

**Board Meeting Handout**  
**Leases (Topic 842) Post-Implementation Review**  
**September 21, 2022**

**Meeting Purpose**

1. The purpose of the September 21, 2022 Board meeting is for the Board to determine whether it would like to add a project to its agenda to amend the guidance in Topic 842, Leases, on the accounting for arrangements between entities under common control. If the Board adds a project and reaches conclusions on the associated issues, the staff will ask the Board for permission to draft a proposed Update for vote by written ballot.

**Questions or the Board**

1. Does the Board want to add a project to its technical agenda to amend the guidance in Topic 842 for:

- (a) Determining whether a lease exists for arrangements between entities under common control
- (b) Accounting (classification, recognition, and measurement) for leases between entities under common control for both lessees and lessors?

**Issue 1—Terms and Conditions to Be Considered for Arrangements Between Entities Under Common Control**

2. Does the Board want to amend Topic 842 to specify what terms and conditions an entity should consider for (i) determining whether a lease exists, and, if so, (ii) classifying and accounting for the lease using Approach 1A or Approach 1B?

3. Does the Board want the proposed amendments to be optional or required?

4. If the Board wants the proposed amendments to be optional, does the Board want the option to be an entity-wide election for all arrangements or situations between entities under common control?

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5. Does the Board want the proposed amendments to apply to:

(a) All entities (those within the scope of paragraph 842-10-65-1(a) through 1(b))

(b) Entities within the scope of paragraphs 842-10-65-1(b). That is, all entities other than:

(i) Public business entities,

(ii) Not-for-profit bond obligors

(iii) Employee benefit plans that file or furnish financial statements with or to the U.S. Securities and Exchange Commission?

6. Does the Board want to require any specific disclosures?

**Issue 2—Accounting for Leasehold Improvements (Lessee Only)**

7. For leasehold improvements associated with leases between entities under common control, does the Board want to add a project to amend the amortization requirements in Topic 842, which require those improvements to be amortized over the shorter of the remaining lease term or the useful life of the improvements?

8. If yes to Question 7, does the Board want to amend Topic 842 to specify that leasehold improvements associated with leases between entities under common control be:

(a) Amortized over the useful life of the improvements as long as the lessee continues to use the underlying asset

(b) Accounted for as a transfer between entities under common control if, and when, the lessee ceases using the underlying asset?

**If yes to Question 8**

9. Does the Board want the amendments to leasehold improvements requirements to apply to:

(a) All entities (those within the scope of paragraph 842-10-65-1(a) through 1(b))

(b) Entities within the scope of paragraphs 842-10-65-1(b). That is, all entities other than:

- (i) Public business entities
- (ii) Not-for-profit bond obligors
- (iii) Employee benefit plans that file or furnish financial statements with or to the U.S. Securities and Exchange Commission?

10. Does the Board want to require any specific disclosures about leasehold improvements?

#### **Transition and Effective Date**

11. Does the Board think that proposed amendments should be applied using *either* of the following methods:

(a) Retrospectively to the beginning of the earliest period presented in accordance with Topic 842 for all arrangements that exist at the date of adoption of a final Update (amendments would not be applicable for arrangements no longer in place at the date of adoption)

(b) Prospectively to all leases that commence on or after the date of adoption of a final Update?

12. Does the Board want amendments applicable to private companies and not-for-profit entities to be effective during interim periods within the fiscal year of adoption?

#### **Permission to Ballot and Comment Period**

13. Has the Board received sufficient information and analyses to make informed decisions on the issues presented? If not, what other information or analyses does the Board need?

14. Does the Board think that the expected benefits of the changes justify the perceived costs? If so, does the Board grant the staff permission to draft a proposed Update for vote by written ballot?

15. What comment period does the Board select for the amendments in the proposed Update?

## Background

### Relevant Leases Guidance

2. Topic 842 was effective for public entities for fiscal years beginning after December 15, 2018, and for most other entities (primarily private companies and most not-for-profit entities) for fiscal years beginning after December 15, 2021. For those other entities, Topic 842 is applicable for interim periods within fiscal years beginning after December 15, 2022.
3. Topic 842 requires that entities determine whether a related party arrangement, including one between entities under common control, is a lease based on the legally enforceable terms and conditions of the arrangement. This is consistent with the determination made for arrangements between unrelated parties. The determination is based on the legally enforceable terms and conditions because GAAP defines a lease as a contract, and the definition of a contract in GAAP refers to enforceable terms and conditions. If an arrangement is determined to be a lease, the classification and accounting for the lease is also based on the legally enforceable terms and conditions for all leases (that is, those between related parties and those between unrelated party leases).
4. The Topic 842 requirements represent a change from the related party requirements in Topic 840. Under Topic 840, determining whether a lease exists and, if so, the associated classification and accounting was based on the economic substance of an arrangement rather than its legal form whenever the terms and conditions were significantly affected by the relationship of the parties.
5. During the project resulting in the issuance of Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, the Board learned that determining the economic substance of arrangements between related parties often was challenging because terms and conditions, if any, between the parties may not be consummated at arms-length. Additionally, the Board acknowledged that in certain situations (such as month-to-month arrangements), legally enforceable terms and conditions may not exist.

### Feedback

6. Certain private company stakeholders stated that determining the legally enforceable terms and conditions in related party arrangements, particularly in arrangements between entities under common control, is challenging. Most recently, the related party guidance was highlighted as an area of complexity at both the June 2022 National Advanced Accounting and Auditing Technical Symposium AICPA ENGAGE Conference and the June 2022 PCC meeting.

7. After the June 2022 PCC meeting, the staff performed additional outreach to determine whether the complexities associated with applying the Topic 842 related party requirements were for all related party arrangements or limited to those between entities under common control. Broadly, that outreach indicated that the complexities were most frequently associated with applying the requirements to common control arrangements.
8. The staff's research indicates that practitioners have interpreted "legally enforceable terms and conditions" as including written and oral terms—both explicit and implicit—when considering related party leases. Specific emphasis is given to considering whether implicit lessee renewal rights exist for purposes of determining the lease term, particularly when (a) the lessee is constructing significant leasehold improvements or (b) the underlying asset is integral to the lessee's operations (for example, a customized production facility).
9. Private company stakeholders have consistently stressed that arrangements between entities under common control often are unwritten or lack sufficient detail (for example, the agreements do not explicitly specify whether lessee-controlled renewal options exist). Moreover, those stakeholders stated that the terms and conditions of the arrangements often are uneconomic and not aligned with other related transactions or agreements. In those cases, private company stakeholders are concerned that they are required to determine whether implicit legally enforceable terms and conditions exist, which may require legal counsel. Additionally, several practitioners indicated that there is diversity in practice in the extent of effort that an entity is expected to expend to evaluate the legal enforceability of written terms and/or identifying implicit terms in arrangements between entities under common control.
10. Broadly, feedback indicates that private company stakeholders are concerned about:
  - (a) Determining whether written lease terms and conditions between entities under common control are legally enforceable and determining whether legally enforceable implicit terms between entities under common control exist
  - (b) The accounting for leasehold improvements under Topic 842 when the lease term in a common control lease is shorter than the useful life of the leasehold improvements.

