FINANCIAL ACCOUNTING STANDARDS BOARD®

# FASB Staff Educational Paper

## Topic 606: Presentation and Disclosure of Retainage for Construction Contractors

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### Educational Paper Purpose

1. Entities that operate in the construction industry are often subject to contracts that contain retainage (or retention) provisions. Topic 606, Revenue from Contracts with Customers, establishes guidance on the presentation of a contract with a customer on the balance sheet as a contract asset or a contract liability and related disclosures, but Topic 606 does not include specific guidance on retainage. The FASB staff received feedback from private company stakeholders in the construction industry that there are questions in practice about the proper application of Topic 606 guidance to retainage. In addition, some users of private company financial statements, including sureties, provided feedback that information about retainage is important to their analysis.

2. The purpose of this educational paper is to (a) clarify the presentation and disclosure requirements in current generally accepted accounting principles (GAAP) about retainage for construction contractors and (b) provide example voluntary disclosures of retainage that would currently be permissible under GAAP and would provide users with more detailed information about contract asset and contract liability balances.

3. This educational paper does not change or modify current GAAP and is not intended to be a comprehensive assessment of the accounting for retainage in accordance with Topic 606. In addition, the exhibits included in this paper are illustrative and do not create additional requirements beyond those in current GAAP. Entities should refer to current GAAP and consider entity-specific facts and circumstances when preparing financial statements.

4. The views expressed in this educational paper are those of the FASB staff. Official positions of the FASB are reached only after extensive due process and deliberations.

### Background

#### *Overview*

5. Topic 606 requires that when an entity enters into a contract with a customer the remaining rights and performance obligations of that contract should be accounted for and presented on a net basis as either a contract asset or a contract liability. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer.

6. Topic 606 also specifies that a receivable is an entity's right to consideration that is unconditional. The determination of whether retainage should be (a) classified as a receivable or (b) included within contract asset or contract liability balances depends on whether the entity's right to payment is unconditional. That determination also affects the presentation and disclosure requirements under GAAP.

***Presentation Requirements Under GAAP***

7. As described in paragraph 5, and in accordance with paragraph 606-10-45-1, when either party to a contract has performed, an entity shall present the contract on the balance sheet as either a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. This analysis is done on a contract-by-contract basis. Accordingly, an entity may present both contract assets and liabilities on its balance sheet, but not for the same contract. Any unconditional rights to consideration are presented separately as a receivable.

***Disclosure Requirements Under GAAP***

8. Topic 606 provides disclosure requirements for contract balances in paragraphs 606-10-50-8 through 50-10, as outlined below. All entities are required to provide the information in paragraph 606-10-50-8(a) and the remaining disclosures below are required only for public business entities. Although they are not required for private companies, entities are permitted to provide any or all of these disclosures.

> **606-10-50-8** An entity shall disclose all of the following:
>
> a. The opening and closing balances of receivables, contract assets, and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed
> b. Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period.
>
> **606-10-50-9** An entity shall explain how the timing of satisfaction of its performance obligations (see paragraph 606-10-50-12(a)) relates to the typical timing of payment (see paragraph 606-10-50-12(b)) and the effect that those factors have on the contract asset and the contract liability balances. The explanation provided may use qualitative information.
>
> **606-10-50-10** An entity shall provide an explanation of the significant changes in the contract asset and the contract liability balances during the reporting period. The explanation shall include qualitative and quantitative information. Examples of changes in the entity's balances of contract assets and contract liabilities include any of the following:
>
> a. Changes due to business combinations
> b. Cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including adjustments arising from a change in the measure of progress, a change in an estimate of the transaction price (including any changes in the assessment of whether an estimate of variable consideration is constrained), or a contract modification
> c. Impairment of a contract asset
> d. A change in the time frame for a right to consideration to become unconditional (that is, for a contract asset to be reclassified to a receivable)
> e. A change in the time frame for a performance obligation to be satisfied (that is, for the recognition of revenue arising from a contract liability).

9. The guidance in Topic 910, Contractors-Construction, provides disclosure requirements for unconditional retainage that is classified as a receivable. Paragraph 910-10-50-7 requires the following disclosures for all entities:

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**910-10-50-7** If receivables include amounts representing balances billed but not paid by customers under contract retainage provisions, a contractor shall disclose, either in the balance sheet or in a note to financial statements, all of the following:

a. The amounts
b. The portion, if any, expected to be collected after one year
c. If practicable, the years in which the amounts are expected to be collected.

