaceutical entity, Pharma. The agreement includes the following, as detailed in paragraphs 605-25-55-88 through 55-93:

a. Biotech licensing certain rights to Pharma

b. Biotech providing research and development services to Pharma.

605-25-55-88 License. Biotech licenses certain rights on an exclusive basis to Pharma for a period of 10 years. The license gives Pharma the exclusive right to market, distribute, and manufacture Drug B as developed using Technology A. Biotech retains all ownership rights to Technology A and Drug B. There are no when-and-if-available clauses or other performance obligations associated with the license, except as described in the paragraphs 605-25-55-890 through 55-93.

605-25-55-89 Research and development. Biotech agrees to provide research and development services on a best-efforts basis to Pharma. Biotech agrees to devote four full-time equivalent employees to the research and development activities, and Pharma expects to devote several full-time equivalent employees to the research and development activities as well. The objective of the research and development services is to develop Drug B using Technology A. The ultimate objective is to receive U.S. Food and Drug Administration approval on Drug B.

605-25-55-90 Compensation under the arrangement is as follows:

a. Biotech receives $5 million up-front upon signing the agreement.

b. Biotech receives $250,000 per year for each full-time equivalent employee who performs research and development activities.

605-25-55-91 None of these payments, once received, is refundable, even if U.S. Food and Drug Administration approval is never received. In addition, Biotech must perform on a best-efforts basis.

605-25-55-92 Pharma must use Biotech to perform the research and development activities necessary to develop Drug B using Technology A because the know-how and expertise related to Technology A is proprietary to Biotech. In other words, Biotech is the only party capable of performing the level and type of research and development services required by Pharma under the agreement. Biotech has determined that the fees charged for the research and development services (that is, the $250,000 per year for each full-time equivalent employee who performs research and development activities) are competitive with the price other third-party vendors charge for similar research and development services (that is, they represent third-party evidence of selling price for those services).

605-25-55-93 Based on an evaluation of the circumstances, there are two deliverables in this arrangement that should be considered for separation:

a. A license deliverable

b. A research and development activities deliverable.

The license deliverable does not meet the first criterion for separation because it does not have standalone value to Pharma. Because Drug B has not yet been developed, the license is of no value to Pharma and could not be sold without the accompanying research and development activities using Technology A, which is proprietary to Biotech. Likewise, Pharma could not sell the license on a standalone basis to another party (that is, because without Biotech agreeing to provide the research and development activities for that other party, the other party would not purchase the license). Therefore, the license and research and development activities should be considered a single unit of accounting in the arrangement.

Effective Date and Transition

A31. Add paragraph 605-25-65-1 and its related heading as follows:

> > Transition Related to *Accounting Standards Update No. 2009-XX, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (A Consensus of the FASB Emerging Issues Task Force)*

605-25-65-1 The following represents the transition and effective date information related to

Accounting Standards Update No. 2009-XX, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements(A Consensus of the FASB Emerging Issues Task Force):

a. The pending content that links to this paragraph shall be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless the vendor elects to adopt the pending content on a retroactive basis in accordance with paragraph 605-25-65-1(e).

b. Earlier application is permitted.

1. If a vendor elects earlier application and the period of adoption is not the first reporting period in the vendor's fiscal year, the pending content that links to this paragraph shall be applied through retrospective application from the beginning of the vendor's fiscal year.

2. Vendors shall disclose the following information at a minimum for all previously reported interim periods in the fiscal year of adoption:

   i. Revenue

   ii. Income before income taxes

   iii. Net income

   iv. Earnings per share

   v. The effect of the change for the appropriate captions presented.

c. In the year of adoption, a vendor shall disclose information that enables users of the financial statements to understand the effect of the change in accounting principle if the pending content that links to this paragraph is adopted on a prospective basis. To satisfy that objective, a vendor shall disclose at a minimum the following qualitative information by similar types of arrangements:

1. A description of any change in the units of accounting

2. A description of the change in how a vendor allocates the arrangement consideration to various units of accounting

3. A description of the changes in the pattern and timing of revenue recognition

4. Whether the adoption of the pending content that links to this paragraph is expected to have a material effect on financial statements in periods after the initial adoption.

d. If the effect of adopting the pending content that links to this paragraph is material, the qualitative information shall be supplemented with quantitative information in the period of adoption to satisfy the objective of enabling users to understand the effect of the change in accounting principle. Depending on a vendor's facts and circumstances, the following are examples of methods (but not the only potential methods) that may individually or in combination provide quantitative information to satisfy that objective:

1. The amount of revenue that would have been recognized in the year of adoption if the related arrangements entered into or materially modified after the effective date were subject to the measurement requirements of Subtopic 605-25 (before the amendments resulting from Update 2009-XX).

2. The amount of revenue that would have been recognized in the year before the year of adoption if the arrangements accounted for under Subtopic 605-25 (before the amendments resulting from Update 2009-XX) were subject to the measurement requirements of the pending content that links to this paragraph.

3. For arrangements that precede the adoption of the pending content that links to this paragraph, the amount of revenue recognized in the reporting period and the amount of the deferred revenue as of the end of the period from applying the guidance in Subtopic 605-25 (before the amendments resulting from Update 2009-XX). For arrangements that were entered into or materially modified after the effective date of the pending content that links to this paragraph, the amount of revenue recognized in the reporting period and the amount of deferred revenue as of the end of the period from applying the guidance in the pending content that links to this paragraph.

e. A vendor may elect, but is not required, to adopt the pending content that links to this paragraph through retrospective application applying the guidance in paragraphs 250-10-45-5 through 45-10. If a vendor elects retrospective application, the disclosures in paragraphs 250-10-50-1 through 50-3 shall be provided.

Issue No. 08-9

Title: Milestone Method of Revenue Recognition

Dates Discussed: November 13, 2008; March 19, 2009; June 18, 2009; September 9–10, 2009

References: FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*

FASB Accounting Standards Codification Topic 450, *Contingencies*

FASB Accounting Standards Codification Topic 605, *Revenue Recognition*

FASB Accounting Standards Codification Topic 840, *Leases*

FASB Accounting Standards Codification Topic 92X, *Entertainment*

FASB Accounting Standards Codification Topic 985, *Software*

FASB Statement No. 5, *Accounting for Contingencies* (now under Topic 450)

Statement No. 13, *Accounting for Leases* (now under Topic 840)

FASB Statement No. 154, *Accounting Changes and Error Corrections* (now under Topic 250)

FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

FASB Invitation to Comment, *Accounting for Certain Service Transactions*

APB Opinion No. 22, *Disclosure of Accounting Policies* (now under Topic 235)

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (now under Topic 605)

AICPA Statement of Position 97-2, *Software Revenue Recognition* (now under Topic 985)

AICPA Statement of Position 00-2, *Accounting by Producers or Distributors of Films* (now under Topic 926)

SEC Staff Accounting Bulletin No. 104, Topic 13, *Revenue Recognition* (now under Topic 605)

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" (now under Topic 605)

EITF Issue No. 08-1, "Revenue Arrangements with Multiple Deliverables"

EITF Abstracts, Topic No. D-96, "Accounting for Management Fees Based on a Formula" (now under Topic 605)

Introduction

1. The ultimate objective of attributing arrangement consideration is to determine when the arrangement consideration should be recognized as revenue. As set forth in Concepts Statement 5, paragraph 83, "recognition involves consideration of two factors, (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important consideration." Generally, revenue is considered both realizable and earned when each one of the following four conditions is met:

a. Persuasive evidence of an arrangement exists
b. The arrangement fee is fixed or determinable
c. Delivery or performance has occurred
d. Collectibility is reasonably assured.

2. The issue of when and if a vendor will receive additional arrangement consideration that is not considered initially fixed upon consummation of the arrangement (for example, arrangement consideration contingent upon achievement of a specified event), relates to whether the arrangement consideration is fixed or determinable and whether collectibility is reasonably assured. This Issue does not address the topic of whether collectibility is reasonably assured.

3. Typically, contingent arrangement consideration becomes fixed or determinable only after the contingency is resolved. At the time the contingency is resolved or the event is achieved, a vendor must determine how to allocate the additional consideration. For arrangements comprising a single deliverable or unit of accounting under which a vendor satisfies its performance obligations to a customer over a period of time, the determination as to whether the additional arrangement consideration relates to past performance, future performance, or both can be very difficult. The purpose of this Issue is to examine the use of the milestone method as one possible method for determining how to allocate the contingent arrangement consideration once it becomes fixed or determinable. Under the milestone method, arrangement consideration earned from the achievement of a milestone may be deemed to be related to the portion of the performance period dedicated to achieving that specific milestone.

Prior EITF Discussion

4. Prior to the November 13, 2008 EITF meeting, this Issue was discussed by the Task Force as part of Issue 08-1. Beginning with the November meeting, this Issue was separated from Issue 08-1 for further discussion. The Task Force reached the following tentative decisions at the September 10, 2008 and November 13, 2008 EITF meetings. The Task Force tentatively defined a milestone as an event for which there is substantial uncertainty at the date the arrangement is entered into that the event will be achieved, when that event can only be achieved based in whole or in part on the vendor's performance or a specific outcome resulting from the vendor's performance and, if achieved, would result in additional payments being due to the vendor.

5. The Task Force also tentatively agreed that based on the foregoing definition of a milestone, arrangement consideration earned from the achievement of a milestone may relate to past performance and the milestone method may be a valid application of the proportional performance model.

6. Furthermore, because an event must be achieved based in whole or in part on the vendor's performance or a specific outcome resulting from the vendor's performance, the Task Force tentatively agreed that a milestone does not include events for which the occurrence is contingent upon the passage of time or a customer's performance.

7. The Task Force also tentatively concluded that the guidance in this Issue is not the only acceptable revenue attribution model for arrangement consideration contingent upon achievement of a milestone (whether or not the milestone is substantive). A vendor should apply the revenue recognition model most appropriate to the facts and circumstances. A vendor's policy for recognizing arrangement consideration that is contingent upon achievement of a milestone shall be applied consistently to similar arrangements.

8. The Task Force also tentatively concluded that the arrangement consideration earned from the achievement of a milestone shall not be recognized as revenue in its entirety in the period in which the milestone is achieved if any portion of the associated milestone arrangement consideration relates to the remaining deliverables in the arrangement. Furthermore, the Task Force tentatively concluded that if the arrangement consideration from an individual milestone is not considered to relate solely to past performance, the vendor would not be precluded from using the milestone method for other milestones in the arrangement.

9. At the November 13, 2008 EITF meeting, the Task Force tentatively agreed that this Issue may be applied to all contractual revenue arrangements (whether written, oral, or implied, and hereinafter referred to as "arrangements") under which a vendor satisfies its performance obligations to a customer over a period of time and when a portion or all of the arrangement consideration is contingent upon the achievement of a milestone(s).

10. The Task Force also discussed whether the scope of this Issue should be limited to deliverables or units of accounting for which the revenue recognition convention is not within the scope of other authoritative literature. The Task Force was not asked to reach a conclusion, but agreed to proceed with a discussion of the Issue under the presumption that this Issue could not be applied if the unit of accounting to which the milestone relates is accounted for under SOP 81-1 and SOP 97-2, and to reconsider the scope at a future meeting.

11. Certain members of the Task Force noted that this Issue does not provide recognition guidance for situations in which a milestone is not considered substantive. Some Task Force members asked whether it should; however, the Task Force did not reach a tentative conclusion on this question.

12. The Task Force affirmed its tentative conclusion that the consideration earned from the achievement of a milestone must relate solely to past performance. The Task Force also discussed but was not asked to reach a conclusion on the measurement criteria that should be applied to the milestone payment when a vendor assesses whether the achievement of a milestone relates solely to past performance.

13. At the March 19, 2009 EITF meeting, the Task Force considered the following Issues:

Issue 1— Whether a license has standalone value in a research and development arrangement

Issue 2— How an entity should account for arrangements with contingent consideration in an arrangement consisting of a single deliverable or unit of accounting.

14. The Task Force agreed not to address Issues 1 and 2. Task Force members expressed a concern that both Issue 1 and Issue 2 encompass broader practice concerns than were originally intended to be addressed by this Issue. Rather, the Task Force reached a consensus-for-exposure to affirm the tentative conclusions reached at the November 13, 2009 EITF meeting. In addition, the Task Force reached a consensus-for-exposure that the scope of this Issue should be based on the following:

> This Issue may be applied to a single deliverable or unit of accounting arising from arrangements under which a vendor satisfies its performance obligations to a customer over a period of time, and when a portion or all of the arrangement consideration is contingent upon uncertain future events or circumstances, except when the guidance in this Issue conflicts with other authoritative literature that provides guidance with respect to the revenue recognition convention for the single deliverable or unit of accounting.

15. The Task Force reached a consensus-for-exposure that when applying the guidance in this Issue a vendor may make an accounting policy election to recognize the arrangement consideration that is contingent upon the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved.

16. The Task Force reached a consensus-for-exposure that, for purposes of this Issue, a milestone is defined as an event for which there is substantial uncertainty at the date the arrangement is entered into that the event will be achieved when that event can only be achieved based in whole or in part on the vendor's performance or a specific outcome resulting from the vendor's performance and, if achieved, would result in additional payments being due to the vendor.

17. The Task Force reached a consensus-for-exposure that the determination of whether a milestone is substantive is a matter of judgment. However, the following principle shall be used in making a determination as to whether a milestone is substantive:

> The consideration earned from the achievement of a milestone is commensurate with either the vendor's performance to achieve the milestone or the enhancement of the value of the delivered item(s) as a result of a specific outcome resulting from the vendor's performance to achieve the milestone. The consideration earned from the achievement of a milestone relates solely to past performance and is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

18. The Task Force reached a consensus-for-exposure that a milestone shall not be considered substantive if any portion of the associated milestone consideration relates to the remaining deliverables in the unit of accounting (that is, it does not relate solely to past performance). In

order to recognize the milestone consideration in its entirety as revenue in the period in which the milestone is achieved, the milestone must be substantive in its entirety. It is not appropriate to bifurcate milestone consideration into substantive and nonsubstantive components. In addition, if a portion of the consideration earned from achieving a milestone may be refunded or adjusted based on future performance (for example, through a penalty or clawback), the contingent consideration is not considered to relate solely to past performance and thus the related milestone cannot be considered substantive. If the arrangement consideration from an individual milestone is not considered to relate solely to past performance, the vendor would not be precluded from using the milestone method for other milestones in the arrangement.

