0609FN

FINANCIAL ACCOUNTING STANDARDS BOARD
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116
Telephone: 203-847-0700 *Fax*: 203-849-9470
Internet address: eitf@fasb.org or cibonn@fasb.org

July 7, 2009

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the June 18, 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 July 2, 2009 Fatal Flaw draft. After your review, please discard the confidential marked version of the minutes.

September Meeting

The next EITF meeting will be held on **September 9-10, 2009,** at the FASB offices in Norwalk, Connecticut. The "Extra" EITF meeting scheduled for July 30, 2009, will not be held. Please plan for the meeting to begin on Wednesday, September 9, at 1:00 p.m. and conclude no later than 5:00 p.m. On Thursday, September 10, we will resume at 8:00 a.m. and conclude no later than 4:00 p.m. The meeting times are tentative and may change. Coffee will be available and lunch will be provided. On Wednesday, September 9, the FASB will host a dinner at a location to be announced later.

Minutes

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

Draft minutes available September 15, 2009
Final minutes available September 29, 2009.

Please call me at 203.956.5226 if you have any questions.

Sincerely,

Chad I. Bonn
Practice Fellow
cibonn@fasb.org

0609FN

MINUTES OF THE JUNE 18, 2009 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Thursday, June 18, 2009
Starting Time: 8:30 a.m.
Concluding Time: 4:30 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

Task Force Members Absent:
None

* For certain issues only.

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

Others at Meeting Table:
*Robert H. Herz, FASB Board Member
Thomas J. Linsmeier, FASB Board Member
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
Shea H. Malcolm, FASB Practice Fellow
Chad I. Bonn, FASB Practice Fellow
* Kevin M. Stoklosa, FASB Assistant Director
* Kristofer E. Anderson, FASB Practice Fellow
* Jeffrey M. Brickman, FASB Senior Investor Liaison
* David B. Elsbree, Jr., FASB Practice Fellow
* Bradley J. Homant, FASB Practice Fellow
* Diane C. Inzano, FASB Practice Fellow
* Ronald W. Maples, FASB Practice Fellow
* Jamie A. Mayer, FASB Practice Fellow
* Chandini C. Smith, FASB Senior Investor Liaison

* For certain issues only.

ADMINISTRATIVE MATTERS

- Prior EITF meeting minutes. An FASB staff member solicited objections to the final minutes of the March 19, 2009 meeting. No objections were noted.

- The Task Force discussed the EITF Agenda Report following decisions made at the meeting held on May 6. The EITF Agenda Committee discussed two proposed issues and provided its recommendations to the FASB chairman, who, after considering input from other Board members on those two issues, made the following decisions:

    a. *Accounting for Distributions to Shareholders with Components of Stock and Cash in the Calculations and Presentation of Earnings per Share*. This issue was added to the EITF agenda and will be discussed at a future meeting.

    b. *Seller Accounting for Contingent Consideration*. This issue was added to the EITF agenda. Refer to the discussion of EITF Issue No. 09-4, "Seller Accounting for Contingent Consideration," elsewhere in these minutes.

- The SEC Observer clarified the SEC staff's position on escrowed share arrangements and overcoming the presumption of compensation for specific shareholders. Refer to the SEC Staff Announcement section elsewhere in these minutes.

- Comment letters on the following Issues were reported as received and distributed to the Task Force:

    a. Five comment letters on EITF Issue No. 08-9, "Milestone Method of Revenue Recognition." Refer to the discussion of Issue 08-9 elsewhere in these minutes for Task Force consideration of those comment letters.

- September 2009 EITF meeting. An FASB staff member asked the Task Force to anticipate a two-day EITF meeting to be held on September 9–10, 2009. Subsequent to the meeting, the FASB staff determined that there would not be an extra EITF meeting held on July 30, 2009.

- 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, July 1, 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, July 1, 2009.

SEC STAFF ANNOUNCEMENT

Topic No. D-110

Topic: Escrowed Share Arrangements and the Presumption of Compensation

Date Discussed: June 18, 2009

The SEC Observer made the following announcement of the SEC staff's position on escrowed share arrangements. The SEC Observer has been asked to clarify SEC staff views on overcoming the presumption that for certain shareholders these arrangements represent compensation.

Historically, the SEC staff has expressed the view that an escrowed share arrangement[1] involving the release of shares to certain shareholders based on performance-related criteria is presumed to be compensatory, equivalent to a reverse stock split followed by the grant of a restricted stock award under a performance-based plan.