### **Issue 1—Terms and Conditions to Be Considered for Arrangements Between Entities Under Common Control**

11. Below are two potential approaches to amend Topic 842 to specify what terms and conditions an entity should consider in common control arrangements for both:
  - (a) Determining whether an arrangement is a lease and, if so,
  - (b) Classification and accounting.

**Approach 1A: Written. If Unwritten, Legally Enforceable Terms and Conditions**

12. Approach 1A would amend Topic 842 to specify that an entity would consider only written terms and conditions. An entity would not be required to determine whether those written terms and conditions are legally enforceable.
13. If no written terms and conditions exist, an entity would continue to apply the existing Topic 842 requirements. That is, an entity would need to consider legally enforceable terms and conditions (oral and implicit) for purposes of determining whether a lease exists and, if so, the associated classification and accounting of a lease. Consistent with Topic 842, if no legally enforceable terms and conditions exist, the arrangement would not be a lease and other GAAP would apply.

**Approach 1B: Written. If Unwritten, Monthly Lease**

14. Approach 1B would amend Topic 842 to specify that an entity would consider only written terms and conditions. An entity would not be required to determine whether those written terms and conditions are legally enforceable.
15. Additionally, this approach would specify that a lease exists and the lease term is one month in situations in which a customer (lessee) exchanges or intends to exchange consideration with a supplier (lessor) to use an identified asset for a period of time.

**Issue 2—Accounting for Leasehold Improvements (Lessee Only)**

16. The staff proposes two approaches for lessee accounting for leasehold improvements associated with leases between entities under common control.

**Approach 2A: Retain Topic 842 Amortization Requirements**

17. Under Approach 2A, a lessee would continue to be subject to the requirements in paragraph 842-20-35-12. That paragraph states that “leasehold improvements shall be amortized over the shorter of the useful life of those leasehold improvements and the remaining lease term, unless the lease transfers ownership of the underlying asset to the lessee or the lessee is reasonably certain to exercise an option to purchase the underlying asset, in which case the lessee shall amortize the leasehold improvements to the end of their useful life.”

**Approach 2B: Amend Topic 842**

18. This approach would amend Topic 842 to specify that leasehold improvements associated with leases between entities under common control be:
  - (a) Amortized by the lessee over the useful life of the improvements (regardless of the lease term) as long as the lessee continues to use the underlying asset

- (b) Accounted for as a transfer between entities under common control if, and when, the lessee ceases using the underlying asset.

## **Transition and Effective Date**

### *Transition*

- 19. The staff proposes that the Board permit an entity to apply amendments made for Issues 1 and 2 using either of the following methods:
  - (a) Retrospectively to the beginning of the earliest period presented in accordance with Topic 842 for all arrangements that exist at the date of adoption of a final Update (amendments would not be applicable for arrangements no longer in place at the date of adoption)
  - (b) Prospectively to all leases that commence on or after the date of adoption of a final Update.
- 20. If an entity applies the amendments retrospectively, the staff recommends that the lease modification requirements in paragraphs 842-10-25-9 through 25-17 be applied to any revised terms and conditions of the lease. Additionally, any amounts that otherwise would have been recognized in earnings would be recognized through a cumulative-effect adjustment to opening retained earnings at the beginning of the fiscal year of adoption.

### *Effective Date*

- 21. The Board will be asked to establish the effective date of final amendments after receiving comments from stakeholders on the amendments in a proposed Update. The staff is proposing that any amendments applicable to private companies and not-for-profit entities be applicable during interim periods within the fiscal year of adoption.

## **Board Meeting Handout**

### **Financial Services—Insurance (Topic 944): Transition for Sold Contracts**

**September 21, 2022**

#### **Meeting Purpose**

1. The Board will redeliberate issues arising from feedback on the proposed Accounting Standards Update, [\*Financial Services—Insurance \(Topic 944\): Transition for Sold Contracts\*](#), which was issued for comment on July 14, 2022, with a 25-day comment period. The Board also will discuss the expected benefits and costs of the proposed amendments and whether to proceed to drafting a final Update for vote by written ballot.

#### **Questions for the Board**

##### **Issue 1: Providing an Accounting Election**

1. Does the Board want to affirm its decision to allow an insurance entity to make an accounting policy election to exclude contracts that meet certain criteria from applying the amendments in Accounting Standard Update No. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, (LDTI) when they have been derecognized before the LDTI effective date?

##### **Issue 2: Election Level**

2. Does the Board want to affirm its decision that the accounting policy election, if elected by an insurance entity, should be consistently applied to all contracts that have been derecognized subject to the scope of the amendments in the proposed Update? Alternatively, does the Board want to allow insurance entities to apply the accounting policy election on a transaction-by-transaction basis?

##### **Issue 3: Contracts**

3. Does the Board want to affirm its decision that only contracts that have been derecognized because of a sale or disposal are eligible for the accounting policy election?

##### **Issue 4: Continuing Involvement**

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4. Does the Board want to affirm and clarify its decision that the accounting policy election be applied only when an insurance entity has no significant continuing involvement with the derecognized contracts?

**Issue 5: Disclosures**

5. Does the Board want to affirm its decisions on the disclosure requirements?

**Issue 6: Transition and Effective Date**

6. Does the Board want to affirm its decisions on the transition and effective date?

**Cost-Benefit Analysis**

7. Has the Board received sufficient information and analyses to make an informed decision on the expected costs and benefits of applying the guidance? If not, what other information or analyses are needed?

**Permission to Ballot**

8. Has the Board received sufficient information and analyses to make informed decisions on the issues presented? If not, what other information or analyses does the Board need?

9. If the Board answers “yes” to the previous question, does it give the staff permission to proceed to draft a final Accounting Standards Update for vote by written ballot?

## Comment Letter Feedback Summary

2. Twelve respondents submitted 11 comment letters on the amendments in the proposed Update. Not all respondents addressed every question. The following table provides the composition of the comment letter respondents by respondent type:

| Type of Respondent     | Number of Respondents |
|------------------------|-----------------------|
| Practitioners          | 4                     |
| Preparers <sup>1</sup> | 6                     |
| Trade Associations     | 2                     |
| Total Respondents      | 12                    |

<sup>1</sup>One preparer comment letter included signatories from two different insurers, and, therefore, the staff counted them individually.

## **Issue 1: Providing an Accounting Election**

### **Background**

3. Update 2018-12 was issued in August 2018 to improve and enhance the financial reporting requirements for long-duration contracts issued by insurance entities. The objective of the proposed Update is to reduce implementation costs and complexity associated with the adoption of LDTI for contracts that have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date. Otherwise, an insurance entity would be required to reclassify a portion of the previously recognized gains or losses to the LDTI transition adjustment because of the adoption of a new accounting standard. Because there is no effect on an insurance entity's future cash flows, such a reclassification could be misleading to financial statement users.

### **Feedback Summary**

4. All 12 respondents agreed that the proposed amendments would reduce cost without significantly reducing the decision-useful information for investors.

### **Alternatives**

5. The Board will consider whether to affirm its previous decision.

## **Issue 2: Election Level**

### **Background**

6. In the proposed Update, the Board decided that the accounting policy election, if elected by an insurance entity, would be consistently applied to all contracts that have been derecognized subject to the scope of the amendments in the proposed Update.