19. The Task Force reached a consensus-for-exposure that to be considered a milestone, an event must be achieved based in whole or in part on the vendor's performance or a specific outcome resulting from the vendor's performance; therefore, a milestone does not include events for which the occurrence is contingent solely upon the passage of time or events that are the result of a counterparty's performance.

20. The Task Force reached a consensus-for-exposure that the guidance in this Issue is not the only acceptable revenue attribution model for arrangement consideration contingent upon achievement of a milestone (whether or not the milestone is substantive). A vendor's policy for recognizing arrangement consideration contingent upon achievement of a milestone shall be applied consistently to similar arrangements.

21. At the June 18, 2009 EITF meeting, the Task Force discussed the comment letters received on the draft abstract as well as transition guidance. The Task Force considered whether to modify the term *substantial uncertainty* as used in paragraph 7 of the draft abstract. Some Task Force members commented that the term *substantial uncertainty* suggested that there needed to be a considerable amount of uncertainty around whether the event will be achieved before the event could be considered a milestone. Those Task Force members observed that the language was only intended to convey a notion of more than the mere presence of uncertainty. After that discussion, the Task Force reached a tentative conclusion to change the terminology to indicate that the uncertainty must be substantive.

22. The Task Force discussed whether the application of the milestone method should be an accounting policy election or whether a vendor should be required to apply that method for all arrangements that include substantive milestones. Task Force members affirmed their prior consensus-for-exposure that the application of the milestone method is a policy election. Task Force members noted that there are many factors an entity must consider in establishing its revenue recognition policies and that an entity should be afforded the opportunity to evaluate its facts and circumstances in determining whether to apply the milestone method or another proportional performance method.

23. Task Force members also discussed whether the milestone method is the only method available to an entity that chooses to recognize arrangement consideration that is contingent upon the achievement of a milestone in its entirety in the period in which the milestone is achieved. Task Force members questioned whether other methods are also available that may achieve the same accounting result.

24. Some Task Force members indicated that they believe that the milestone method is the only method available that would provide an entity with the opportunity to recognize arrangement consideration that is contingent upon the achievement of a milestone in its entirety in the period in which the milestone is achieved. Those Task Force members clarified their belief that the policy election option provided by this Issue is not an option that provides an entity with the opportunity to apply a method other than the method described in this Issue that results in recognition of consideration from a milestone in its entirety in the period the milestone is achieved. Those Task Force members also observed that the optionality of this Issue relates to recognizing all of the contingent consideration in the period of achievement, instead of an alternative accounting method that would defer a portion of the contingent consideration. Other Task Force members noted that the Task Force had not previously discussed whether other proportional performance methods exist that could result in the same accounting result. The Task Force requested that the FASB staff perform additional analysis to determine the types of transactions that may be within the scope of this Issue and how this Issue may affect those transactions.

Current EITF Discussion

25. At the September 9–10, 2009 EITF meeting, the Task Force discussed the analysis provided by the FASB staff on the types of transactions that may be within the scope of this Issue. Some Task Force members expressed concerns that this Issue may now affect arrangements more broadly than the Task Force had originally intended. Those Task Force members questioned whether the scope of this Issue should be limited to research and development arrangements. Other Task Force members observed that limiting the scope of this Issue to research and development arrangements would not be preferable as it would perpetuate industry specific guidance rather than provide broad guidance for contingent payments.

26. Other Task Force members questioned whether to modify the definition of a milestone such that substantive uncertainty would be a factor to consider as opposed to a requirement, based on facts and circumstances.

27. The Task Force requested that the FASB staff perform additional analysis on the scope of this Issue.

Status

28. Further discussion is expected at a future meeting.

Issue No. 09-2

Title: Research and Development Assets Acquired and Contingent Consideration Issued In an Asset Acquisition

Dates Discussed: March 19, 2009; June 18, 2009; September 9–10, 2009

References: FASB Accounting Standards Codification Topic 340, *Deferred Costs and Other Assets*

FASB Accounting Standards Codification Topic 350, *Intangibles—Goodwill and Other*

FASB Accounting Standards Codification Topic 605, *Revenue Recognition*

FASB Accounting Standards Codification Topic 730, *Research and Development*

FASB Accounting Standards Codification Topic 805, *Business Combinations*

FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging*

FASB Accounting Standards Codification Topic 985, *Software*

FASB Statement No. 2, *Accounting for Research and Development Costs* (now under Topic 730)

FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* (now under Topic 985)

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (now under Topic 815)

FASB Statement No. 141 (revised 2007), *Business Combinations* (now under Topic 805)

FASB Statement No. 142, *Goodwill and Other Intangible Assets* (now under Topic 350)

FASB Statement No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets* (now under Topic 360)

FASB Interpretation No. 6, *Applicability of FASB Statement No. 2 to Computer Software* (now under Topic 730)

AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (now under Topic 350)

International Accounting Standard 36, *Impairment of Assets*

International Accounting Standard 38, *Intangible Assets*

International Financial Reporting Standard 3 (revised 2008), *Business Combinations*

EITF Issue No. 96-6, "Accounting for the Film and Software Costs Associated with Developing Entertainment and Educational Software Products" (now under Topic 985)

EITF Issue No. 99-5, "Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements" (now under Topic 340)

EITF Issue No. 00-2, "Accounting for Web Site Development Costs" (now under Topic 350)

EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities" (now under Topic 730)

EITF Issue No. 08-6, "Equity Method Investment Accounting Considerations" (now under Topic 323)

Introduction

1. Prior to Statement 141(R), research and development assets were accounted for in the same manner irrespective of whether they were purchased as individual assets, as part of a group of assets, or in a business combination. In accordance with Topic 730, research and development assets are only recognized if the assets have a future alternative use, otherwise the assets are expensed at the acquisition date. Tangible assets that meet the future alternative-use criterion are initially capitalized at allocated cost. Intangible assets that meet the future alternative-use criterion are also initially capitalized at allocated cost and subsequently accounted for in accordance with Topic 350. In addition to Topic 730, other accounting literature addresses different aspects of accounting for research and development activities; for example, costs associated with computer software (for internal use or sale). This other accounting literature is based on the accounting requirements in Topic 730.

2. Statement 141(R) amends Topic 730 and other U.S. GAAP on research and development assets acquired in a business combination. Statement 141(R) requires that all research and development assets acquired in a business combination be initially recognized and measured at fair value, regardless of whether those assets have an alternative future use. These amendments have created inconsistencies between the accounting for research and development assets acquired in a business combination and those acquired in an asset acquisition.

Issues

3. The issues are:

Issue 1— Whether the costs of acquired tangible and intangible research and development assets that are acquired in an asset acquisition and that do not have a future alternative use, shall be expensed immediately or capitalized

Issue 2— If the Task Force decides that all acquired research and development assets shall be initially capitalized, how acquired research and development assets shall be subsequently accounted for.

Issue 3—How an entity should account for contingent consideration related to an asset acquisition.

Issue 4—Whether the Task Force wishes to provide factors to consider when determining whether contingent payment is for an asset or for future services.

Scope

4. The scope of this Issue includes all tangible and intangible research and development assets acquired (either individually or with a group of other assets) and contingent consideration issued in a transaction other than a business combination. This Issue includes:

a. Tangible and intangible assets resulting from research and development activities—for example, patents, blueprints, formulas, and designs for new products or processes
b. Tangible and intangible assets to be used in research and development activities—for example, materials and supplies, equipment and facilities, and specific in-process research and development projects.

5. Payments to third parties for services to perform research and development activities are not considered acquired assets and are excluded from the scope of this Issue.

Prior EITF Discussion

6. At the March 19, 2009 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that all tangible and intangible research and development assets acquired in an asset acquisition shall be capitalized pursuant to paragraphs 805-50-30-1 through 30-3 (formerly Appendix D of Statement 141(R)) regardless of whether those assets have a future alternative use.

7. In connection with Issue 1, the Task Force also discussed the recognition and measurement of contingent consideration in an acquisition of tangible and intangible research and development assets. The Task Force observed that it may be difficult to differentiate between when the contingent consideration represents an additional payment for the acquired research and development tangible and intangible assets and when the contingent consideration represents a payment for services performed subsequent to the transaction date, when the seller maintains some form of continuing involvement. As a result, the Task Force requested that the FASB staff develop alternatives for discussion at a future meeting, including whether the Task Force could provide factors to consider when an entity is evaluating whether contingent consideration is payment for assets or future services.

8. On Issue 2, the Task Force reached a tentative conclusion that intangible research and development assets acquired in an asset acquisition shall be considered indefinite-lived until the completion or abandonment of the associated research and development activities. During the period those assets are considered indefinite–lived, they shall not be amortized but shall be tested for impairment in accordance with paragraphs 350-30-35-17 through 35-20. Once the research and development efforts are completed or abandoned, the entity shall determine the useful life of the assets based on the guidance in Topic 350. The Task Force observed that the tentative conclusion conforms the subsequent measurement for tangible and intangible research and development assets acquired in an asset acquisition with the subsequent measurement for similar assets acquired in a business combination. Consistent with the guidance in paragraph 360-10-35-49, intangible assets acquired that have been temporarily idled shall not be accounted for as if

abandoned. Tangible research and development assets acquired in an asset acquisition shall be subsequently accounted for in accordance with their nature.

9. The FASB staff noted that the tentative conclusion on Issue 2 will change the current application of Topic 350 for intangible research and development assets that have a future alternative use. Currently, intangible assets acquired outside of a business combination for use in research and development activities are evaluated pursuant to paragraph 11 of Topic 350 to determine whether such assets are indefinite-lived or finite-lived assets.

10. At the June 18, 2009 EITF meeting, the Task Force did not have a substantive discussion on this Issue and was not asked to reach a conclusion.

Current EITF Discussion

11. At the September 10, 2009 EITF meeting, the Task Force affirmed as a consensus-for-exposure its tentative conclusion on Issues 1 and 2 that the cost of all tangible and intangible research and development assets acquired in an asset acquisition shall be capitalized regardless of whether those assets have a future alternative use.

12. On Issue 3, the Task Force reached a consensus-for-exposure that contingent consideration in an asset acquisition shall be accounted for in accordance with existing U.S. GAAP. For example, if the contingent consideration meets the definition of a derivative, Topic 815 (formerly Statement 133) would require that it be recognized at fair value. In addition, Topic 450 (formerly Statement 5) may require recognition of the contingent consideration if it is probable that a liability has been incurred and the amount of that liability can be reasonably estimated, and Subtopic 323-10 (formerly Issue 08-6) may require the recognition of the contingent consideration if it relates to the acquisition of an investment that is accounted for under the equity method. Where contingent consideration relating to the acquisition of the asset is recognized at inception in accordance with existing authoritative guidance, such amount would be included in the initial measurement of the cost of the acquired assets. If a contingent payment relating to the asset acquisition is subsequently made that is not recognized at the inception of the arrangement, that payment would be capitalized as part of the cost of the asset. However, if the contingent consideration arrangement is a derivative, changes in the carrying value of a derivative instrument subsequent to inception would not be recognized as part of the cost of the asset.

13. Task Force members noted that this decision does not fully align the accounting for research and development assets acquired in asset acquisitions and business combinations. Some Task Force members were supportive of recognizing all contingent consideration at fair value consistent with the accounting in a business combination. Those Task Force members believed that recognition of contingent consideration at fair value resulted in a better reflection of the economics of the transaction and provided more useful information to investors. Other Task Force members were concerned with complexities associated with recognizing contingent consideration in an asset acquisition at fair value.

14. On Issue 4, the Task Force reached a consensus-for-exposure that an entity is required to differentiate between contingent consideration that relates to the acquisition of the assets and

contingent consideration that relates to the performance of future services from the seller. That differentiation would be required when the assets are acquired. The Task Force observed that it may be difficult to determine whether contingent consideration relates to the acquired asset or to future services. Certain Task Force members believed that factors should be included with this Issue to assist in making that determination. Other Task Force members believed that sufficient guidance exists for distinguishing between payments for assets and services in a business combination and that guidance was sufficient to consider for asset acquisitions. The Task Force reached a consensus-for-exposure not to provide factors for assisting in making this determination but decided to request input from constituents as to whether additional guidance is necessary.

Disclosure

15. The Task Force reached a consensus-for-exposure that an entity should disclose how contingent consideration in an asset acquisition will be accounted for when the contingent payment is made. This disclosure is in addition to disclosures required by other specific applicable U.S. GAAP, which may include the nature of the contingent payment arrangement and an estimate of the possible contingent consideration or range of contingent consideration or a statement that such an estimate cannot be made.

Effective Date, Transition Method, and Transition Disclosures

16. The Task Force reached a consensus-for-exposure that this Issue shall be effective for acquisitions of assets occurring in fiscal years beginning on or after December 15, 2009. Earlier application is not permitted.

Board Ratification

17. At the September 23, 2009 meeting, the Board ratified the consensus-for-exposure reached by the Task Force for this Issue and approved the issuance of a proposed Accounting Standards Update (proposed Update) for a public comment period. The amendments to the FASB Accounting Standards Codification™ to be included in the proposed Update are included as Appendix 09-2A.

Status

18. The proposed Update will be posted to the FASB website no later than September 30, 2009. Comments on the proposed Update will be due no later than October 26, 2009. Further discussion is expected at a future meeting.