***Additional Presentation and Disclosures Permissible Under GAAP***

10. Certain users, including sureties, of private construction company financial statements provided feedback that the presentation and disclosure requirements under Topic 606 do not always provide decision-useful information because the netting of contract assets and contract liabilities can sometimes obscure the information about retainage. Accordingly, entities may want to consider whether to supplement the required presentation and disclosure with additional voluntary information.

11. Other sources, including the AICPA's *Construction Contractors: Audit and Accounting Guide*, also provide illustrations of voluntary disclosures that may provide users with additional information to meet their needs.

12. Examples of such voluntary presentation and disclosure that would be permissible under GAAP include:

    a) *Parenthetical Disclosure*: As illustrated in Exhibit A, entities may include parenthetical disclosure of the amount of retainage that is included in contract assets and contract liabilities on the face of the balance sheet. Such parenthetical disclosure is consistent with Topic 606 because the balance sheet still complies with the netting requirements in paragraph 606-10-45-1. The parenthetical provides additional information about the composition of the net balance.

    b) *Use of Subtotals*: As illustrated in Exhibit B, entities may use additional line items (subtotals) to present contract assets and contract liabilities on the balance sheet to provide additional information to users about those balances on the face of the financial statements.

    c) *Alternative Descriptions*: Paragraph 606-10-45-5 states that, while the guidance uses the terms *contract asset* and *contract liability*, an entity is not prohibited from using alternative descriptions on the balance sheet for those items. Accordingly, entities could use terms such as *billings in excess of revenue* or *revenue in excess of billings* on the balance sheet. However, if an entity uses alternative descriptions for a contract asset, it must also provide sufficient information for a user of the financial statements to distinguish between receivables and contract assets.

    d) *Additional Disclosures in the Notes*: The disclosures in paragraphs 606-10-50-8 through 50-10 outlined in paragraph 8 may be provided by all entities. Furthermore, the FASB staff observes that the guidance does not preclude an entity from disaggregating contract balances within the notes to the financial statements. While an entity may disclose the components of contract asset and contract liability balances within the notes, it should not disaggregate individual contracts as contract assets *and* contract liabilities.

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## Exhibits

13. The FASB staff developed the following illustrations of voluntary disclosures of retainage that would be permissible under GAAP as described in paragraph 12.

| EXHIBIT A - Parenthetical Disclosure of Retainage<br>Excerpt from Consolidated Balance Sheets<br>December 31, 20X1 and 20X0 | | |
|---|---|---|
| | ***20X1*** | ***20X0*** |
| **Assets** | | |
| **Current Assets** | | |
| Contract assets, including conditional retainage of $[ ] and $[ ] at December 31, 20X1 and 20X0, respectively[1] | XXX | XXX |
| **Total Current Assets** | $ X,XXX | $ X,XXX |
| | | |
| **Liabilities and Stockholders' Equity** | | |
| **Current Liabilities** | | |
| Contract liabilities, net of conditional retainage of $[ ] and $[ ] at December 31, 20X1 and 20X0, respectively[1] | XXX | XXX |
| **Total Current Liabilities** | $ X,XXX | $ X,XXX |

| EXHIBIT B - Disaggregation of Contract Balances as Subtotals<br>Excerpt from Consolidated Balance Sheets<br>December 31, 20X1 and 20X0 | | |
|---|---|---|
| | ***20X1*** | ***20X0*** |
| **Assets** | | |
| **Current Assets** | | |
| Contract assets[1] | | |
| Revenue earned in excess of billings | XXX | XXX |
| Conditional retainage | XXX | XXX |
| Total contract assets | XXX | XXX |
| | | |
| **Total Current Assets** | $ X,XXX | $ X,XXX |
| | | |
| **Liabilities and Stockholders' Equity** | | |
| **Current Liabilities** | | |
| Contract liabilities[1] | | |
| Billings in excess of revenue earned | XXX | XXX |
| Less: conditional retainage | (XXX) | (XXX) |
| Total contract liabilities | XXX | XXX |
| | | |
| **Total Current Liabilities** | $ X,XXX | $ X,XXX |

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[1]In accordance with Topic 606, contracts are to be presented on the balance sheet on a contract-by-contract basis as *either* a contract asset or a contract liability. Accordingly, an entity may present both contract assets and contract liabilities that arise from *different* contracts on its balance sheet but may not present both a contract asset and a contract liability for the *same* contract.