### **Feedback Summary**

7. Eight respondents agreed that for purposes of consistency, an insurance entity should consistently apply the accounting policy election to all contracts derecognized before the LDTI effective date. Respondents generally stated that consistent application would benefit the needs of financial statement users.
8. Four respondents agreed that insurance entities should be allowed to make an accounting policy election. However, those respondents recommended that the election be made on a transaction-by-transaction basis. That is, an insurance entity may elect that an accounting policy election be applied at the sale or disposal transaction level as opposed to an entity-wide election.

### **Alternatives**

9. The Board will consider the following alternatives:

- (a) Alternative A: Affirm that the accounting policy election, if elected by an insurance entity, should be consistently applied to all contracts that have been derecognized subject to the scope of the proposed amendments.
- (b) Alternative B: Allow an insurance entity on a transaction-by-transaction basis to apply the accounting policy election to all contracts within a sale or disposal transaction that have been derecognized subject to the scope of the proposed amendments.

### **Issue 3: Contracts**

#### **Background**

- 10. The amendments in the proposed Update state that the accounting policy election would only apply to contracts that have been derecognized because of sale or disposal before the LDTI effective date.

#### **Feedback Summary**

- 11. All respondents agreed that contracts that have been derecognized because of sale or disposal should be included in the scope of a final Update. However, two respondents indicated that the Board should clarify if contracts derecognized because of recapture should be included in the scope of a final Update.

#### **Alternatives**

- 12. The Board will consider the following alternatives:
  - (a) Alternative A: Affirm the Board's previous decision to limit the scope to contracts that have been derecognized because of a sale or disposal.
  - (b) Alternative B: Clarify that the scope includes contracts derecognized because of a sale or disposal and contracts that are terminated through recaptures.

### **Issue 4: Continuing Involvement**

#### **Background**

- 13. In the proposed Update, the Board decided that the accounting policy election would apply only when an insurance entity has no continuing involvement with the derecognized contracts other than either of the following allowable circumstances:
  - (a) Investment management, policy servicing, or other administrative arrangements
  - (b) Standard merger and acquisition representations and warranties.
- 14. The Board also decided that either of the following are forms of continuing involvement and would prohibit an insurance entity from applying the accounting policy election:

- (a) A direct or indirect interest in an equity method investee or a consolidated entity that provides significant influence or continuing significant exposure to the risks and rewards of the derecognized contracts
- (b) Any other arrangement that allows for significant participation in the ongoing performance of the derecognized contract.

### **Feedback Summary**

- 15. Respondents generally agreed with the guidance in that the accounting policy election should only apply when an insurance entity has no continuing involvement with the derecognized contracts. Several respondents suggested clarifications in proposed paragraph 944-40-65-2(r)(1) related to significant continuing involvement, direct and indirect interests, and equity method investments. Some respondents noted that proposed paragraph 944-40-65-2(r)(2) uses the phrase *significant participation* and suggested that the term *significant* be included in proposed paragraph 944-40-65-2(q)(2), but otherwise agreed with proposed paragraph 944-40-65-2(r)(2).
- 16. Respondents agreed that the examples provided in proposed paragraph 944-40-65-2(s) do not constitute continuing involvement and would not prohibit applying the accounting policy election.

### **Significant Continuing Involvement**

- 17. Several respondents recommended that the Board clarify if “no continuing involvement” means “no significant continuing involvement” based on the examples provided in proposed paragraph 944-40-65-2(r) through (s). Three respondents recommended that the Board clarify that only *significant continuing involvement* should be considered.

### **Direct and Indirect Interests**

- 18. Three respondents indicated that the inclusion of the phrase *direct or indirect interest* should be reconsidered in proposed paragraph 944-40-65-2(r)(1).

### **Equity Method Investments**

- 19. Four respondents recommended that the Board clarify how significant influence is defined in proposed paragraph 944-40-65-2(r)(1).

### **Alternatives**

- 20. The Board will consider the following alternatives:

- (a) Alternative A: Affirm the guidance in proposed paragraph 944-40-65-2(r) through (s); specifically, the Board's previous decisions that continuing involvement is demonstrated by a direct or indirect interest in an equity method investee that provides significant influence or continuing significant exposure to the risks and rewards of the derecognized contracts.
- (b) Alternative B: Affirm the guidance in proposed paragraph 944-40-65-2(r) through (s) and clarify that significant continuing involvement is demonstrated by holding an interest that provides significant influence that exposes the insurance entity to the risks and rewards of the derecognized contracts, as described in paragraphs 323-10-15-6 through 15-11.

## **Issue 5: Disclosures**

### **Background**

- 21. In the proposed Update, the Board decided to require disclosure of the accounting policy election to inform users when an insurance entity has applied the accounting policy election. It also required a qualitative description of the transaction to which the insurance entity applied the accounting policy election.

### **Feedback Summary**

- 22. All 12 respondents agreed with the Board's decision to require disclosure of the use of the accounting policy election.
- 23. One respondent noted that the Board should clarify that these disclosures would be in addition to the disclosures required for contracts not subject to the amendments in Update 2018-12.
- 24. If the Board selects alternative B in Issue 2, one respondent stated that the Board should clarify that the disclosure criterion would include a description of all contracts that meet the criterion for the election for which the election was applied and those for which the election was not applied.

### **Alternatives**

- 25. The Board will consider whether to affirm its previous decision.

## **Issue 6: Transition and Effective Date**

### **Background**

26. The Board decided that the effective dates of the amendments in the proposed Update would align with the LDTI effective date, which is as follows:
- (a) For public business entities that meet the definition of a U.S. Securities and Exchange Commission (SEC) filer, excluding entities eligible to be smaller reporting companies as defined by the SEC, the proposed amendments would be effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early application would be permitted.
  - (b) For all other entities, the proposed amendments would be effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. Early application would be permitted.

### **Feedback Summary**

27. One respondent supported extending the proposed election to contracts that are derecognized after LDTI's effective date but before the insurance entity's first financial statements that reflect the application of LDTI are issued or available to be issued. No other respondents provided comments on the transition and effective date.

### **Alternatives**

28. The Board will consider whether to affirm its previous decision.

**Board Meeting Handout**  
**Post-Implementation Review of Topic 606, Revenue from Contracts with  
Customers**  
**September 21, 2022**

**Meeting Purpose**

1. The purpose of this meeting is to provide the Board with an update of the post-implementation review (PIR) activities completed to date for Topic 606, Revenue from Contracts with Customers. This discussion will primarily focus on PIR activities conducted since the July 2021 Board meeting.

**Questions for the Board**

**PIR Activities for Nonpublic Entities**

1. For nonpublic entities, does the Board have any questions or comments on the feedback received to date as part of the PIR process?
2. Would the Board like the staff to perform research on any issues specific to nonpublic entities?

**PIR Research Summary**

3. Does the Board have any feedback on the research completed to date on certain issues listed in paragraph 86 of this handout?

**Next Steps**

4. Does the Board have any feedback on the remaining research issues in paragraph 87 of this handout?
5. Does the Board have any feedback on the next steps for PIR?