Appendix 09-02A

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–30. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u> and deleted text is ~~struck out.~~

Amendments to Topic 730

2. Supersede paragraphs 730-10-05-2 through 05-3, with a link to transition paragraph 730-10-65-1, as follows:

730-10-05-2 <u>Paragraph superseded by Accounting Standards Update 2009-XX.</u> ~~At the time most research and development costs are incurred, the future benefits are at best uncertain. In other words, there is no indication that an economic resource has been created. Moreover, even if at some point in the progress of an individual research and development project the expectation of future benefits becomes sufficiently high to indicate that an economic resource has been created, the question remains whether that resource should be recognized as an asset for financial accounting purposes. Although future benefits from a particular research and development project may be foreseen, they generally cannot be measured with a reasonable degree of certainty. There is normally little, if any, direct relationship between the amount of current research and development expenditures and the amount of resultant future benefits to the entity. Research and development costs therefore fail to satisfy the suggested measurability test for accounting recognition as an asset.~~

730-10-05-3 <u>Paragraph superseded by Accounting Standards Update 2009-XX.</u> ~~Also, there is often a high degree of uncertainty about whether research and development expenditures will provide any future benefits. Thus, even an indirect cause and effect relationship can seldom be~~

~~demonstrated. Because there is generally no direct or even indirect basis for relating costs to revenues, the principles of associating cause and effect and systematic and rational allocation cannot be applied to recognize research and development costs as expenses. That is, the notion of matching, when used to refer to the process of recognizing costs as expenses on any sort of cause and effect basis, cannot be applied to research and development costs. The general lack of discernible future benefits at the time the costs are incurred indicates that the immediate recognition principle of expense recognition should apply.~~

3. Amend paragraph 730-10-15-4, with a link to transition paragraph 730-10-65-1, as follows:

730-10-15-4 The guidance in this Topic does not apply to the following transactions and activities:

a. Accounting for the costs of research and development activities conducted for others under a contractual arrangement, which is a part of accounting for contracts in general. Indirect costs, including indirect costs that are specifically reimbursable under the terms of a contract, are also excluded from the scope of this Topic.

b. Activities that are unique to entities in the extractive industries, such as prospecting, acquisition of mineral rights, exploration, drilling, mining, and related mineral development.

c. The acquisition, development, or improvement of a process by an entity for use in its selling or administrative activities. A process may be intended to achieve cost reductions as opposed to revenue generation. However, (e), below, specifically excludes market research or market testing activities from research and development activities. Those activities were excluded because they relate to the selling function of an entity. Thus, while in the broadest sense of the word, a process may be used in all of an entity's activities, the acquisition, development, or improvement of a process by an entity for use in its selling or administrative activities shall be excluded from the definition of research and development activities. To the extent, therefore, that the acquisition, development, or improvement of a process by an entity for use in its selling or administrative activities includes costs for computer software, those costs are not research and development costs. Examples of the excluded costs of software are those incurred for development by an airline of a computerized reservation system or for development of a general management information system. See Subtopic 350-40 for guidance related to costs of computer software developed or obtained for internal use and Subtopic 985-20 for computer software intended to be sold, leased, or marketed.

d. Routine or periodic alterations to existing products, production lines, manufacturing processes, and other ongoing operations even though those alterations may represent improvements.

e. Market research or market testing activities.

f. Research and development assets acquired in a business combination. Tangible and intangible assets acquired in a business combination that are used in research and development activities are recognized and measured at fair value in accordance with Subtopic 805-20~~, regardless of whether they have an alternative future use~~. After initial recognition, tangible assets acquired in a business combination that are used in research and development activities are accounted for in accordance with their nature. After initial recognition, intangible assets acquired in a business combination that are used in research and development activities are accounted for in accordance with Topic 350.

4. Amend paragraph 730-10-25-1, with a link to transition paragraph 730-10-65-1, as follows:

730-10-25-1 Tangible and intangible **research and development** assets acquired shall be capitalized and initially measured in accordance with paragraph 805-50-30-3. All other ~~**Research and development** costs~~ research and development costs encompassed by this Subtopic shall be charged to expense when incurred. As noted in paragraph 730-10-15-4(f), this Topic does not apply to tangible and intangible assets acquired in a business combination that are used in research and development activities.

5. Amend paragraph 730-10-25-2, with a link to transition paragraph 730-10-65-1, as follows:

730-10-25-2 Elements of costs shall be identified with research and development activities as follows (see Subtopic 350-50 for guidance related to website development):

a. Tangible Assets. Tangible assets (for example, materials, equipment, and facilities)

~~Materials, equipment, and facilities. The costs of materials (whether from the entity's normal inventory or acquired specially for research and development activities) and equipment or facilities~~ that are acquired (either individually or with a group of assets) ~~or constructed~~ for research and development activities ~~and that have alternative future uses (in research and development projects or otherwise)~~ shall be capitalized ~~as tangible assets~~ when acquired ~~or constructed~~. Tangible assets acquired in other than a business combination shall be measured at allocated cost consistent with paragraph 805-50-30-3. The cost of such materials consumed in research and development activities and the depreciation of such equipment or facilities used in those activities are research and development costs. ~~However, the costs of materials, equipment, or facilities that are acquired or constructed for a particular research and development project and that have no alternative future uses (in other research and development projects or otherwise) and therefore no separate economic values are research and development costs at the time the costs are incurred.~~ See Topic 360 for guidance related to property, plant, and equipment; the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10 for guidance related to impairment and disposal; and paragraphs 360-10-35-2 through 35-6 for guidance related to depreciation.

b. Personnel. Salaries, wages, and other related costs of personnel engaged in research and development activities shall be included in research and development costs.

c. Intangible assets purchased from others. ~~The costs of intangible~~ Intangible assets that are purchased from others (either individually or with a group of assets) for use in research and development activities ~~and that have alternative future uses (in research and development projects or otherwise) shall be accounted for in accordance with Topic 350.~~ shall be measured at allocated cost consistent with paragraph 805-50-30-3. All intangible assets acquired for use in research and development activities shall be considered indefinite lived until the completion or abandonment of the associated research and development activities. During the period those assets are considered indefinite lived, they shall not be amortized but shall be tested for impairment in accordance with Subtopic 350-30. Once the research and development efforts are completed, the entity shall determine the useful life of the assets on the basis of the guidance in Subtopic 350-30. The amortization of those intangible assets used in research and development activities is a research and development cost. Payments for another entity's services to perform research and development or reimbursements for research and development costs are not considered intangible assets purchased from others. ~~However, the costs of intangibles that are purchased from others for a particular research and development project and that have no alternative future uses (in other research and development projects or otherwise) and therefore no separate economic values are research and development costs at the time the costs are incurred.~~

d. Contract services. Payments for services performed by others in connection with the research and development activities of an entity, including research and development conducted by others ~~in~~on behalf of the entity, shall be included in research and development costs.

e. Indirect costs. Research and development costs shall include a reasonable allocation of indirect costs. However, general and administrative costs that are not clearly related to research and development activities shall not be included as research and development costs.

6. Amend paragraphs 730-10-25-3 through 25-4, with a link to transition paragraph 730-10-65-1, as follows:

730-10-25-3 When software for use in research and development activities is purchased or leased, its cost shall be accounted for as specified by (c) in the preceding paragraph and paragraph 730-10-25-1. ~~That is, the cost shall be charged to expense as incurred unless the software has alternative future uses (in research and development or otherwise).~~

730-10-25-4 Development of software to be used in research and development activities, including costs incurred by an entity in developing computer software internally for use in its research and development activities, are research and development costs and, therefore, shall be charged to expense when incurred;~~incurred. The alternative future use test does not apply to the internal development of computer software;~~ paragraph 730-10-25-2(c) applies only to intangibles purchased from others. This includes costs incurred during all phases of software development because all of those costs are incurred in a research and development activity.

7. Amend paragraph 730-10-55-3, with a link to transition paragraph 730-10-65-1, as follows:

730-10-55-3 Nonrefundable advance payments for future research and development activities for materials, equipment, facilities, and purchased intangible assets ~~that have an alternative future use (in research and development projects or otherwise)~~ are within the scope of this Subtopic. Subtopic 730-20 ~~(Research and Development>Overall Research and Development Arrangements)~~ provides guidance on accounting for nonrefundable advance payments for goods or services that have the characteristics that will be used or rendered for future research and development activities pursuant to an executory contractual arrangement.

8. Amend paragraph 730-20-25-14, with a link to transition paragraph 730-10-65-1, as follows:

730-20-25-14 Paragraph 730-10-55-3 states that nonrefundable advance payments for future research and development activities for materials, equipment, facilities, and purchased intangible assets ~~that have an alternative future use (in research and development projects or otherwise)~~ shall be recognized in accordance with Subtopic 730-10 ~~(Research and Development>Overall)~~.

9. Amend paragraph 730-20-35-1, with a link to transition paragraph 730-10-65-1, as follows:

730-20-35-1 Nonrefundable advance payments capitalized under paragraph 730-20-25-13 shall be <u>accounted for in accordance with Subtopic 730-10</u> ~~recognized as an expense~~ as the related goods are delivered or the related services are performed. An entity shall continue to evaluate whether it expects the goods to be delivered or services to be rendered. If an entity does not expect the goods to be delivered or services to be rendered, the advance payment capitalized under paragraph 730-20-25-13 shall be charged to expense. The guidance in this paragraph does not apply to refundable advance payments for future research and development activities. An entity shall not apply the guidance in this paragraph by analogy to other types of advance payments.

Amendments to Topic 805

10. Amend paragraph 805-20-35-5, with a link to transition paragraph 730-10-65-1, as follows:

805-20-35-5 Additional guidance on subsequently measuring and accounting for assets acquired in a business combination is addressed in Subtopic 350-30, which prescribes the accounting for **identifiable intangible assets** acquired in a business combination, including recognition of intangible assets used in research and development activities~~, regardless of whether those assets have an alternative future use,~~ and their classification as indefinite-lived until the completion or abandonment of the associated research and development efforts.

11. Add paragraph 805-50-30-2A, with a link to transition paragraph 730-10-65-1, as follows:

805-50-30-1 Paragraph 805-50-25-1 discusses exchange transactions that trigger the initial recognition of assets acquired and liabilities assumed. Assets are recognized based on their cost to the acquiring entity, which generally includes the transaction costs of the asset acquisition, and no gain or loss is recognized unless the **fair value** of noncash assets given as consideration differs from the assets' carrying amounts on the acquiring entity's books.

805-50-30-2 Asset acquisitions in which the consideration given is cash are measured by the amount of cash paid, which generally includes the transaction costs of the asset acquisition. However, if the consideration given is not in the form of cash (that is, in the form of noncash assets, liabilities incurred, or **equity interests** issued), measurement is based on either the cost to the acquiring entity or the fair value of the assets (or net assets) acquired, whichever is more clearly evident and, thus, more reliably measurable.

<u>**805-50-30-2A** An entity is required to determine if contingent payments in an arrangement to acquire assets relate to the acquisition of the asset **(contingent consideration)** or the performance of future services by the seller. Contingent consideration in an asset acquisition shall be accounted for in accordance with other Topics. For example, if the contingent consideration meets the definition of a derivative, Topic 815 would require that it be recognized at fair value. Alternatively, Topic 450 may require the recognition of the contingent consideration if it is probable that a liability has been incurred and the amount of that liability can be reasonably estimated or Subtopic 323-10 may require the recognition of the contingent consideration related to the acquisition of an investment that is accounted for under the equity method. When the contingent consideration is recognized (either initially when the assets are acquired or when the contingency is resolved and the consideration is paid or becomes payable),</u>

that amount would be included in the measurement of the cost of the acquired asset or group of assets. However, adjustments to the carrying value of a derivative instrument related to an asset acquisition that occur subsequent to the inception of the arrangement shall not be recognized as part of the cost of the asset.

12. Amend paragraph 805-50-30-3, with a link to transition paragraph 730-10-65-1, as follows:

805-50-30-3 Acquiring assets in groups requires not only ascertaining the cost of the asset (or net asset) group but also allocating that cost to the individual assets (or individual assets and liabilities) that make up the group. The cost of such a group is determined using the concepts described in ~~the preceding two~~paragraphs 805-50-30-1 through 30-2A. The cost of a group of assets acquired in an asset acquisition is allocated to the individual assets acquired or liabilities assumed based on their relative fair values and does not give rise to **goodwill**.

13. Add paragraph 805-50-50-5, with a link to transition paragraph 730-10-65-1, as follows:

805-50-50-5 For asset acquisitions that include a contingent consideration arrangement, in addition to the disclosures required by other specific guidance, for example, Topic 815; Topic 450; or Subtopic 323-10, disclose how the contingent consideration will be accounted for when the contingency is resolved and the consideration is paid or becomes payable.

Amendments to Topic 985

14. Amend paragraph 985-20-25-1, with a link to transition paragraph 730-10-65-1, as follows:

985-20-25-1 All costs incurred to establish the technological feasibility of a computer software product to be sold, leased, or otherwise marketed are research and development costs. Those costs shall be charged to expense when incurred as required by Subtopic 730-10. Tangible and intangible assets acquired in an asset acquisition that are used in research and development activities are recognized and measured in accordance with Topic 730.