## Background

2. The main objectives of the PIR process are (a) to determine whether a standard is accomplishing its stated purpose, (b) to evaluate the selected standard's implementation and continuing compliance costs and related benefits, and (c) to provide feedback to improve the standard-setting process.
3. The staff last provided an update on Revenue PIR at the Board meeting on July 28, 2021. During that Board meeting, the staff provided the Board with an overview of the PIR activities completed to date and feedback received for public companies, the staff's preliminary observations on the issues raised during the PIR process, and the PIR plan for nonpublic entities. While the Board made no decisions, it provided the staff with direction about additional research and outreach.

## PIR Activities for Nonpublic Entities

4. The PIR activities for nonpublic entities were started after the majority of the PIR activities for public companies were completed because the Topic 606 effective dates for nonpublic entities were later than the effective date for public companies.
5. The staff has solicited feedback from stakeholders of nonpublic entities on the adoption and recurring costs, as well as the benefits associated with the implementation of Topic 606 through individual meetings, group meetings, and surveys. The following table summarizes the nonpublic entity outreach that the staff conducted.

| Stakeholder Category                    | Number of Stakeholders |
|-----------------------------------------|------------------------|
| Users (Buy-Side, Sell-Side, and Credit) | 8                      |
| Preparers—Nonpublic Entities            | 2                      |
| Preparers Survey                        | 13                     |
| Trade Groups                            | 4                      |
| Auditors                                | 14                     |
| Advisory Groups                         | 4                      |
| Other Miscellaneous Group               | 3                      |
| Total                                   | 48                     |

## Financial Statement User Outreach

6. To understand the costs and benefits of Topic 606 for financial statement users of nonpublic entities, the staff contacted all user members on the Not-for-Profit Advisory Committee (NAC) and the Private Company Council (PCC), as well as a few user stakeholder groups as suggested by the NAC members and some provided feedback as following.
7. Users on the PCC expressed that the benefits of Topic 606 outweighed the costs of adoption. The benefits of Topic 606 mentioned primarily related to the additional disclosures provided by the new revenue standard. They explained that the disclosure requirements resulted in greater transparency, improved understanding of businesses, and enhanced comparability period-to-period and across industries. For instance, one user stated that the level of detail disclosed under Topic 606 allows users to better understand how an entity's revenue is generated. In addition, this user noted that the enhanced comparability enables users to assess the quality of companies' processes and identify potential inefficiencies. The staff notes that user feedback for nonpublic entities was consistent with user feedback for public companies in that Topic 606 provides more useful and transparent information, primarily through improved disclosures, and achieves its expected benefits across sectors.
8. The users on the PCC noted that the costs they incurred as a result of Topic 606 were consistent with the Board's expectations. They explained that there were some costs associated with training employees and transitioning to the new standard, including additional analysis because of different applications of Topic 606 by some companies. However, those challenges have been eased as preparers and users gain experience with the standard. Additionally, one user noted that as preparers disclose more information under Topic 606, users can spend more time analyzing additional information and looking at it in different ways. While more information inherently leads to more costs, users consistently expressed that they prefer more information and that the benefits outweigh the costs. The users further explained that the costs were mostly one-time occurrences. The staff noted that this feedback is consistent with the feedback from public company users.
9. One PCC user noted inconsistency in the presentation of contract assets and contract liabilities and conditional and unconditional retainage among companies in the construction industry applying Topic 606.
10. According to feedback from a surety user group on the implementation of Topic 606, the participants observed differences in their clients' adoption dates (for example, in whether they availed themselves of the deferral in Accounting Standards Update No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*). They said that they had not noticed significant changes in the income statement post-adoption. However, they highlighted differences in the information presented in the footnotes

and the need to obtain additional information from management to complete its analysis. Additionally, they are having difficulty determining how much of the contract assets relate to work performed but not invoiced (often known as “under billings”) as opposed to retainage. Overall, they have not seen significant improvements in disclosures after the implementation of the new revenue standard.

### **Preparer Outreach**

11. The staff solicited feedback from preparers on their implementation of Topic 606, primarily through a preparer survey conducted between late 2021 and early 2022. This section also includes miscellaneous feedback from surveys with attendees of a private-company-focused conference and webcast, an outreach call with preparers in higher education, and emailed feedback on certain industry-specific challenges.

### ***Preparer Survey***

12. In order to solicit feedback from more nonpublic entities, the staff created a survey on the implementation activities of nonpublic entities and related cost-benefit considerations. The questions in the survey were primarily identified from the survey for public companies but simplified and tailored for nonpublic entities. In addition, questions unique to nonpublic entities, such as disclosure exemptions, were included. Those questions were evaluated by the FASB’s post-doctoral fellow to ensure the survey and questions were framed in a neutral way and by the preparer members on PCC and NAC to ensure that the questions were understandable and clear. The survey was then distributed to PCC and NAC members, two trade groups that have private company members, and outreach participants (including practitioners and stakeholder groups that were asked by the staff to share the survey link with their clients).
13. In total, 13 entities responded to the survey. Overall, the majority of preparers that responded to the staff’s survey indicated that Topic 606 had no material effect on amounts recognized in their financial statements. A construction company commented that Topic 606 accelerated its revenue recognition from bonus clauses and pending change orders (for example, due to guidance on variable consideration). In addition, most preparers that responded to the survey noted that they applied the modified retrospective transition method and used one or more disclosure exemptions for nonpublic entities under Topic 606.

14. The industries of survey respondents are shown in the table below.

| <b>Preparer Survey Respondents by Industry</b>   | <b>Number of Respondents</b> |
|--------------------------------------------------|------------------------------|
| Finance and Insurance                            | 3                            |
| Construction                                     | 2                            |
| Mining, Oil, and Gas                             | 2                            |
| Arts, Entertainment, and Recreation              | 1                            |
| Biotech and Pharma                               | 1                            |
| Health care                                      | 1                            |
| Utilities                                        | 1                            |
| Professional, Scientific, and Technical Services | 1                            |
| Unspecified                                      | 1                            |
| <b>Total</b>                                     | <b>13</b>                    |

15. The sizes of survey respondents are shown in the table below.

| <b>Preparer Survey Respondent Revenue</b>           | <b>Number of Entities</b> |
|-----------------------------------------------------|---------------------------|
| More than \$1 Billion in Revenues                   | 3                         |
| Between \$250 Million and \$1 Billion in Revenues   | 1                         |
| Between \$100 Million and \$250 Million in Revenues | 1                         |
| Between \$50 Million and \$100 Million in Revenues  | 1                         |
| \$25 Million and \$50 Million in Revenues           | 2                         |
| Below \$10 Million in Revenues                      | 4                         |
| Unspecified                                         | 1                         |
| <b>Total</b>                                        | <b>13</b>                 |

#### *General Questions*

16. Seven entities (54 percent) utilized the 1-year deferral, 2 entities (23 percent) chose to adopt the standard on the original effective date and the other 3 entities (23 percent) chose to adopt before the original effective date.
17. Of 12 entities that provided a response to the question on the transition method used, 9 entities (75 percent) chose the modified retrospective transition method when adopting Topic 606 while 3 entities (25 percent) chose the full retrospective method.
18. All entities responded that they used one or more educational resources in preparation for the adoption. Four entities used implementation resources on the FASB's website, seven entities used the AICPA Audit and Accounting Guide on revenue recognition, eight entities used education provided by external personnel (for example, consultants and auditors), three entities referenced public entities' revenue recognition reporting, and eight entities used third-party publications on revenue.