15. Amend paragraph 985-20-25-8, with a link to transition paragraph 730-10-65-1, as follows:

985-20-25-8 The cost of purchased computer software to be sold, leased, or otherwise marketed ~~that has no alternative future use~~ shall be capitalized in accordance with Subtopic 730-10. ~~accounted for the same as the costs incurred to develop such software internally, as specified in paragraphs 985-20-25-1 through 25-6.~~

16. Supersede paragraphs 985-20-25-9 through 25-10, with a link to transition paragraph 730-10-65-1, as follows:

985-20-25-9 Paragraph superseded by Accounting Standards Update 2009-XX.~~An entity shall capitalize the total cost of purchased software if the criteria specified in paragraph 985-20-25-2 are met at the time of purchase. Otherwise, the cost will be charged to expense as research and development. For example, if the technological feasibility of a software product as a whole (that is, the product that will be ultimately marketed) has been established at the time software is purchased, the cost of the purchased software shall be capitalized and further accounted for in accordance with the other provisions of this Subtopic. The cost of software purchased to be integrated with another product or process shall be capitalized only if technological feasibility is established for the software component and if all research and development activities for the other components of the product or process are completed at the time of purchase.~~

985-20-25-10 Paragraph superseded by Accounting Standards Update 2009-XX. ~~If purchased software has an alternative future use, the cost shall be capitalized when the software is acquired and accounted for in accordance with its use. The alternative future use test also applies to purchased software that will be integrated with a product or process in which the research and development activities for the other components are not complete.~~

17. Amend paragraph 985-20-55-13, with a link to transition paragraph 730-10-65-1, as follows:

985-20-55-13 An entity may purchase software that will be integrated into another software or hardware product. The cost of purchased computer software to be sold, leased, or otherwise marketed shall be capitalized when the software is acquired, regardless of whether technological

<u>feasibility is established at the time of purchase.</u> ~~Assuming that purchased computer software has no alternative future use, its costs can be capitalized only if the technological feasibility of the product to be ultimately marketed has been established at the time of purchase. Such factors as the timing of receipt or the status of hardware and internal software development may be crucial in determining whether technological feasibility is established at the time of purchase.~~

18. Supersede paragraph 985-20-55-14 and its related heading, with a link to transition paragraph 730-10-65-1, as follows:

~~**> > > Software Purchased Before Technological Feasibility Established**~~

985-20-55-14 <u>Paragraph superseded by Accounting Standards Update 2009-XX.</u> ~~An entity may purchase software before technological feasibility has been established. For example, an entity purchases software for $100,000 that can be resold for $75,000. The amount of $25,000 would be charged to research and development, and $75,000 would be capitalized. If the software product reached technological feasibility, the $75,000 would be included in the cost of the software product. If the technological feasibility of the software was never established, the $75,000 would be classified as inventory.~~

19. Amend paragraph 985-20-55-18, with a link to transition paragraph 730-10-65-1, as follows:

985-20-55-18 Costs incurred for **product enhancements** ~~should be charged to expense as~~ <u>are considered</u> research and development until the technological feasibility of the enhancement has been established <u>and should be accounted for in accordance with Subtopic 730-10</u>. If the original product will no longer be marketed, any unamortized cost of the original product should be included with the cost of the enhancement for purposes of applying the net realizable value test and amortization provisions. If the original product will remain on the market along with the enhancement, the unamortized cost of the original product should be allocated between the original product and the enhancement.

20. Amend paragraph 985-350-25-1, with a link to transition paragraph 730-10-65-1, as follows:

985-350-25-1 Paragraph 985-20-25-3 addresses capitalizing costs of producing **product masters** incurred after establishing technological feasibility. Paragraph ~~985-20-25-10~~ 985-20-25-8 addresses capitalizing the costs of purchased software~~ that has an alternative future use~~.

Amendments to Topic 350

21. Amend paragraph 350-30-35-7, with a link to transition paragraph 730-10-65-1, as follows:

350-30-35-7 An intangible asset shall not be written down or off in the period of acquisition unless it becomes impaired during that period. ~~However, paragraph 730-10-25-2(c) requires amounts assigned to intangible assets acquired in a transaction other than a business combination that are to be used in a particular research and development project and that have no alternative future use to be charged to expense at the acquisition date.~~

22. Amend paragraph 350-30-35-17A, with a link to transition paragraph 730-10-65-1, as follows:

350-30-35-17A Intangible assets acquired in a business combination or an asset acquisition that are used in research and development activities ~~(regardless of whether they have an alternative future use) ~~shall be considered indefinite lived until the completion or abandonment of the associated research and development efforts. During the period those assets are considered indefinite lived they shall not be amortized but shall be tested for impairment in accordance with the following paragraph. Once the research and development efforts are completed or abandoned, the entity shall determine the useful life of the assets based on the guidance in this Section. Consistent with the guidance in paragraph 360-10-35-49, intangible assets ~~acquired in business combination ~~that have been temporarily idled shall not be accounted for as if abandoned.

23. Amend paragraph 350-30-50-1, with a link to transition paragraph 730-10-65-1, as follows:

350-30-50-1 For **intangible assets** acquired either individually or as part of a group of assets (in either an asset acquisition or a business combination), all of the following information shall be disclosed in the notes to financial statements in the period of acquisition:

a. For intangible assets subject to amortization, all of the following:

   1. The total amount assigned and the amount assigned to any **major intangible asset class**

   2. The amount of any significant **residual value**, in total and by major intangible asset class

   3. The weighted-average amortization period, in total and by major intangible asset class.

b. For intangible assets not subject to amortization, the total amount assigned and the amount assigned to any major intangible asset class.

c. The amount of research and development assets acquired in a transaction other than a business combination~~ and written off in the period and the line item in the income statement in which the amounts written off are aggregated~~.

d. For intangible assets with renewal or extension terms, the weighted-average period before the next renewal or extension (both explicit and implicit), by major intangible asset class.

This information also shall be disclosed separately for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively if the aggregate fair values of intangible assets acquired, other than goodwill, are significant.

24. Amend paragraph 350-40-15-7, with a link to transition paragraph 730-10-65-1, as follows:

350-40-15-7 The following costs of internal-use computer software are included in research and development and shall be accounted for in accordance with the provisions of Subtopic 730-10:

a. Purchased or leased computer software used in research and development activities ~~where the software does not have alternative future uses~~

b. All internally developed internal-use computer software (including software developed by third parties, for example, programmer consultants) in either of the following circumstances:

1. The software is a pilot project (that is, software of a nature similar to a pilot plant as noted in paragraph 730-10-55-1(h)).

2. The software is used in a particular research and development project~~project, regardless of whether the software has alternative future uses~~.

25. Amend paragraph 350-50-25-4, with a link to transition paragraph 730-10-65-1, as follows:

350-50-25-4 All costs relating to software used to operate a website shall be accounted for under Subtopic 350-40 unless a plan exists or is being developed to market the software externally. Software for which a plan exists or is being developed to market the software externally is subject to Subtopic 985-20.~~985-20, and costs associated with the development of that software shall be expensed until technological feasibility is established.~~ See paragraph 985-20-25-2.

26. Amend paragraph 350-50-25-6, with a link to transition paragraph 730-10-65-1, as follows:

350-50-25-6 Costs ~~incurred to purchase software tools, or costs~~ incurred during the application development stage for internally developed tools, shall be accounted for in accordance with paragraph 350-40-15-7.~~capitalized unless they are used in research and development and meet either of the following conditions:~~

a. Subparagraph superseded by Accounting Standards Update 2009-XX.~~They do not have any alternative future uses.~~

b. Subparagraph superseded by Accounting Standards Update 2009-XX.~~They are internally developed and represent a pilot project or are being used in a specific research and development project (see paragraph 350-40-15-7).~~

Amendment to Topic 340

27. Amend paragraph 340-10-25-1, with a link to transition paragraph 730-10-65-1, as follows:

340-10-25-1 Design and development costs for products to be sold under long-term supply arrangements shall be expensed as incurred. Design and development costs for molds, dies, and other tools that a supplier will own and that will be used in producing the products under a long-term supply arrangement shall be capitalized as part of the molds, dies, and other tools (subject to an impairment assessment under the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10) unless the design and development is for molds, dies, and other tools involving new technology, in which case, the costs shall be ~~expensed as incurred in~~ accounted for in accordance with Subtopic 730-10.

Amendment to Topic 605

28. Amend paragraph 605-35-25-40, with a link to transition paragraph 730-10-65-1, as follows:

605-35-25-40 Learning or start-up costs are sometimes incurred in connection with the performance of a contract or a group of contracts. In some circumstances, follow-on or future contracts for the same goods or services are anticipated. Such costs usually consist of labor, overhead, rework, or other special costs that must be incurred to complete the existing contract or contracts in progress and are distinguished from research and development costs. (Section 730-10-25 requires that certain research and development costs be charged to expense when incurred.) A direct relationship between such costs and the anticipated future contracts is often difficult to establish, and the receipt of future contracts often cannot reasonably be anticipated.

Master Glossary

29. Amend the Master Glossary, with a link to transition paragraph 730-10-65-1, as follows:

Contingent Consideration

Usually an obligation of the **acquirer** to transfer additional assets or **equity interests** to the former **owners** of an **acquiree** (or former owners of an asset or asset group) as part of the exchange for **control** of the acquiree (or an asset or asset group) if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

Effective Date and Transition

30. Add paragraph 730-10-65-1 and its heading as follows:

> Transition Related to Accounting Standards Update No. 2009-XX, Research and Development (Topic 730): *Research and Development Assets Acquired and Contingent Consideration Issued in an Asset Acquisition (A Consensus of the FASB Emerging Issues Task Force)*

730-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2009-XX, Research and Development (Topic 730): *Research and Development Assets Acquired and Contingent Consideration Issued in an Asset Acquisition (A Consensus of the FASB Emerging Issues Task Force).*

a. The pending content that links to this paragraph shall be applied on a prospective basis for acquisitions of assets occurring in fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years.

b. Earlier application is prohibited.

Issue No. 09-3

Title: Certain Revenue Arrangements That Include Software Elements

Dates Discussed: March 19, 2009; June 18, 2009; September 9–10, 2009

References: FASB Accounting Standards Codification Topic 605, *Revenue Recognition*

FASB Accounting Standards Codification Topic 840, *Leases*

FASB Accounting Standards Codification Topic 985, *Software*

FASB Statement No. 13, *Accounting for Leases* (now under Topic 840)

FASB Statement No. 154, *Accounting for Changes and Error Corrections* (now under Topic 250)

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (now under Topic 605)

AICPA Statement of Position 91-1, *Software Revenue Recognition*

AICPA Statement of Position 97-2, *Software Revenue Recognition* (now under Topic 985)

SEC Staff Accounting Bulletin No. 104, Topic 13, *Revenue Recognition*

International Accounting Standard 18, *Revenue*

EITF Issue No. 00-3, "Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware" (now under Topic 985)

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" (now under Topic 605)

EITF Issue No. 03-5, "Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software" (now under Topic 985)

EITF Issue No. 08-1, "Revenue Arrangements with Multiple Deliverables"

Introduction

1. Products or services that contain software that is "more than incidental" to the products or services as a whole are within the scope of SOP 97-2. SOP 97-2 requires the use of vendor-specific objective evidence (VSOE) of selling price to separate deliverables in a multiple-element arrangement. SOP 97-2 frequently includes within its scope certain software-enabled devices for which the vendor is seldom able to determine VSOE (since products are only sold in conjunction with other deliverables), which often results in an uneconomic pattern of revenue recognition.

2. Issue 08-1, as proposed, would, among other things, modify Issue 00-21 to require an entity to use its best estimate of selling price to separate deliverables in multiple-deliverable revenue

arrangements when VSOE or third-party evidence (TPE) of selling price do not exist. Following the discussions in Issue 08-1, constituents have questioned whether software revenue arrangements require a model that differs from the measurement principles in Issue 08-1 or whether the scope of SOP 97-2 should be amended to exclude some transactions involving software-enabled devices that may not have been contemplated at the time of the original deliberations on SOP 97-2.

3. At the November 13, 2008 EITF meeting, the Task Force considered whether to (a) expand the scope of Issue 08-1 to include transactions accounted for under SOP 97-2, (b) expand the scope of Issue 08-1 to specifically include revenue related to software-enabled devices, or (c) not expand the scope of Issue 08-1 but recommend that a separate project be added to the EITF agenda to evaluate the scope of SOP 97-2 and the accounting for revenue arrangements with multiple deliverables within the scope of SOP 97-2. The Task Force reached a consensus-for-exposure on Issue 08-1 that the scope of Issue 08-1 should be the same as the scope of Issue 00-21 and that the scope should not be expanded to include deliverables within the scope of SOP 97-2. The Task Force also recommended to the FASB chairman that a separate Issue be added to the EITF agenda to consider changes to the accounting for multiple element arrangements under SOP 97-2. The FASB chairman, who was present at the meeting, considered the Task Force recommendation and input from other Board members also in attendance, and decided to add this Issue to the EITF agenda. The Task Force noted that it would be preferable if any amendments arising from future Task Force deliberations on SOP 97-2 were to have an effective date that is consistent with Issue 08-1.

Issues

4. The issues are:

Issue 1— Whether this Issue should modify the measurement criteria or the scope of SOP 97-2

Issue 2— If the Task Force decides to change the scope of SOP 97-2, how the scope of SOP 97-2 should be modified.

Scope

5. This Issue applies to multiple-deliverable revenue arrangements that include tangible products and software.

Prior EITF Discussion

6. At the March 19, 2009 EITF meeting, the Task Force discussed Issue 1, including user input, and reached a tentative conclusion that this Issue should focus on amending the scope of SOP 97-2. Some Task Force members observed that they believe that addressing the scope of SOP 97-2 would result in an incremental improvement in financial reporting. As it relates to measurement, some Task Force members noted that conceptually they did not believe that measurement criteria for revenue transactions should vary by industry. Other Task Force members observed that they believe that modification of the measurement criteria for software transactions should be addressed by the FASB and IASB in their joint project on revenue recognition rather than by the Task Force because it would require a wholesale reconsideration of SOP 97-2, would likely result in a significant change in practice and possibly require a

significant length of time to reach a consensus-for-exposure. Task Force members also discussed user input received regarding a broad change to measurement of software revenue recognition. The staff noted that in its discussion with users of financial statements of "pure" software companies, there was no support for allowing the use of management estimates for allocating arrangement consideration to software deliverables. The staff also noted that in discussions with users of financial statements of entities in industries in which there was not uniform application of SOP 97-2, such as the gaming, networking, and medical device industries, those users were more supportive of a change to the scope of SOP 97-2, particularly if it would achieve more comparability between entities.

7. On Issue 2, the Task Force reached a tentative conclusion that SOP 97-2 and Issue 03-5 should be modified such that the following products would be considered non-software deliverables and therefore would be excluded from the scope of SOP 97-2:

> Tangible products containing software components and non-software components that function together to deliver the product's essential functionality.

8. The Task Force discussed the application of the scope modification in various arrangements, such as when the software could be sold separately from the hardware and when alternative software was available that would provide similar functionality. The Task Force also discussed whether and how to require that software be separated into those components that were essential to the product's functionality and those that were not. The Task Force requested that the FASB staff prepare illustrative examples of how the proposed scope amendment would be applied to transactions currently accounted for in accordance with SOP 97-2 for discussion at a future meeting.

9. The Task Force did not discuss and was not asked to reach a conclusion on the effective date and transition for this Issue.