19. Of 12 entities that provided response to the question on whether the reported amounts, if any, are materially different as a result of adopting Topic 606, 10 entities (83 percent) noted no material difference. In comparison, 2 entities (17 percent) noted a material difference in the reported amounts of either contract asset/contract liability or contract cost asset.
20. The table below shows the number of respondents who elected to apply disclosure exemptions for nonpublic entities in a variety of areas. Eight entities (62 percent) utilized some of the disclosure exemptions for nonpublic entities.

| <b>Disclosure Exemptions Elected by Nonpublic Entities</b>                                                  | <b>Number of Entities</b> |
|-------------------------------------------------------------------------------------------------------------|---------------------------|
| Disaggregation of revenue                                                                                   | 5                         |
| Contract balances                                                                                           | 5                         |
| Significant judgments on determining recognition timing and transaction price                               | 5                         |
| Practical expedients related to significant financing component or incremental costs of obtaining a contact | 3                         |
| Transaction price allocation to remaining performance obligations                                           | 1                         |

21. Eight entities (62 percent) did not incur more costs than the amount that they had initially budgeted for implementation. Three entities (23 percent) incurred higher than budgeted audit costs, 1 entity (8 percent) contracted additional personnel, and 1 entity (8 percent) incurred additional costs for dual bookkeeping (offline tracking) because of the limitation of their IT systems.
22. Eleven entities (85 percent) did not expect incremental costs beyond the initial adoption. One entity (8 percent) expected to get continuous support from contractor(s) and 1 entity (8 percent) expected that its offline tracking costs would remain in order to capture certain information, which could not be provided by its current IT system, for revenue reporting.

#### *Personnel Change*

23. Of 12 entities that provided a response to this question, most entities (75 percent) made no personnel changes to accommodate implementation activities. Three entities (25 percent) redeployed current personnel or contracted external personnel to support the implementation. The areas that required additional support were technical accounting, contract review, and external reporting (disclosures). However, no entities indicated that they hired new employees as a result of the implementation.

#### *Dual Reporting*

24. Most entities (77 percent) did not need dual reporting. Two entities (15 percent) were required to report under both GAAP and IFRS Standards. Both entities noted no changes to their converged revenue recognition practices under GAAP and IFRS Standards. One health care

entity (8 percent) was required to report bad debts as an expense for Medicare cost reporting but reclassified those bad debts to a reduction of revenue for GAAP reporting. Additionally, the health care entity noted that it would keep dual reporting in the foreseeable future.

#### *Process, including IT Systems*

25. Eight entities (62 percent) reported no changes to their IT systems. Three entities utilized Excel, Access, or some other spreadsheet solutions (23 percent) as a result of implementation activities. Two entities (15 percent) updated their existing IT systems to accommodate the implementation.
26. Of 7 entities that responded to a question on how they comply with the new standard without making changes to their existing IT systems, 4 entities (57 percent) commented that their existing IT systems could accommodate the data needs for the new standard without any changes, 1 entity (14 percent) made manual top-side journal entry or entries or adjustment(s), 1 entity commented that Topic 606 had no material effect to the financial statements and that no changes were required, and 1 entity in the mining/oil/gas industry commented that it did not generate any revenue before the implementation of Topic 606. Therefore, Topic 606 had already been built into the IT systems at the time of the implementation.
27. Three entities noted that the implementation of Topic 606 helped them better understand what is offered to customers and two entities noted that the implementation improved internal controls over contracts. One entity made changes to sale contract terms for new or existing contracts to eliminate dual bookkeeping.

#### *Audit Costs*

28. Eight entities (62 percent) reported no change to their audit fees as a result of implementing Topic 606. Five entities (38 percent) reported higher audit fees as a result of implementing Topic 606, of which 2 entities estimated the higher audit fees would remain on a recurring basis. The reasons for the higher audit fees were increased hours in the first year of implementation, additional testing, additional disclosures, and additional time spent on contract review.

#### *Education of Investors and Other Stakeholders*

29. Of 11 entities that provided a response, 9 entities (82 percent) said that they did not provide educational assistance to investors, lenders, grantors, or regulatory agencies about Topic 606. One entity (9 percent) provided additional revenue materials to its financial statement users. One entity had discussions with its financial statement users on revenue. One health care entity commented that its donors did not know or seem interested in learning anything about the

implicit price concessions, although those donors were confused about the differences between implicit price concessions, contractual allowances, and charity care.

### ***Other Miscellaneous Feedback***

30. The staff also received feedback during the Not-for-Profit and Private Company Webcast in June 2021 through polling responses. Respondents found a variety of resources to be helpful for the adoption of Topic 606, including the AICPA Audit and Accounting Guide on revenue recognition (25 percent), third-party publications (25 percent), virtual or in-person training provided by consultants or auditors (17 percent), implementation resources on the FASB's website (17 percent), public companies' revenue recognition reporting (5 percent), and other resources (11 percent).
31. One NAC member connected the staff with a not-for-profit (NFP) preparer from higher education who shared feedback on the effect of Topic 606. Overall, the preparer did not experience significant challenges in adopting Topic 606, and the new standard had minimal effect on its financial statements. In addition, the preparer did not expect incremental recurring costs beyond implementation. In connection with adoption, the preparer took the opportunity to build more robust documentation to help internal and external stakeholders better understand the business and activities that drive its revenue.
32. One NAC member shared an observation from a NFP financial officer group meeting. She noted that none of the participants had any concerns or specific feedback about Topic 606.
33. The staff also received emailed feedback on challenges in certain industries. One email was from a project-oriented private company that shared the challenges of implementing 606 related to allocation of revenue among different performance obligations and documentation compliance. The other email was from a consulting firm that observed diversity in practice due to different interpretations by accountants serving the Common Interest Realty Associations industry and suggested an alternative presentation for that industry.

### **Practitioner Outreach**

34. The staff performed outreach with 14 practitioners (13 audit firms and 1 professional services firm) during 2021 to discuss their experiences working with private companies and NFP entities on the implementation of Topic 606. In addition, feedback was received through the survey with participants of AICPA ENGAGE conferences in 2020 and 2021.

### ***General Feedback***

35. General feedback was solicited from practitioners on (a) the forms of education used to assist in the adoption of Topic 606, (b) how the one-year deferral was utilized, (c) whether there was a significant financial effect of adopting Topic 606, (d) how converged GAAP versus IFRS Standards continues to be, and (e) the costs and benefits of Topic 606 adoption. Practitioner participants provided the following feedback.

### ***Educational Resources***

36. Practitioners identified several resources that were helpful for them as well as their clients in adopting Topic 606. Specifically, practitioners mentioned that the FASB website, Transition Resource Group memos, and Q&A sessions were helpful. Outside of the resources provided by the FASB, practitioners stated that they and their clients relied on interpretative guides provided by the AICPA and accounting firms, and relevant webcasts. Overall, practitioners stated that many nonpublic entities relied on advisors and auditors to assist in the implementation because available staff was often limited and education was time consuming.