10. At the June 18, 2009 EITF meeting, the Task Force discussed assumptions and examples provided by the FASB staff and generally agreed with the conclusions in those examples of how the tentative conclusions reached at the March 19, 2009 meeting could be interpreted to apply. Some Task Force members observed that the assumptions and examples could be viewed as creating an arbitrary division between different types of software arrangements with hardware elements thereby creating a bright line in determining when a software-enabled product is or is not within the scope of SOP 97-2. Other Task Force members observed that such lines are a consequence of deciding to modify the scope of SOP 97-2 rather than the measurement and separation criteria within SOP 97-2. The Task Force discussed whether the tentative consensus would provide opportunity for structuring a software transaction to avoid accounting for an arrangement under SOP 97-2. Some Task Force members observed that judgment would be required in assessing the substance of the transaction and/or product in applying this consensus and indicated that the assumptions and examples would be helpful considerations in applying the consensus-for-exposure.

11. On Issue 1, the Task Force affirmed as a consensus-for-exposure its tentative conclusion from the previous meeting that the scope of this Issue should focus on modifying the scope of SOP 97-2 rather than the measurement and separation criteria within SOP 97-2.

12. On Issue 2, the Task Force affirmed as a consensus-for-exposure its tentative conclusion from the previous meeting that:

> Tangible products containing software components and non-software components that function together to deliver the product's essential functionality are not within the scope of SOP 97-2.

13. The Task Force also agreed that the draft abstract should include examples that illustrate the application of the consensus-for-exposure. The Task Force also requested that the FASB staff seek constituent feedback on whether they agree with the Task Force's decision in this Issue to modify the scope of SOP 97-2 rather than its measurement and separation criteria.

14. The Task Force also reached a consensus-for-exposure that the disclosures and transition provisions included in the consensus-for-exposure reached at the June 18, 2009 EITF meeting for Issue 08-1 also apply to arrangements within the scope of this Issue.

Current EITF Discussion

15. At the September 9–10, 2009 meeting, the Task Force discussed the comment letters received on the draft abstract. Task Force members agreed to continue to address this Issue even though it overlaps certain issues being considered in the FASB and IASB's joint revenue recognition project. Some Task Force members observed that most comment letter respondents were supportive of the guidance in the consensus-for-exposure and believed that guidance would significantly improve financial reporting until the joint project has been completed. Task Force members reached a consensus to focus the scope of this Issue on determining which arrangements are within the scope of the software revenue recognition guidance rather than pursue a broader change to the allocation and measurement guidance for all software transactions.

16. The Task Force discussed the factors included in the draft abstract and agreed to modify paragraph 5(a) (pending paragraph 985-605-15-4(e)(1)) to address respondent concerns that the draft abstract language created a bright line because it stated that if a tangible product always contains software components when the product is sold, the software is considered essential to the functionality of the product. Task Force members agreed to the following modification to clarify their intent that this consideration was meant to be applied as a rebuttable presumption rather than an absolute:

> A rebuttable presumption exists that software elements are essential to the functionality of the tangible product if sales of the tangible product without the software elements are infrequent.

17. Task Force members also agreed to include an additional factor to consider in applying the scope exception and to modify Example 7 in the draft abstract (Case G in pending paragraphs

985-605-55-224 through 55-225) in order to clarify that the hardware components of a tangible product must substantively contribute to the functionality of the tangible product for the scope exception to apply. These changes were made to clarify some respondent's concerns that the draft abstract could be interpreted to mean that integrating non-substantive hardware components with software could result in the software being excluded from the software revenue recognition guidance. The following factor was added to address those concerns:

> The non-software elements of the tangible product must substantively contribute to the tangible product's essential functionality. For example, the tangible product should not simply provide a mechanism to deliver the software to the customer.

18. Task Force members also requested that the guidance resulting from this consensus clarify that the hardware elements of a tangible product are always outside of the scope of the software revenue guidance.

Disclosure

19. The Task Force affirmed as a consensus the consensus-for-exposure concerning the ongoing disclosure requirements that were included in the draft abstract consistent with Issue 08-1.

Effective Date, Transition Method, and Transition Disclosures

20. The Task Force affirmed as a consensus that the effective date, transition method, and transition disclosures required by this Issue would be the same as required by the consensus reached at the September 9–10, 2009 EITF meeting on Issue 08-1.

Board Ratification

21. At the September 23, 2009 meeting, the Board ratified the consensus reached by the Task Force in this Issue. The draft amendments to the FASB Accounting Standards Codification™ to be included in the Accounting Standards Update are included as Appendix 09-3A.

Status

22. No further EITF discussion is planned.

Appendix 09-3A

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–8. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is underlined and deleted text is ~~struck out.~~

Amendments to Subtopic 985-605

2. Amend paragraph 985-605-15-3, with a link to transition paragraph 985-605-65-1, as follows:

985-605-15-3 The guidance in this Subtopic applies to the following transactions and activities:

a. Licensing, selling, leasing, or otherwise marketing computer software.

b. Subparagraph superseded by Accounting Standards Update 2009-XX.~~Leases of software that include property, plant, or equipment, if the software is more than incidental (see [c]) to the property, plant, or equipment as a whole. Any revenue attributable to the software, including postcontract customer support, shall be accounted for separately in conformity with the guidance in this Subtopic (see Subtopics 840-20 and 840-30 for guidance on revenue attributable to the property, plant, and equipment).~~

c. The software and software-related elements of ~~Other~~ arrangements ~~for products or services~~ that include software that is ~~more than incidental~~ more-than-incidental to the products or services in the arrangement as a whole. Indicators that ~~of~~ software ~~that~~ is more-than-incidental to the products or services in an arrangement ~~a product~~ as a whole include (but are not limited to):

1. The software is a significant focus of the marketing effort or is sold separately.

2. The vendor is providing **postcontract customer support**.

3. The vendor incurs significant costs that are within the scope of Subtopic 985-20.

In such arrangements, the guidance in this Subtopic applies to the software and software-related elements in the arrangement unless a scope exception in paragraph 985-605-15-4 is present. Software-related elements include software products and services such as those listed in paragraph 985-605-25-5~~ as well as any nonsoftware deliverable or deliverables for which a software deliverable is essential to their functionality~~. A service is within the scope of this Subtopic if software in the arrangement is essential to the functionality of that service. ~~For example, in an arrangement that includes software, computer hardware that will contain the software, and additional unrelated equipment, if the software is essential to the functionality of the hardware, the hardware would be considered software-related. However, if the software is not essential to the functionality of the additional unrelated equipment, the equipment would not be considered software-related.~~

d. More-than-insignificant discounts on future purchases that are offered by a vendor in a software arrangement. More-than-insignificant discounts have all of the following characteristics:

1. Incremental to the range of discounts reflected in the pricing of the other elements of the arrangement

2. Incremental to the range of discounts typically given in comparable transactions

3. Significant.

If the discount or other concessions in an arrangement are more than insignificant, a presumption is created that an additional element or elements (as defined in paragraph 985-605-25-5) are being offered in the arrangement. Judgment is required when assessing whether an incremental discount is significant.

e. Arrangements to deliver software or a software system, either alone or together with other products or services~~services,~~ that require significant production, modification, or customization of software (~~See~~see Subtopic ~~605-35.)~~605-35). Paragraphs 985-605-25-88 through 25-107 provide guidance on applying contract accounting to certain arrangements involving software. If a software arrangement includes services that meet the criteria discussed in paragraph 985-605-25-78, those services should be accounted for separately.

The guidance beginning in paragraph 985-605-55-119 addresses the scope application of this Subtopic to a **hosting arrangement**.

3. Amend paragraph 985-605-15-4, with a link to transition paragraph 985-605-65-1, as follows:

985-605-15-4 The guidance in this Subtopic does not apply to the following transactions and activities:

a. Arrangements for products or services containing software that is incidental to the products or services as a whole

b. Leases of software that include a tangible product (such as property, plant, or ~~equipment~~equipment), if the software is incidental to the tangible product ~~property, plant, or equipment~~ as a whole or the software and nonsoftware components of the tangible product function together to deliver the tangible product's essential functionality

c. Marketing and promotional activities not unique to software transactions, such as the following:

1. Insignificant discounts on future purchases that are offered by a vendor in a software arrangement. For example, a vendor may offer a small discount (a coupon or other form of offer for 5 percent off) on additional licenses of the licensed product or other products that exist at the time of the offer but are not part of the arrangement.

2. Discounts that are not incremental to discounts typically given in comparable transactions (for example, volume purchase discounts comparable to those generally provided in comparable transactions).

d. Nonsoftware components of tangible products

e. Software components of tangible products that are sold, licensed, or leased with tangible products when the software components and nonsoftware components of the tangible product function together to deliver the tangible product's essential functionality

f. Undelivered elements that relate to software that is essential to the tangible product's functionality in (e).

4. Add paragraph 985-605-15-4A, with a link to transition paragraph 985-605-65-1, as follows:

985-605-15-4A In determining whether a tangible product is delivered with software components and nonsoftware components that function together to deliver the tangible product's essential functionality, a vendor shall consider all of the following:

a. If sales of the tangible product without the software elements are infrequent, a rebuttable presumption exists that software elements are essential to the functionality of the tangible product.

b. A vendor may sell products that provide similar functionality, such as different models of similar products. If the only significant difference between similar products is that one product includes software that the other product does not, the products shall be considered the same product for the purpose of evaluating factor (a).

c. A vendor may sell software on a standalone basis. The vendor may also sell a tangible product containing that same software. The separate sale of the software shall not cause a presumption that the software is not essential to the functionality of the tangible product.

d. Software elements do not need to be embedded within the tangible product to be considered essential to the tangible product's functionality.

e. The nonsoftware elements of the tangible product must substantively contribute to the tangible product's essential functionality. For example, the tangible product should not simply provide a mechanism to deliver the software to the customer.

5. Amend paragraph 985-605-25-10, with a link to transition paragraph 985-605-65-1, as follows:

985-605-25-10 The following are exceptions to the guidance in the preceding paragraph:

a. If the only undelivered element is postcontract customer support, the entire fee shall be recognized ratably (see paragraphs 985-605-25-66 through 25-75).

b. If the only undelivered element is services that do not involve significant production, modification, or customization of software (for example, training or installation), the entire fee shall be recognized over the period during which the services are expected to be performed (see paragraphs 985-605-25-76 through 25-85).

c. If the arrangement is in substance a subscription, the entire fee shall be recognized ratably (see paragraphs 985-605-25-58 through 25-59).

d. If the fee is based on the number of copies, the arrangement shall be accounted for in conformity with paragraphs 985-605-25-52 through 25-57.

e. There may be instances in which there is vendor-specific objective evidence of the fair values of all undelivered elements in an arrangement but vendor-specific objective evidence of fair value does not exist for one or more of the delivered elements in the arrangement. In such instances, if both of the conditions in the following paragraph are met, the fee shall be recognized using the residual method as follows:

1. The total fair value of the undelivered elements, as indicated by vendor-specific objective evidence, is deferred.

2. The difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.

f. If an arrangement includes deliverables that are within the scope of this Subtopic (software deliverables) and deliverables that are not within the scope of this Subtopic (nonsoftware deliverables), a vendor shall allocate arrangement consideration to the nonsoftware deliverables, and to the software deliverables as a group, in accordance with paragraph 605-25-15-3A. The nonsoftware deliverables may include software deliverables that are considered essential to the functionality of a tangible product. If the arrangement includes more than one software deliverable, the portion of the arrangement consideration allocated to the software deliverables as a group in accordance with the guidance in paragraph 605-25-15-3A would be further subject to the separation and allocation guidance of this Subtopic. If a tangible product contains software that is not essential to the product's functionality, that nonessential software and any other deliverables within the arrangement (other than the nonsoftware components of the tangible product) that relate to that nonessential software are within the scope of this Subtopic. If an undelivered element relates to a deliverable within the scope of this Subtopic and a deliverable excluded from the scope of this Subtopic, the undelivered element shall be bifurcated into a software deliverable and a nonsoftware deliverable. The software deliverable is within the scope of this Subtopic and the nonsoftware deliverable is not within the scope of this Subtopic.

6. Add paragraph 985-605-50-1, with no link to a transition paragraph 985-605-65-1, as follows:

985-605-50-1 For multiple-element arrangements that include deliverables within the scope of this Subtopic and deliverables that are not within the scope of this Subtopic, a vendor shall provide the disclosures included in the pending content in paragraphs 605-25-50-1 through 50-2.

7. Add paragraphs 985-605-55-211 through 55-236 and their related headings, with a link to transition paragraph 985-605-65-1, as follows:

>>Example 13—Arrangements That Include Tangible Products and Software Elements

985-605-55-211 The following cases illustrate the guidance in paragraphs 985-605-15-3 through 15-4 and paragraph 985-605-25-10. The cases provide guidance for purposes of allocating arrangement consideration in a multiple-element revenue arrangement that includes a tangible product and software. The cases illustrate whether a product contains software elements and nonsoftware elements that function together to deliver the tangible product's essential functionality as discussed in paragraph 985-605-15-4. The cases are:

a. Computer with operating system included (Case A)

b. Computer with operating system excluded more than infrequently (Case B)

c. Computer and multiple operating systems (Case C)

d. Computer with additional software products included (Case D~~F~~)

e. Personal digital assistant (Case E)

f. Computer with operating system sold separately (Case F)

g. Computer and undelivered software elements (Case G)

h. Standalone sale of an operating system (Case H)

i. Computer with nonessential software and postcontract customer support included (Case I)

j. Networking equipment (Case J)

k. Similar products (Case K)

l. Change in business practice (Case L).

>>>Case A: Computer with Operating System Included

985-605-55-212 Vendor sells a personal computer that includes an operating system that, along with the hardware, provides the basic functionality of a personal computer including the ability to manage the computer and its hardware functions, the ability to manage and interact with a range of hardware peripherals, and the ability to communicate through a variety of types of computer networks. This arrangement has no undelivered elements . Vendor infrequently sells the personal computer without the operating system.

985-605-55-213 Because both the hardware and operating system are necessary to deliver the computer's essential functionality, the arrangement would be excluded from the scope of this Subtopic.

>>>Case B: Computer with Operating System Excluded More Than Infrequently

985-605-55-214 Consider the same fact pattern as in Case A, except that Vendor sells the personal computer both with and without the operating system more than infrequently.