### ***Usefulness of One-Year Deferral***

37. Generally, private companies and NFP entities utilized deferral dates; however, feedback was mixed on whether the deferral allowed those entities to be more prepared for implementation. For instance, several practitioners highlighted that the deferrals gave entities more time to see how other entities in their industry adopted the standard, while others stated that entities did not use the time afforded by the deferral to prepare for adoption.

### ***Financial Effect***

38. Practitioners stated that, overall, entities did not see a significant change in financial results as an outcome of adopting Topic 606.

39. Some practitioners mentioned that entities made slight adjustments to their contracts to avoid significant changes in the timing of revenue recognition. For instance, one practitioner highlighted that some entities changed contract terms to avoid over time revenue recognition. (The staff notes that this practice was also mentioned in outreach with practitioners and preparers for public companies.) The most significant change that resulted from the adoption of Topic 606 was the change in disclosures. Several practitioners highlighted that disclosures improved as a result of Topic 606; however, many nonpublic entities took advantage of disclosure exemptions.

### *Convergence*

40. Practitioners stated there was a high degree of convergence between Topic 606 and IFRS 15, *Revenue from Contracts with Customers*, for nonpublic entities.

### *GAAP Departure*

41. Practitioners noted that very few of their clients took material GAAP departures in their adoption of Topic 606.

### *Costs of Adoption*

42. Practitioners generally stated that the costs for private companies and NFP entities to adopt Topic 606 were significant, but most were one-time costs and ongoing costs are minimal. Three general ongoing costs that practitioners mentioned include (a) ongoing education and training costs for employees, (b) making manual adjustments to the system data that continues to be tracked under legacy GAAP to reconcile to the reported amount under the new standard, and (c) continuing to assess challenging areas of the guidance such as variable consideration, licensing, and other areas identified in outreach.
43. Regarding the ongoing cost of dual reporting, several practitioners stated that private companies and NFP entities continue to track revenue using old systems that have not been updated to reflect Topic 606 adoption. At period ends, those entities reconcile the differences between the two sets of books and, if material, make adjusting entries to account for the changes that resulted from the adoption of Topic 606. Practitioners noted that entities that operate in this manner incur ongoing costs to assess the materiality of those differences periodically.

### *Benefits of Adoption*

44. Practitioners stated that there were several benefits that came as a result of the adoption of Topic 606 from a private company or NFP entity perspective. Adoption of Topic 606 led entities to better understand their contracts with customers, which in turn led to better communication within entities, improved documentation, and more robust internal controls. Specifically, one practitioner noted that many entities are now operating with a focus on the accounting for revenue, which has made it easier to evaluate new revenue streams.

### ***Challenging Areas of Topic 606***

45. Practitioner outreach participants also were asked to discuss challenging areas of Topic 606. Overall, the challenges faced by private companies and NFP entities were similar to the challenges faced by public companies. However, private companies and NFP entities benefited

from observing and learning from public company adoption. Several practitioners noted that nonpublic entities typically have less resources available to research the accounting for complex revenue arrangements. The staff has summarized several challenging areas that were discussed in outreach with practitioners.

#### *Principal versus Agent*

46. Many practitioners stated that nonpublic entities continue to have challenges in considering whether they are a principal or agent in their revenue arrangements. Outreach participants expressed that this area continues to be challenging and judgmental.

#### *Variable Consideration*

47. A few practitioners mentioned that private companies had challenges with variable consideration, specifically with estimating variable consideration with little history and applying the constraint. One practitioner noted that the challenges related to understanding the variable consideration and constraint guidance. That practitioner stated that once entities understood the guidance, they were able to apply it.

#### *Licensing*

48. Several practitioners said that licensing was a challenging area. Some stated that challenges were related to the ongoing issue that was attempted to be addressed through EITF Issue No. 19-B, "Revenue Recognition—Contract Modifications of Licenses of Intellectual Property." Other practitioners stated that entities had challenges understanding the shift from over time revenue recognition under the prior guidance to a mix of upfront and over time revenue recognition under the new standard. Furthermore, nonpublic entities had challenges in identification of performance obligations and allocation of consideration between those performance obligations. Those challenges affect upfront and over time revenue recognition.

#### *Standalone Selling Price*

49. Practitioners stated that determining standalone selling prices (SSP) is challenging, but most said that it was not a significant issue. One practitioner stated that establishing SSP is challenging for private companies who are just getting started as they sell products or services at prices with little consistency. Also, this practitioner stated that there is no industry consensus on what method of determining SSP is acceptable, which makes the auditing more challenging.

### *Short-Cycle Manufacturing*

50. More than half of the practitioners explained that short-cycle manufacturing is a challenge for private companies. Several practitioners noted that their manufacturing clients that shifted from point in time to over time revenue recognition had a hard time understanding that rationale for that change. Several practitioners noted that some entities amended their contract terms (such as terms related to enforceable right to payment) to avoid the over time accounting model. Those entities suggested that the amendment to their contract aligned more closely with their expectation of the economics. Other entities did not change their contracts but continue to track revenue using their previous IT systems and then make top-side adjustments at period ends if there is a material difference in the amount of revenue recognized. Practitioners noted that the cost of adoption related to the short-cycle manufacturing issue varied by industry and company, but, generally, initial adoption costs were significant, and the ongoing cost is minimal. Another notable ongoing cost related to the short-cycle manufacturing issue is assessing whether there is an enforceable right to the payment, one of the criteria for over time revenue recognition.

### *Other Challenges*

51. One practitioner noted that there is diversity in practice on how an entity reports retainage, specifically in the construction industry. For example, there are different opinions on whether retainage on an in-process contract for which work still needs to be performed is a contract asset/liability or a contract receivable.

### **ENGAGE Survey Feedback**

52. During the National Advanced Accounting & Auditing Session at the AICPA ENGAGE 2020 Conference, participants were asked about using the private company deferral and the challenges with the implementation of Topic 606. Of 165 respondents, 45 percent of respondents chose to utilize the deferral, 44 percent had adopted the standard without utilizing the deferral, and 11 percent were undecided at the time. Identifying performance obligations (32 percent of 156 respondents) was the most significant challenge for private companies in adopting Topic 606, followed by information gathering (28 percent), resource constraints (21 percent), systems (12 percent), and employee training (8 percent).

53. The staff received additional feedback during the AICPA ENGAGE 2021 Conference. Fifty-nine percent of 227 respondents utilized resources on the FASB's website to assist their clients in preparing for the adoption of Topic 606 and more than half of 212 respondents noted that implementing Topic 606 resulted in higher audit fees.

## **Advisory Group Outreach**

54. The staff solicited feedback from three advisory groups (PCC, NAC, and Investor Advisory Committee (IAC)) on their perspectives on the adoption of Topic 606 for private companies and NFP entities.

## **PCC**

55. The staff met with the PCC members on April 20, 2021, to discuss their experience or observations of the adoption Topic 606 by private companies.

56. Before the PCC meeting, a pre-meeting survey was sent to PCC members asking about challenging areas after adoption. The challenging areas highlighted by the survey respondents included accounting for approved change orders in the construction industry, applying the disclosure guidance, implementing guidance on principal agent considerations, and allocating the transaction price.

57. During the meeting, PCC practitioner members shared that they utilized resources on the FASB's website to educate themselves and prepare for adoption. In addition, PCC preparer members and practitioner members noted that the deferral for private companies was helpful in preparing for adoption and for leveraging public company filings.

58. One PCC member mentioned that he noticed one-time transitional effects when analyzing period-over-period trends. However, most entities generally did not experience a major change in the measurement of revenue, but some franchisors and insurance agencies noted differences. Another member shared that significant time was spent during the transition to draft significant accounting policies and disclosures. The consistency of contracts across an entity also affected the level of difficulty and time required to implement the standard.

59. Some challenges mentioned by the PCC members included determining performance obligations, accounting for variable consideration, and evaluating the cost of acquiring contracts. Principal versus agent considerations were challenging for the franchising, technology, and insurance industries. One PCC practitioner member asserted that Topic 605 had clearer guidance on principal versus agent considerations and suggested providing additional parameters under Topic 606 to address the issue.

60. During a closed session between the PCC and AICPA—Private Companies Practice Section Technical Issues Committee (TIC) on September 27, 2021, TIC identified three challenging areas for private companies under Topic 606, including the accounting for material rights, the revenue recognition of short-cycle manufacturing, and the presentation of retainage in the construction industry (see more feedback from TIC in the next section: Stakeholder Group Outreach).

## **NAC**

61. The staff met with the NAC members on September 14, 2021, to discuss the adoption of Topic 606 for NFP entities. The staff discussed with members the following topics: (a) how they utilized educational materials to implement the standard, (b) challenging areas of Topic 606, (c) changes that occurred as a result of adoption, and (d) the related costs and benefits.
62. Before the meeting, a pre-meeting survey was sent to NAC members asking about how they prepared for the adoption of Topic 606 and whether the financial results under the new standard differ from the financial results under prior guidance. In the survey, respondents shared a variety of ways they prepared for the adoption of the new standard, including utilizing the FASB's website, attending conferences, and reviewing AICPA revenue recognition guidance, firm guides, and implementation guidance. Respondents noted that their financial results did not differ significantly after adoption. However, a respondent shared that intellectual property licensing rules caused significant changes in presentation for some entities.
63. During the meeting, NAC members stated that they were pleased with the educational materials provided by the FASB and other sources such as the AICPA, audit firms, and other local organizations. Members in the NFP health care industry noted that AICPA industry-specific implementation guidance was beneficial, which is consistent with the feedback from other stakeholder groups.
64. Another general theme among the feedback was that larger NFP organizations tackled the adoption of Topic 606 earlier while smaller organizations are still in the middle of adoption, with other matters over the past two years (such as COVID-19) adding to the burden of adoption.
65. NAC members described how the adoption of Topic 606 affected their respective industries. The feedback has been broken out as follows by health care and education:
  - (a) Health care providers utilized AICPA industry-specific implementation guidance for applying Topic 606 to their specific fact patterns. In general, hospital systems and health care providers observed that Topic 606 did not change their revenue recognition accounting; the primary changes occurred in presentation and disclosure of bad debt expense. For continuing care retirement communities, the most significant effect was that there were a variety of areas to consider upon adoption, such as customer acquisition costs, performance obligations, and the interaction with the leasing standard. In this industry, many organizations did not have enough staff to handle adoption, which resulted in many outsourcing work. Another cost of adoption described was the increase in documentation because that documentation was needed to support the new revenue recognition model. However, NAC members described that in the long run, organizations could benefit from good documentation of controls, systems, and contracts.

- (b) NAC members in higher education stated that implementation of Topic 606 was relatively straightforward and that the effect of adoption was generally not material.

66. NAC members discussed the disclosures that are required as a result of Topic 606. Several members stated that the cost of additional disclosure was manageable, and many entities, especially NFPs that are not public business entities, took advantage of the nonpublic entity exemptions offered in the guidance. In addition, one practitioner member explained that a few clients questioned the necessity of some disclosures, such as the contract asset and liability opening and closing balance requirements.

### ***IAC***

67. During the November 9, 2021 meeting, IAC members discussed several emerging issues and trends related to revenue recognition. Although members have seen an improvement with new disclosures, investors noted that additional disclosures and further disaggregation of revenue would be useful. One IAC member suggested including a disclosure of the underlying amount of the customer deposits as a result of the rise of significant financing components in customer deposits. Another IAC member recommended increased disclosures for transactions with payments based on consumption or usage (in the technology industry) because it is difficult to determine how revenue is booked under those models. Moreover, that IAC member commented that the difference between gross revenue and net revenue could be highly material, and companies are generally not disclosing the difference (disclosure is not required by the guidance). That member also noted that the difference could materially affect the valuation of the company.

### **Stakeholder Group Outreach**

68. The staff performed outreach with various stakeholder groups, including TIC, two preparer trade groups, and two expert panels at the AICPA.

### ***TIC***

69. During a closed session between the PCC and TIC on September 27, 2021, TIC members shared some challenging areas for which practical expedients could be considered for private companies under Topic 606.

70. The challenging areas TIC members identified include:

- (a) Accounting for Material Rights: Many private companies have resorted to manual top-side adjustments. TIC members noted that the bifurcation of material rights might be irrelevant if all of the cash flows have been received.
- (b) Revenue Recognition of Short-Cycle Manufacturing: Topic 606 resulted in significant changes for certain manufacturing companies requiring revenue to be recognized over time as opposed to at a point in time. TIC members explained that many companies had not updated their processes to account for this change, which has resulted in many nonpublic entities performing manual processes with limited internal controls.
- (c) Presentation of Retainage in the Construction Industry: Members noted that diversity in practice exists because companies are presenting retainage as a contract asset, a contract liability, or a receivable resulting in confusion among financial statement users.

71. At the liaison meeting between the FASB and the TIC on September 28, 2021, TIC members shared their observations on the implementation of Topic 606. TIC members used a variety of resources to educate themselves and prepare for the adoption of the new revenue guidance. Although TIC members used FASB resources, they found firm guides and third-party interpretative guidance to be more helpful because they include additional content and observations related to practical application of the guidance.

72. The time between public company and private company adoption of Topic 606 proved valuable for implementation because most private companies could learn from the public company adoption. Experience with the public company adoption allowed practitioners to identify key areas to focus training on when preparing for private company adoption. However, TIC members still observed challenges with implementation. Some specific areas of difficulty included identifying separate performance obligations, point in time and over time revenue recognition, principal versus agent considerations, retainage presentation, and allocation of the transaction price. TIC members used TRG materials and third-party interpretative guidance materials that include examples of practical application issues to overcome some of those challenges. Additionally, private companies appreciated the disclosure exemptions, which they indicated made implementation easier.

73. TIC members only noted a few specific cases in which financial results significantly differed between Topic 605 and Topic 606. Two examples of significant differences include point in time and over time revenue recognition in short-cycle manufacturing arrangements and breakage in the gaming industry.