985-605-55-215 Because Vendor sells the personal computer without an operating system more than infrequently, the operating system is not considered essential to the functionality of the personal computer. Therefore, the computer would be excluded from the scope of this Subtopic, and the operating system would be considered a separate deliverable that is within the scope of this Subtopic.

>>>Case C: Computer and Multiple Operating Systems

985-605-55-216 Consider the same fact pattern as in Case A, except that Vendor also sells the personal computer with a different operating system that provides essentially the same functionality as the operating system in Case A.

985-605-55-217 Vendor infrequently sells the personal computer without an operating system, which indicates that an operating system is essential to the functionality of Vendor's personal computer. All deliverables would be excluded from the scope of this Subtopic.

>>>Case D: Computer with Additional Software Products Included

985-605-55-218 Consider the same fact pattern as in Case A, except that Vendor also includes a productivity software bundle with the personal computer that allows users to create, edit, and use documents, spreadsheets, and presentations. Vendor frequently sells the same computer both with and without the productivity software. When the productivity software is included with the software, the functionality of the productivity software is prominently displayed in the marketing materials and specifications of the computer. The productivity software is also sold separately.

985-605-55-219 The productivity software would not be considered necessary for the computer to provide its essential functionality. While the operating system is essential to deliver the personal computer's basic functionality, the productivity software is not. This is demonstrated by the fact that the computer is frequently sold both with and without the productivity software. The computer and operating system would be considered one deliverable that is excluded from the scope of this Subtopic. The productivity software would remain within the scope of this Subtopic.

>>>Case E: Personal Digital Assistant

985-605-55-220 Vendor sells a personal digital assistant. The personal digital assistant provides several functions, such as phone, camera, and computing functionality, that allow the user to access and use various software programs, such as a music player and games. The personal digital assistant contains an operating system that allows the customer to access the functionality of the device, including the ability to utilize software that is necessary to provide the phone, camera, and other functionality. The phone and camera software are frequently included on the personal digital assistant, but the music player and game software are excluded more than infrequently. The phone, camera, and music player software are not sold separately, but the game software is sold separately.

985-605-55-221 The personal digital assistant hardware, operating system, phone, and camera software are essential to the functionality of the personal digital assistant and would be considered one deliverable that is outside the scope of this Subtopic. The music player and game software would be considered software deliverables within the scope of this Subtopic because the product also is sold more than infrequently without this software. Whether the software is sold separately does not affect the conclusion in this example.

>>>Case F: Computer with Operating System Sold Separately

985-605-55-222 Vendor sells a personal computer that includes an operating system that, along with the hardware, provides the basic functionality of a personal computer, including the ability to manage the computer and its hardware functions, the ability to manage and interact with a range of hardware peripherals, and the ability to communicate through a variety of types of computer networks. The arrangement has no undelivered elements. Vendor never sells the personal computer without the operating system but does sell the operating system for the personal computer separately. The personal computer hardware cannot function without an operating system, and the operating system does not function without the computer hardware.

985-605-55-223 Vendor determines that the operating system is necessary to deliver the computer's essential functionality as evidenced by the fact that the vendor does not sell the computer without the operating system. Accordingly, the computer and operating system would be considered one deliverable that is excluded from the scope of this Subtopic. Whether the software is sold separately in a different transaction does not affect the conclusion in this example. The critical assessment is whether the computer and the operating system in one transaction are both necessary to provide the computer's essential functionality. See paragraph

985-605-55-227 for an illustration of how Vendor would account for the separate sale of the operating system without the computer.

>>>Case G: Computer and Undelivered Software Elements

985-605-55-224 Consider the same fact pattern as in Case A, except that Vendor also provides a specified upgrade right for the next version of its operating system along with postcontract customer support, including information about available upgrades of the operating system.

985-605-55-225 Because the computer and operating system are determined to be a single nonsoftware deliverable that is excluded from the scope of this Subtopic, all deliverables related to that nonsoftware deliverable are also considered nonsoftware deliverables and excluded from the scope of this Subtopic. Accordingly, the postcontract customer support and specified upgrade right for the operating system would be nonsoftware deliverables excluded from the scope of this Subtopic.

>>>Case H: Standalone Sale of an Operating System

985-605-55-226 Vendor releases a new upgraded version of its computer operating system. Vendor sells the upgraded operating system in a standalone transaction to a customer that had previously purchased a computer that contained a prior version of Vendor's operating system. Vendor now includes the upgraded operating system on all of its computers. When sold with the personal computer, the operating system is combined with the personal computer as a single nonsoftware deliverable that is excluded from the scope of this Subtopic.

985-605-55-227 The separate sale of the operating system would be within the scope of this Subtopic. Even though this software would be considered a nonsoftware deliverable if it were sold with the computer, this Subtopic only provides a scope exception for the operating system when it is part of an arrangement that includes the sale of a tangible product.

>>>Case I: Computer with Nonessential Software and Postcontract Customer Support Included

985-605-55-228 Consider the same fact pattern as in Case D, except that Vendor also provides postcontract customer support for both the computer (including the operating system) and productivity software.

985-605-55-229 The combined computer and operating system product is considered to be a single nonsoftware deliverable, and the productivity software is considered to be a software deliverable consistent with Case D. Because the postcontract customer support relates to deliverables within the scope of this Subtopic and deliverables outside the scope of this Subtopic, it must be bifurcated into software and nonsoftware related components. Postcontract customer support relating to the productivity software would be a deliverable within the scope of this Subtopic. Postcontract customer support relating to the computer (including the operating system) would be a nonsoftware deliverable that is outside the scope of this Subtopic.

>>>Case J: Networking Equipment

985-605-55-230 Vendor sells networking equipment that provides its energy company customers with the ability to remotely monitor and manage their customers' energy use. Vendor sells an integrated package of equipment and software that consists of a monitoring device that is placed at the energy company's customer location to collect data that it then relays back to the energy company's remote location and software that allows the energy company to analyze the data and interface with its billing system. The software is installed on the energy company's computer system, which is not purchased from Vendor. The equipment does not have functionality without the software, and the software does not have functionality without the equipment. Vendor's customers will initially purchase all of these components together; however, they also can separately purchase replacement or expansion equipment or updated versions of the software at a subsequent time.

985-605-55-231 The equipment and software would all be considered nonsoftware elements outside the scope of this Subtopic. The monitoring and relay equipment work together with the software (though not as a physically combined unit) to deliver the product's essential functionality and allow the energy company to access and analyze its customer's usage data. Vendor cannot access the functionality of the equipment without the software. Although Vendor does sell the equipment separately without the software, it only does so in replacement situations or as the customer base of the energy company expands. The customer would have needed to previously acquire the software for the replacement equipment to function.

>>>Case K: Similar Products

985-605-55-232 Vendor sells two models of personal digital assistant devices—Model 100 and Model 200. Model 100 (including the software delivered on Model 100) is considered to be a nonsoftware deliverable excluded from the scope of this Subtopic when applying this Subtopic. The difference between the two models is that Vendor infrequently sells the Model 200 without music player software. The music player software is not included on Model 100, but customers can separately purchase the software for use on Model 100. There is no substantive difference in the other hardware or software components of the two models.

985-605-55-233 Vendor would need to assess whether the two models are the same product or different products. If they are the same product, then the music player software would not be considered essential to the functionality of Model 200. Because there is no substantive difference between the two models other than the inclusion of the music player software, Vendor determines that the two models are the same product. When Vendor sells Model 200, it considers the music player software to be a software deliverable within the scope of this Subtopic when allocating the arrangement consideration.

>>>Case L: Change in Business Practice

985-605-55-234 Vendor sells engineering software that it always sells with postcontract customer support. Vendor does not have vendor-specific objective evidence for postcontract customer support and applies this Subtopic when accounting for the arrangement, which results in the software and postcontract customer support being combined into one unit of accounting. The software can be used on various computer systems. As a result of technological developments, Vendor changes its business model such that its software is now included on an integrated workstation device. The device offers several advanced features including voice command and touch-screen design capabilities. Vendor does not sell the workstation device without the engineering software, and the software is not sold separately from the device because the workstation is needed for the software to function. Vendor continues to sell the previous version of its engineering software separately, but its market strategy is to transition customers to its new advanced technology.

985-605-55-235 Vendor determined that the hardware components of the workstation device along with the engineering software are necessary to provide the product's essential functionality. Both the device and the postcontract customer support relating to the engineering software are now considered nonsoftware deliverables and are excluded from the scope of this Subtopic.

985-605-55-236 When a vendor's business model changes, judgment will be necessary to determine whether the software provided with a tangible product is essential to the product's functionality. For example, if the device does not provide substantive functionality beyond that provided by the software, the software would likely not be essential to the functionality of the device. In that case, the software and postcontract customer support would continue to be included within the scope of this Subtopic.

8. Add paragraph 985-605-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2009-XX, Software (Topic 985): *Certain Revenue Arrangements That Include Software Elements (A Consensus of the FASB Emerging Issues Task Force)*

985-605-25-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2009-XX, Software (Topic 985): *Certain Revenue Arrangements That Include Software Elements (A Consensus of the FASB Emerging Issues Task Force):*

a. The pending content that links to this paragraph shall be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless the vendor elects to adopt the pending content on a retrospective basis in accordance with paragraph 985-605-25-65-1(d).

b. Earlier application is permitted.

1. If a vendor elects earlier application and the period of adoption is not the first reporting period in the vendor's fiscal year, the pending content that links to this paragraph shall be applied through retrospective application from the beginning of the vendor's fiscal year.

2. If earlier application is elected in a period other than the first reporting period in the vendor's fiscal year, the vendor shall disclose at a minimum the following information for all previously reported interim periods in the year of adoption: revenue, income before income taxes, net income, earnings per share, and the effect of the change for the appropriate captions presented.

c. If a vendor elects to apply the pending content that links to this paragraph on a prospective basis, the vendor shall provide the disclosures included in paragraphs 605-25-65-1(c) through 65-1(d).

d. A vendor may elect, but is not required, to adopt the pending content that links to this paragraph through retrospective application applying the guidance in paragraphs 250-10-45-5 through 45-10. If a vendor elects retrospective application, the disclosures in paragraphs 250-10-50-1 through 50-3 shall be provided.

e. A vendor must adopt the pending content that links to this paragraph in the same period and use the same transition method that it uses to adopt the pending content that links to paragraph 605-25-65-1.

Issue No. 09-4

Title: Seller Accounting for Contingent Consideration

Dates Discussed: June 18, 2009; September 9–10, 2009

References: FASB Accounting Standards Codification Topic 450, *Contingencies*

FASB Accounting Standards Codification Topic 460, *Guarantees*

FASB Accounting Standards Codification Topic 805, Business Combinations

FASB Accounting Standards Codification Topic 810, *Consolidation*

FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging*

FASB Statement No. 5, *Accounting for Contingencies* (now under Topic 450)

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (now under Topic 815)

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 141 (revised 2007), *Business Combinations* (now under Topic 805)

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (now under Topic 810)

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (now under Topic 460)

FASB Staff Position FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (now under Topic 805)

FASB Concepts Statement No. 6, *Elements of Financial Statements*

AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements*) (now under Topic 810)

International Accounting Standard 39, *Financial Instruments: Recognition and Measurement*

Introduction

1. Statement 141(R) requires that a buyer in a business combination recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred to the seller in exchange for the acquiree. In addition, a buyer is required to remeasure contingent consideration classified as an asset or liability to its fair value through current period earnings (or other comprehensive income if the arrangement is a hedging instrument) each reporting period. This requirement to initially and subsequently recognize contingent consideration at fair value is a change from Statement 141 under which contingent consideration in a business combination

typically was not recognized by a buyer at the date of acquisition but, rather, when the contingency was resolved and the additional consideration was issuable to the seller.

2. While Topic 805 does not provide guidance on the seller's accounting in a business combination, Topic 810 (originally issued as Statement 160 concurrent with Statement 141(R)), provides the seller's accounting for the deconsolidation of a subsidiary. In the event that a parent ceases to have a controlling financial interest in a subsidiary (including the sale of a subsidiary) and deconsolidation is required, paragraph 810-10-40-5 requires that the gain or loss recognized upon deconsolidation of a subsidiary be measured as the difference between (a) the aggregate of (1) the fair value of any consideration received, (2) the fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated, and (3) the carrying amount of any noncontrolling interest in the former subsidiary at the date the subsidiary is deconsolidated, and (b) the carrying amount of the former subsidiary's assets and liabilities.

3. Prior to Statement 160, a seller typically accounted for contingent consideration only when the contingency was resolved and consideration was received consistent with the gain contingency literature in Topic 450 unless the contingent consideration met the definition of a derivative under Topic 815. Questions have been raised as to whether contingent consideration associated with a transaction resulting in the deconsolidation of a subsidiary is required to be recognized at fair value or treated as a gain contingency. Further, if the contingent consideration is to be recognized at fair value, constituents have questioned what should be the subsequent accounting for the corresponding asset or liability.

Issues

4. The issues are:

Issue 1— Whether paragraph 810-10-40-5 (and its reference to "the fair value of any consideration received") requires that a seller recognize the acquisition-date fair value of *all* contingent consideration as part of the consideration received when deconsolidating a subsidiary.

Issue 2— If the Task Force concludes a seller is required to recognize the acquisition-date fair value of *all* contingent consideration as part of the consideration received when deconsolidating a subsidiary, how the seller should subsequently account for contingent consideration.

Prior EITF Discussion

5. At the June 18, 2009 EITF meeting, only Issue 2 was presented to the Task Force for consideration. Certain Task Force members questioned whether this Issue should be expanded, from subsequent measurement to address the initial measurement of seller contingent consideration. Those Task Force members observed that while one interpretation of Topic 810 could be that contingent consideration should initially be recorded at fair value, that Topic did not amend the guidance in Topic 450 for the recognition of gain contingencies. Accordingly, those Task Force members do not believe that the initial measurement of seller-contingent consideration is clear under Topic 810. After further discussion between Task Force members and FASB Board members who were present at the meeting, the FASB Chairman agreed that this Issue could be expanded to reconsider seller accounting for contingent consideration at initial measurement and also address subsequent measurement.