74. Costs incurred by practitioners as a result of adopting Topic 606 were comparable to expected costs among TIC members. Much of the upfront costs were due to hiring personnel and educating clients. TIC members noted that there also will be some reoccurring costs, including manual adjustments identified for clients who have not yet updated their processes to comply with Topic 606.
75. The staff had a follow-up discussion with TIC members on November 11, 2021. None of the members raised concerns with the new standard. For the short-cycle manufacturing issue, none of the members raised concerns about inappropriate revenue recognition acceleration related to this issue. For principal versus agent considerations, TIC members shared that assessing control has helped the assessment and has improved this issue.
76. Although there were costs to implementing Topic 606, TIC members agreed that the new revenue standard has achieved its expected benefits. Overall, TIC members indicated that the new revenue standard has resulted in improved risk assessments, strengthened disclosures, and provided greater consistency by removing industry-specific guidance.

#### ***Preparer Trade Groups***

77. The staff met with private company group members of one trade group in December 2021. After the initial introductory meeting, the staff met with two preparer members in January 2022 who volunteered to provide additional information. One of the preparers was from a large construction company and the other preparer was from a small software company. Both members leveraged FASB resources to educate employees and encouraged the FASB to continue publishing helpful material. In addition, they leveraged third-party educational resources such as big four firm guides and industry specific interpretive guidance from the AICPA and other industry groups to assist in implementation. Both members did not take the deferral offered in 2020 and neither took any GAAP departures. Both private company members noted that education was the most costly and challenging aspect of adopting Topic 606. Although the cost of education was significant, both noted that the benefits of adoption outweighed the cost. For example, one preparer member stated that adoption allowed them to streamline their processes and made greater automation possible. Another challenge identified by these preparer members included identifying performance obligations when contracts have multiple performance obligations and performance obligations related to multiple contracts.
78. The staff performed outreach with small business group members of another trade group (which is primarily made up of practitioners and private companies) in December 2021. The group members provided feedback consistent with other stakeholder groups. For education purposes, the participants used the FASB guidance, and also relied on public company adoption, white papers from accounting firms, and TRG resources for education. One member stated that an area of improvement could be incorporating more industry-specific examples

and different scenarios in GAAP. However, that member acknowledged that might be outside the scope of the FASB process.

79. The participants highlighted several challenges in the adoption of Topic 606. Companies had challenges determining performance obligations and some lacked proper internal controls to support the new standard. From a practitioner's perspective, it was challenging to advise and help clients understand how the change from Topic 605, Revenue Recognition, to Topic 606 affected them. The committee members stated that changes were mostly seen in the software, manufacturing, and distribution industries, and they mostly related to changes from point in time to over time revenue recognition. The committee members observed diversity in whether companies were continuing to make top-side entries or changed their processes to accommodate over time recognition.

### ***AICPA Expert Panels***

80. In November 2021, the staff performed outreach with a group of AICPA members that focus on health care entities. Panelists stated that health care organizations primarily looked to AICPA industry-specific guides for education, but early on in adoption, leaned more on FASB resources.
81. AICPA health care panelists identified several challenges that health care organizations faced when adopting Topic 606. They described that health care organizations struggled with the implicit and explicit price concession guidance, point in time versus over time changes, and the differences between the information they needed to prepare for external reporting versus the information they use internally. The panelists also identified that principal versus agent considerations as an issue for health care entities because they have difficulty establishing control because many entities legally cannot control what physicians do. One unexpected cost of adoption was related to changes in terminology, such as implicit price concessions. This change caused effort for stakeholders to understand the new geographical layout of financial statements, specifically regarding bad debts.
82. In the health care industry, a significant benefit identified by panelists was the additional disclosures required under Topic 606. In addition, the new standard helped entities think about performance obligations and better understand the risks associated with their revenue. Overall, outreach participants stated that for health care entities, revenue did not significantly change as a result of adoption.
83. The staff performed outreach with another group of AICPA members that focus on NFP entities in November 2021, and feedback was consistent with feedback received from other NFP stakeholders. For many organizations, Topic 606 did not materially change revenue recognition, and disclosures were the most significant change. Participants noted that many

entities adopted the new guidance through manual adjustments (top-side entries) rather than by changing their processes. The panelists stated that those adjustments were often immaterial and did not represent a significant ongoing cost for NFP entities. The panelists also added that smaller entities had an easier transition because they typically had fewer revenue streams, compared with large entities that took more time to collect data and understand their contract structure for implementation.

## **PIR Monitoring Activities and Research Update**

84. As part of the PIR process, the FASB continues to monitor potential application issues of Topic 606 in practice. The staff has reviewed published reports on SEC comment letter trends, PCAOB inspections trends, and reports about restatements. Additionally, the staff continues to monitor IASB activities regarding revenue recognition. The staff also has continued to monitor and respond to technical inquiries related to revenue recognition.
85. During the 2021 Invitation to Comment, *Agenda Consultation*, four comment letters were received that encouraged the Board to prioritize the revenue PIR project. One comment letter respondent provided specific comments on the issues related to revenue recognition for licensing arrangements and determining whether an entity is a principal or an agent. This respondent stated that those two issues should be a top priority and be addressed by the Board in the near term. This respondent observed that an entity's evaluation of whether it controls the specified service evaluating whether it is a principal or an agent may be unclear or complex and identifying an entity's customer or customers also can be complex in certain arrangements. This respondent also stated that there is cost and complexity in applying the guidance in Topic 606 to licensing transactions, primarily related to identifying performance obligations, allocating transaction price to the identified performance obligations, and accounting for contract modifications.
86. As directed by the Board at the July 2021 Board meeting, the staff has performed research on the following areas raised during the PIR process:
- (a) Disclosures: Considering potential improvements to the disclosures, such as providing more specificity around disaggregated revenue
  - (b) Short-Cycle Manufacturing: Applying the criteria for determining whether revenue should be recognized over time or at a point in time for contract manufacturers
  - (c) Principal versus Agent: Identifying the customer and determining which party controls the good or service before it is transferred to the customer

- (d) Licensing: Determining when a license is distinct from other services in the contract (such as software with updates) and in allocating the total transaction price when the contract includes a sales-based or usage-based royalty
  - (e) Variable Consideration: Applying the guidance on estimates of variable consideration (especially for contracts with sales or usage-based royalties that are not licenses of intellectual property) and determining when and how estimated amounts should be constrained.
87. The remaining issues raised during the PIR process for potential research are listed below:
- (a) Consideration Payable to a Customer: Identifying the customer and determining which payments should be accounted for as a reduction to revenue
  - (b) Standalone selling prices (SSP): Estimating SSP in certain situations, especially when the new performance obligation has never been sold on a standalone basis or has little or no cost basis (or an undeterminable cost basis)
  - (c) Incremental Cost of Obtaining a Contract: Determining, in some situations, which costs should be capitalized and determining the amortization period.

## **Next Steps**

88. The staff will continue to monitor the recurring costs and benefits of Topic 606 implementation and provide the Board with periodic updates on any emerging issues raised by stakeholders.
89. In November 2022, the FASB, the IASB, and the American Accounting Association will hold the Accounting for an Ever-Changing World joint conference. The conference will share academic research papers focused on whether Topic 606 has accomplished its stated objective, provided benefits to users of financial information, resulted in unexpected implementation or continuing application costs, or given rise to unexpected economic consequences. The feedback received from the academic conference, along with the findings from reviewing other academic papers on Topic 606, will be shared with the Board at a future meeting.