6. The Task Force briefly discussed subsequent measurement considerations if the initial measurement is determined to be at fair value. Because subsequent measurement guidance may be impacted by the decisions reached by the Task Force on initial measurement, the Task Force deferred further discussion on subsequent measurement and required disclosures until a future meeting.

7. One Task Force member questioned whether it was necessary to continue discussion of this Issue given that seller contingent consideration could potentially be within the scope of the FASB and IASB's joint project on accounting for financial instruments. The Task Force decided to continue discussion of this Issue because it is a current practice issue, but will continue to monitor the scope of the Boards' joint project.

8. The Task Force also determined that the scope of this Issue is limited to contingent consideration arrangements that are within the scope of Topic 810.

Current EITF Discussion

9. At the September 9–10, 2009 EITF meeting, the Task Force discussed Issue 1 but did not reach any consensus. Some Task Force members were supportive of recognizing contingent consideration at fair value upon initial measurement, while other Task Force members believed that the contingent consideration should be accounted for as a gain contingency under Topic 450.

10. On Issue 2, some Task Force members were supportive of recognizing contingent consideration at fair value in subsequent periods. Those Task Force members observed that this treatment would align the accounting for contingent consideration between a buyer and a seller in a business combination. Other Task Force members were not supportive of recognizing contingent consideration at fair value in subsequent periods. Some of those Task Force members were concerned that a seller may not have sufficient information available to estimate the fair value of the contingent consideration arrangement.

11. An FASB staff member observed that reasonable interpretations of paragraph 810-10-40-5 appeared to exist to support either recognizing the fair value of the contingent consideration upon deconsolidation of the subsidiary or accounting for the consideration as a gain contingency. Given that no subsequent measurement guidance was included in Statement 160 (now under Topic 810) for contingent consideration, the FASB staff member also observed that the appropriate accounting for subsequent measurement of the contingent consideration was also unclear if the consideration was recognized at fair value upon deconsolidation.

Status

12. No further EITF discussion is planned.

Issue No. 09-B

Title: Consideration of an Insurer's Accounting for Majority-Owned Investments When Ownership Is through a Separate Account

Date Discussed: September 9–10, 2009

References: FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*

FASB Accounting Standards Codification Topic 810, *Consolidation*

FASB Accounting Standards Codification Topic 944, *Financial Services – Insurance*

FASB Accounting Standards Codification Topic 946, *Financial Services – Investment Companies*

FASB Statement No. 154, *Accounting Changes and Error Corrections* (now under Topic 250)

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (now under Topic 810)

AICPA Statement of Position 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts* (now under Topic 944)

AICPA Audit and Accounting Guide, *Investment Companies* (now under Topic 946)

EITF Issue No. 85-12, *Retention of Specialized Accounting for Investments in Consolidation* (now under Topic 810)

Introduction

1. Life insurance entities offer certain products that provide an investment return and, in some cases, insure mortality risk. To facilitate the pass through of investment return risk, a separate account is established by the insurance entity. A separate account is not a distinct legal entity, but rather an accounting entity created by and under the control of the insurance entity that owns 100 percent of the assets held in the separate account. The separate account arrangement legally isolates certain assets backing variable annuity contracts from the other assets of the insurance entity (the other assets of the insurance entity are held in the general account of the insurer). The main reason for this structure is to protect assets backing the separate account component of variable annuity contracts from the general creditors of the insurance entity should the insurance entity become insolvent.

2. While the insurance entity cannot make investment allocation decisions for contract holders, the insurance entity does hold title to the investments in a separate account and generally has certain rights associated with those investments, such as the ability to vote on behalf of the contract holder. In return, the insurance entity generally receives an asset management and/or

administrative fee. Separate accounts operate similar to mutual funds and invest in assets that match the investment objective of the insurance contracts that the separate account assets fund, including individual securities, real estate, and mutual funds. An insurance entity also may invest separately in the same investments through its general account or through its interest in the separate account.

3. Assuming the separate account meets the criteria in paragraph 944-80-25-2, the separate account assets representing contract holder funds are measured at fair value and reported in the insurance entity's financial statements as a summary total, with an equivalent summary total reported for related liabilities. The related investment performance and amount credited to the contract holder is netted to zero in the same statement of operations line item.

4. Certain separate accounts are required to issue standalone financial statements and are considered investment companies as noted in paragraph 946-10-05-3. Paragraph 946-810-45-2 states that consolidation or use of the equity method by an investment company of a non-investment company investee is not appropriate, but Topic 946 does not address whether consolidation of investment company investees is required. In practice, if a separate account holds a majority interest in a mutual fund, the separate account generally has not consolidated the mutual fund in its standalone financial statements.

5. Paragraph 810-10-25-15 states that if the specialized industry accounting principles are appropriate at the subsidiary level, those principles should be retained in consolidation. Accordingly, if the separate account was a legal entity, the insurer would apply this guidance and not consolidate the mutual fund. However, because a separate account is not a separate legal entity and may be required to prepare separate financial statements, it is unclear whether this guidance applies to separate accounts. Additionally, with the issuance of Statement 160, questions have arisen about how to present the noncontrolling interest if the investment were to be consolidated. It also is not clear whether the insurer should combine its general account interest with the separate account interest when assessing whether the insurer has a controlling interest in the investment.

Issues

6. The issues are:

Issue 1— How an insurer should account for a majority-owned investment in a mutual fund when that insurer's separate account holds the majority ownership interest

Issue 1a— If the Task Force concludes that the insurer should consolidate the mutual fund in Issue 1, how the consolidated mutual fund should be reflected in the financial statements of the insurer

Issue 2— How an insurer should account for a majority-owned investment in a mutual fund when majority ownership is through a combination of interests held by its separate and general accounts, but neither the separate account nor the general account individually has a majority interest

Issue 2a— If the Task Force concludes that the insurer should consolidate the mutual fund in Issue 2, how the consolidated mutual fund should be reflected in the financial statements of the insurer.

Scope

7. This Issue applies to insurance entities that hold a majority-owned investment in a voting-interest mutual fund through a separate account that meets all of the conditions in paragraph 944-80-25-2 or through a combination of separate and general account interests. This Issue does not apply to insurance entities that hold a majority-owned investment in a mutual fund through their general account. The guidance in this Issue is applicable only to insurance entities within the scope of this Issue and should not be used by analogy in other investment situations.

Current EITF Discussion

8. At the September 9–10, 2009 EITF meeting, the Task Force reached a consensus-for-exposure on Issue 1 that an insurer would not be required to consolidate a mutual fund in situations in which that insurer holds a majority-owned investment in the mutual fund through its separate account pursuant to 810-10-25-15.

9. In discussing Issue 1, some Task Force members indicated that they believe that specialized industry accounting that applies to investment companies and that is retained in consolidation by non-investment company parents pursuant to paragraph 810-10-25-15 should apply to separate account arrangements that meet the definition of an investment company in Topic 946. Other Task Force members indicated that although the insurer may legally have the majority voting rights in the mutual fund through its management of the separate account, they were unsure whether control over the mutual fund resided with the insurer because the separate account contract holders bore the risks and rewards of the mutual fund investment and had the ability to direct the investments in the separate account including whether or not to invest in the mutual fund.

10. The Task Force also reached a consensus-for-exposure on Issue 2 that an insurer would not be required to consolidate a mutual fund in situations in which an insurer holds a majority-owned investment in that mutual fund through a combination of interests held by its separate and general accounts, but neither the separate account nor the general account individually has a majority interest.

11. During the discussion of Issue 2, some Task Force members indicated that they believe that the insurer's general account interest and contract holder's separate account interests should be viewed as two different interests when assessing whether the insurer has a controlling interest in the investment in the mutual fund. That is, the general account interest and the separate account interest should not be combined for determining whether a controlling interest exists. Other Task Force members noted that if the separate account interest did not result in consolidation in Issue 1, then the combination of a general account interest with a separate account interest should not require consolidation either.

12. The Task Force decided not to address Issues 1a and 2a, but requested that a question for respondents be included in the proposed Accounting Standards Update about whether

constituents believe that additional guidance is required on how an insurer should consolidate a majority-owned investment in a mutual fund if some or all of that interest is held by a separate account and the insurer has determined that it should consolidate the investment.

Disclosure

13. During the Task Force's deliberations, no additional disclosure requirements were recommended for exposure.

Effective Date, Transition Method, and Transition Disclosures

14. The Task Force reached a consensus-for-exposure that this Issue shall be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. Early adoption would not be permitted. The consensus requires retrospective application to all prior periods upon the date of adoption.

15. The transition disclosures in paragraphs 250-10-50-1 through 50-3 would be required.

Board Ratification

16. At the September 23, 2009 meeting, the Board ratified the consensuses-for-exposure reached by the Task Force in this Issue and approved the issuance of a proposed Accounting Standards Update (proposed Update) for public comment. The draft amendments to the FASB Accounting Standards Codification™ to be included in the proposed Update are included as Appendix 09-BA.

Status

17. The proposed Update will be posted to the FASB website no later than September 30, 2009. Comments on the proposed Update are will be due no later than October 26, 2009. Further discussion is expected at a future meeting

Appendix 09-BA

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™

Introduction

A1. The Accounting Standards Codification is amended as described in paragraphs 2–4. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is underlined and deleted text is ~~struck out~~.

Amendments to Subtopic 944-80

A2. Amend paragraph 944-80-25-3, with a link to transition paragraph 944-80-65-1, as follows:

944-80-25-2 The guidance in the following paragraph applies if the **separate account arrangement** meets all of the following conditions:

a. The separate account is recognized legally; that is, the separate account is established, approved, and regulated under special rules such as state insurance laws, federal securities laws, or similar foreign laws.

b. The separate account assets supporting the contract liabilities are insulated legally from the **general account** liabilities of the insurance entity; that is, the contract holder is not subject to insurer default risk to the extent of the assets held in the separate account.

c. The insurer must, as a result of contractual, statutory, or regulatory requirements, invest the contract holder's funds within the separate account as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies.

d. All investment performance, net of contract fees and assessments, must as a result of contractual, statutory, or regulatory requirements be passed through to the individual contract holder. Contracts may specify conditions under which there may be a minimum guarantee, but not a ceiling, as a ceiling would prohibit all investment performance from being passed through to the contract holder.

944-80-25-3 All of the following guidance applies if a separate account arrangement meets all of the conditions in the preceding paragraph:

a. The portion of separate account assets representing contract holder funds shall be reported in the insurance entity's financial statements as a summary total, with an equivalent summary total reported for related liabilities.

b. Any liabilities related to minimum guarantees and insurance benefit liabilities under the contracts in excess of the **fair value** of separate account assets representing contract holder funds shall be recognized as general account liabilities.

c. Contract fees and assessments shall be reported in accordance with paragraph 944-605-25-5.

d. Solely for the purpose of evaluating the retention of specialized accounting for investments in consolidation as described in paragraph 810-10-25-15, a separate account arrangement shall be considered a subsidiary. The insurer is not required to consolidate a majority-owned voting-interest investment held by a separate account if the investment is not or would not be consolidated in the standalone financial statements of the separate account.

e. The insurer is not required to combine its general account interest in a voting-interest investment with any separate account interest in the same investment when assessing whether the insurer has a controlling interest in that investment.

A3. Supersede paragraph 944-80-55-7, with a link to transition paragraph 944-80-65-1, as follows:

944-80-55-7 Paragraph superseded by Accounting Standards Update 2009-XX. ~~Accounting for~~

~~equity investments, including mutual funds, would depend on percentage ownership. If Subaccount XYZ owns more than 50 percent of the outstanding shares of a mutual fund, the accounting and classification of the items included in the column titled Separate Account at General Account Value would reflect consolidating the mutual fund into Subaccount XYZ. That is, if the mutual fund held debt and equity securities, those amounts would be included in the debt and equity securities lines of the table in the following paragraph.~~

A4. Add paragraph 944-80-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2009-XX, Financial Services—Insurance (Topic 944): Consideration of an Insurer's Accounting for Majority-Owned Investments When Ownership Is through a Separate Account (A Consensus of the FASB Emerging Issues Task Force)

944-80-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2009-XX, Financial Services—Insurance (Topic 944): *Consideration of an Insurer's Accounting for Majority-Owned Investments When Ownership Is through a Separate Account (A Consensus of the FASB Emerging Issues Task Force)*

a. The pending content that links to this paragraph shall be applied on a retrospective basis in fiscal years beginning after December 15, 2010, and interim periods within those fiscal years.

b. Earlier application is prohibited.

c. The disclosures in paragraphs 250-10-50-1 through 50-3 shall be provided.

Issue No. 09-E

Title: Accounting for Stock Dividends, Including Distributions to Shareholders with Components of Stock and Cash

Date Discussed: September 9–10, 2009

References: FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*

FASB Accounting Standards Codification Topic 260, *Earnings per Share*

FASB Accounting Standards Codification Topic 480, *Distinguishing Liabilities from Equity*

FASB Accounting Standards Codification Topic 505, *Equity*

FASB Accounting Standards Codification Topic 855, *Subsequent Events*

FASB Statement No. 128, *Earnings per Share* (now under Topic 260)

FASB Statement No. 165, *Subsequent Events* (now under Topic 855)

AICPA Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins* (now under Topic 260 and Topic 505)

IAS 33, *Earnings Per Share*

Introduction

1. The Internal Revenue Service (IRS) requires real estate investment trusts (REITs) to distribute at least 90 percent of their taxable income. Historically, some REITs have issued "special dividends," that is, dividends above the REIT's recurring quarterly dividend, in periods of large, non-recurring earnings. In many cases, REITs issued these special dividends in the form of cash and stock, subject to approval by the IRS by means of a private letter ruling.

2. In 2008, the IRS issued a ruling that allows REITs to make distributions in the form of cash and stock to satisfy their annual distribution requirements, which may be in the form of normal recurring dividends or special dividends, without having obtained a private letter ruling in advance. For a REIT to qualify for taxable dividend treatment under the IRS Revenue Procedure, the distribution must offer shareholders the ability to elect to receive their entire dividend distribution in cash or stock of equivalent value. If too many shareholders elect to receive cash, each shareholder electing to receive cash must receive a pro rata amount of cash corresponding to their proportionate interest in the distribution, but in no event will any shareholder electing to receive cash receive less than 10 percent of their entire distribution in cash. The distribution must be declared for a taxable year ending on or before December 31, 2009.

3. In January 2009, the IRS extended this guidance to closed-end investment funds, which are also required to distribute at least 90 percent of their taxable income.

4. Although this guidance is currently only effective for taxable years ending on or before

December 31, 2009, entities may continue to declare special dividends in the form of cash and stock in future periods if they obtain a private letter ruling from the IRS.

5. Diversity in practice has developed regarding how entities account for these arrangements. Some entities consider the stock portion of the dividend to be a new stock issuance that is reflected in earnings per share (EPS) prospectively. Others consider it to be a stock dividend under paragraph 260-10-55-12 and retrospectively restate shares outstanding and EPS.

6. There is also diversity in practice as to when a stock dividend is recorded. Some believe a stock dividend should be reflected in earnings per share on the date the dividend is declared. Others believe that a stock dividend should be reflected in earnings per share when the trading price of the shares has been adjusted to reflect the effects of the stock dividend (the ex-dividend date) or when the dividend is settled.

Issues

7. The issues are:

Issue 1 —Whether the stock portion of a distribution to shareholders that contains components of cash and stock and allows shareholders to select their preferred form of the distribution (with a limit on the amount of cash that will be distributed in total) should be accounted for as a stock dividend for EPS purposes

Issue 2 —If the Task Force reaches a tentative conclusion in Issue 1 that the stock portion of the distribution is a stock dividend, whether an entity should reflect a stock dividend in EPS in its financial statements prior to the earlier of the ex-dividend date or the date the number of shares to be issued is known for purposes of applying the provisions of paragraph 260-10-55-12.

Current EITF Discussion

8. At the September 9–10, 2009 EITF meeting, the Task Force discussed Issue 1 and reached a consensus-for-exposure that the stock portion of a distribution to shareholders that contains components of cash and stock and allows shareholders to select their preferred form of the distribution (with a limit on the amount of cash that will be distributed in total) should be considered a stock dividend for purposes of applying the EPS provisions of Topic 260. Retrospective application of EPS would be required, regardless of whether the actual stock distribution is proportionate. The Task Force also reached a consensus-for-exposure that only the minimum portion of the distribution that will be issued in shares should be accounted for as a stock dividend. For example, if the cash available to be distributed is limited to 40 percent of the total value of the distribution, 60 percent of the total value of the distribution would be considered a stock dividend. The remaining 40 percent of the total value of the distribution that is available to be distributed in cash would not be considered a stock dividend, even if 40 percent of shareholders do not elect to receive cash and, therefore, more than 60 percent of the distribution is in shares. That is because shareholders have the option to receive cash or shares for 40 percent of the distribution that is not contingent on the outcome of elections made by other shareholders.

9. Some Task Force members did not agree that the stock portion of a distribution to shareholders that contains components of cash and stock and allows shareholders to select their preferred form of distribution (with a limit on the amount of cash that will be distributed in total) should be considered a stock dividend because the proportional interest of each shareholder would not remain the same unless all shareholders elected to receive cash or all shareholders elected to receive shares. The Task Force decided to present the views of these Task Force members as an alternative view in the questions for respondents in the proposed Accounting Standards Update (proposed Update) to allow respondents to provide comments on both views.

10. On Issue 2, the Task Force reached a consensus-for-exposure that an entity should reflect a stock dividend in EPS in its financial statements on the later of the ex-dividend date or the date the number of shares to be issued is known. The Task Force decided that this guidance should not be limited to stock dividends described in Issue 1 but should apply to all stock dividends.

11. The Task Force also reached a consensus-for-exposure that for the stock dividend portion of a distribution to shareholders described in Issue 1 that has not yet been retroactively reflected in EPS for all periods presented, an entity shall not include the shares to be distributed in the computation of diluted EPS.

Disclosure

12. Paragraph 260-10-50-2 requires disclosure of any transaction that occurs after the end of the most recent period but before the financial statements are issued or are available to be issued that would have changed materially the number of common shares or potential common shares outstanding at the end of the period if the transaction had occurred before the end of the period.

13. In connection with Issue 2, the Task Force reached a consensus-for-exposure that if EPS has not yet been adjusted retroactively for all periods presented to reflect a stock dividend, an entity shall disclose that EPS for all periods presented is subject to change upon settlement of the stock dividend. An entity shall also disclose the number of shares that would be issuable if the settlement of the stock dividend occurred on the reporting date (for example, the number of shares that would be issuable using the period-end market price).

Effective Date, Transition Method, and Transition Disclosures

14. The Task Force reached a consensus-for-exposure that the amendments in this proposed Update would be effective for interim and annual periods ending on or after December, 15, 2009, and would be applied on a retrospective basis.

Board Ratification

15. At the September 23, 2009 meeting, the Board ratified the consensus-for-exposure reached by the Task Force in this Issue and approved the issuance of a proposed Update for public comment. The amendments to the FASB Accounting Standards Codification™ to be included in the proposed Update are included as Appendix 09-EA.

Status

16. The proposed Update will be posted to the FASB website no later than September 30, 2009. Comments on the proposed Update will be due no later than October 26, 2009. Further discussion is expected at a future meeting

Appendix 09-EA

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™

Introduction

A1. The Accounting Standards Codification is amended as described in paragraphs 2–8. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is underlined and deleted text is ~~struck out~~.

Amendments to Subtopic 505-20

A2. Amend paragraph 505-20-05-3, with a link to transition paragraph 505-20-65-1, as follows:

505-20-05-2 Many recipients of stock dividends look upon them as distributions of corporate earnings, and usually in an amount equivalent to the fair value of the additional shares received. If the issuances of stock dividends are so small in comparison with the shares previously outstanding, such issuances generally do not have any apparent effect on the share market price and, consequently, the market value of the shares previously held remains substantially unchanged.

505-20-05-3 However, a **stock dividend** really takes nothing from the property of the ~~corporation~~ entity and adds nothing to the interests of the stockholders; that is, the ~~corporation's~~ entity's property is not diminished and the interests of the stockholders are not increased. ~~The~~Except as described in the following paragraph, the proportional interest of each shareholder remains the same. The only change is in the evidence that represents that interest; the new shares and the original shares together representing the same proportional interests that the original shares represented before the issuance of the new ones.

A3. Add paragraph 505-20-05-3A, with a link to transition paragraph 505-20-65-1, as follows:

505-20-05-3A In certain situations, shareholders are given an election to receive their entire dividend distribution in cash or shares of equivalent value, with a limitation placed on the amount of cash that will be distributed in the aggregate to all shareholders (for example, the total amount of cash available to be distributed may be limited to 40 percent of the total distribution). If too many shareholders elect to receive cash, each shareholder electing to receive cash receives a pro rata amount of cash corresponding to its proportionate interest in the distribution. In those situations, although the proportional interest of each individual shareholder may not remain the same, the minimum portion of the distribution that will be issued in shares shall be accounted for as a stock dividend. For example, if an entity with 1 million shares outstanding declares a $10 per-share dividend to be issued in cash or shares at the election of the shareholder, but the cash available to be distributed is limited to 40 percent ($4 million) of the total value of the distribution, 60 percent ($6 million in shares) of the total value of the distribution shall be considered a stock dividend. The remaining 40 percent of the distribution would be considered a cash dividend or stock issuance on the basis of the elections of the shareholders.

A4. Amend paragraph 505-20-15-3, with a link to transition paragraph 505-20-65-1, as follows:

505-20-15-3 The guidance in this Subtopic does not apply to the accounting for a distribution or issuance to shareholders of any of the following:

a. Shares of another corporation held as an investment

b. Shares of a different class

c. Rights to subscribe for additional shares

d. Shares of the same class in cases in which each shareholder is given an election to receive cash or shares. However, if a limitation is placed on the amount of cash available to be distributed in the aggregate to all shareholders, this Subtopic applies to the minimum portion of the distribution that will be issued in shares. For example, if the cash available to be distributed is limited to 40 percent of the total value of the distribution, this Subtopic applies to the 60 percent of the total value of the distribution that will be distributed in shares because each shareholder's option to receive greater than 40 percent in cash is contingent upon the outcome of elections made by other shareholders. This Subtopic does not apply to the 40 percent that may be distributed in cash because each shareholder has an option that is not contingent upon other shareholder elections to receive cash or shares for 40 percent of the total distribution.

Amendments to Subtopic 260-10

A5. Add paragraph 260-10-45-57A and its related heading, with a link to transition paragraph 505-20-65-1, as follows:

>> Distributions to Shareholders with Components of Stock and Cash

260-10-45-57A For a stock dividend that meets the description in paragraph 505-20-05-3A that has not yet been retroactively reflected in EPS for all periods presented (see paragraph 260-10-55-12), an entity shall not include the shares to be distributed in the computation of diluted EPS. However, the entity shall provide the disclosures required by paragraph 260-10-50-3.

A6. Add paragraph 260-10-50-3, with a link to transition paragraph 505-20-65-1, as follows:

260-10-50-3 If EPS has not yet been adjusted retroactively for all periods presented to reflect a stock dividend (see paragraph 260-10-55-12), an entity shall disclose that EPS for all periods presented is subject to change to reflect the stock dividend. An entity also shall disclose the number of shares that would be issued if the stock dividend occurred on the reporting date (for example, the number of shares that would be issued using the period-end market price).

A7. Amend paragraph 260-10-55-12, with a link to transition paragraph 505-20-65-1, as follows:

260-10-55-12 If the number of common shares outstanding increases as a result of a stock dividend or stock split (see Subtopic 505-20) or decreases as a result of a reverse stock split, the computations of basic and diluted EPS shall be adjusted retroactively for all periods presented to reflect that change in capital structure. If changes in common stock resulting from stock dividends, stock splits, or reverse stock splits occur after the close of the period but before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25), the per-share computations for those and any prior-period financial statements presented shall be based on the new number of shares. Stock dividends shall be retroactively reflected in earnings per share on the later of the ex-dividend date or the date the number of shares to be issued is known. If per-share computations reflect such changes in the number of shares, that fact shall be disclosed.

Effective Date and Transition

A8. Add paragraph 505-20-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2009-XX, Equity (Topic 505) and Earnings per Share (Topic 260): Accounting for Stock Dividends, Including Distributions to Shareholders with Components of Stock and Cash (A Consensus of the FASB Emerging Issues Task Force)

505-20-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2009-XX, Equity (Topic 505) and Earnings per Share (Topic 260): *Accounting for Stock Dividends, Including Distributions to Shareholders with Components of Stock and Cash (A Consensus of the FASB Emerging Issues Task Force)***:**

a. The pending content that links to this paragraph shall be effective for the first reporting period, including interim periods, ending after December 15, 2009.

b. The pending content that links to this paragraph requires retrospective application for all periods presented.

Status of Open Issues and Agenda Committee Items

The following represents the FASB staff's assessment of the status and immediate plans with respect to the open Issues on the Task Force's agenda. The Issues on the proposed agenda for the November 19, 2009 meeting are considered either high priority issues or issues on which meaningful progress can be made within the staff's given complement of resources. The staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
08-9	Milestone Method of Revenue Recognition	10/08	11/08, 3/09, 6/09, 9/09		Uhl	Cadambi/ Bonn	The FASB staff will prepare a Discussion document for a future Working Group meeting	Working Group meeting to be held in November 2009
09-2	Research and Development Assets Acquired In an Asset Acquisition	1/09	3/09, 6/09, 9/09	11/09	Hauser	Farber/ Anderson	The FASB staff will prepare an Issue Supplement for a future meeting	Proposed Update comment period closes October 26, 2009 November 19, 2009 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
09-B	Consideration of an Insurer's Accounting for Majority-Owned Investments When the Ownership Is through a Separate Account	1/09	9/09	11/09	Pippolo	Brower/ Bonn	The FASB staff will prepare an Issue Supplement for a future meeting	Proposed Update comment period closes October 26, 2009 November 19, 2009 EITF meeting
09-D	Application of the AICPA Audit and Accounting Guide, *Investment Companies*, by Real Estate Investment Companies	2/09		11/09	Schroeder	Yang/ Mills	The FASB staff will prepare a Discussion document for a future Working Group meeting	Working Group meeting to be held in November 2009
09-E	Accounting for Distributions to Shareholders with Components of Stock and Cash in the Calculations and Presentation of Earnings per Share	5/09	9/09	11/09	Bielstein	Inzano/ Mills	The FASB staff will prepare an Issue Supplement for a future meeting	Proposed Update comment period closes October 26, 2009 November 19, 2009 EITF meeting

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	11/02	N/A	Not scheduled	TBD	The Board's project on QSPE's is not expected to address this Issue and, therefore, the FASB staff will bring this Issue to the Agenda Committee at a future meeting to determine whether to begin discussions on this Issue or to request that the Issue be removed from the agenda.	Future Agenda Committee or EITF Meeting
06-12	Accounting for Physical Commodity Inventories for Entities within the Scope of the AICPA Audit and Accounting Guide, Brokers and Dealers in Securities	8/06	11/06	Not scheduled	TBD	Pending the outcome of the Board's project to amend ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*.	Future EITF Meeting
08-10	Selected Statement 160 Implementation	10/08	11/08, 1/09	Not scheduled	Bonn/ Nickell	Pending the outcome on the Board's project to reconsider the scope of FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*.	Future EITF Meeting

Issues Pending Further Consideration by the Agenda Committee

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
09-4	Seller Accounting for Contingent Consideration	5/09	6/09, 9/09	11/09	Homant/ Inzano	No further EITF discussion is expected on this Issue	Future Agenda Committee meeting
N/A	Application of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets," When a Special-Purpose Entity Holds Equity Securities and Whether an Investment That Is Redeemable at the Option of the Investor Should Be Considered an Equity Security or Debt Security	9/00	N/A	Not scheduled	TBD	Statement 155 did not address this Issue. Therefore, the FASB staff will bring this Issue to the Agenda Committee at a future meeting to determine whether to begin discussions on this Issue.	Future Agenda Committee meeting