When evaluating whether the presumption of compensation has been overcome, registrants should consider the substance of the arrangement, including whether the arrangement was entered into for purposes unrelated to, and not contingent upon, continued employment. For example, as a condition of a financing transaction, investors may request that specific significant shareholders, who also may be officers or directors, participate in an escrowed share arrangement. If the escrowed shares will be released or canceled without regard to continued employment, specific facts and circumstances may indicate that the arrangement is in substance an inducement made to facilitate the transaction on behalf of the company, rather than as compensatory. In such cases, the SEC staff generally believes that the arrangement should be recognized and measured according to its nature and reflected as a reduction of the proceeds allocated to the newly-issued securities.[2,3]

The SEC staff believes that an escrowed share arrangement in which the shares are automatically forfeited if employment terminates is compensation, consistent with the principle articulated in paragraph A87(a) of FASB Statement No. 141 (revised 2007), *Business Combinations*.

[1] Under these arrangements, which can be between shareholders and a company or directly between the shareholders and new investors, shareholders agree to place a portion of their shares in escrow in connection with an initial public offering or other capital-raising transaction. Shares placed in escrow are released back to the shareholders only if specified performance-related criteria are met.

[2] The SEC staff notes that discounts on debt instruments are amortized using the effective interest method as discussed in APB Opinion No. 21, *Interest on Receivables and Payables*, while discounts on common equity are not generally amortized.

[3] Consistent with the views in SAB Topic 5.T., *Accounting for Expenses or Liabilities Paid by Principal Stockholder(s)*, and SAB Topic 1.B., *Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity*, the SEC staff believes that the benefit created by the shareholder's escrow arrangement should be reflected in the company's financial statements even when the company is not party to the arrangement.

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

References: FASB Statement No. 13, *Accounting for Leases*

FASB Statement No. 45, *Accounting for Franchise Fee Revenue*

FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*

FASB Statement No. 66, *Accounting for Sales of Real Estate*

FASB Statement No. 68, *Research and Development Arrangements*

FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

FASB Statement No. 157, *Fair Value Measurements*

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*

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*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

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*

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

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables"

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

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.

Current EITF Discussion

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.

Disclosure

32. The Task Force reached a consensus-for-exposure that the following information shall be disclosed in the notes to the financial statements:

> The objective of this disclosure guidance is to provide both qualitative and quantitative information regarding the significant judgments made in applying this Issue and changes in either those judgments or the application of this Issue 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 vendor shall disclose 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 related deliverables

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 why 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.

33. The Task Force also discussed whether multiple-deliverable revenue arrangement disclosures should include information relating to how revenue allocation and changes to assumptions or methods affect profit margins. The Task Force decided not to include such disclosure in the consensus-for-exposure, but asked the FASB staff to include a question in the notice to recipients about whether the disclosures should be expanded to discuss profit margins.

Effective Date and Transition

34. The Task Force reached a consensus-for-exposure 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. Earlier application is permitted as of the beginning of a vendor's fiscal year provided the vendor has not previously issued financial statements for any period within that year.

35. The Task Force also reached a consensus-for-exposure that the following information shall be disclosed in the notes to the financial statements for each period in the initial year of adoption:

> For each reporting period in the initial year of adoption, a vendor shall disclose the amount of its revenue recognized subject to the measurement requirements of this Issue and the amount of revenue that would have been recognized if the related transactions were subject to the measurement requirements of Issue 00-21.

Board Ratification

36. At the July 1, 2009 meeting, the Board ratified the consensus-for-exposure reached by the Task Force in this Issue and approved the issuance of a draft abstract for a public comment period.

Status

37. The draft abstract will be posted to the FASB website by no later than July 7, 2009. Comments on the draft abstract are due by August, 14, 2009. Further discussion is expected at a future meeting.

Appendix 08-1A

***EITF ABSTRACTS* (DRAFT[*])**

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 Statement No. 13, *Accounting for Leases*

FASB Statement No. 45, *Accounting for Franchise Fee Revenue*

FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*

FASB Statement No. 66, *Accounting for Sales of Real Estate*

FASB Statement No. 68, *Research and Development Arrangements*

FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

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

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*

FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*

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*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

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

AICPA Statement of Position 00-2, *Accounting by Producers or Distributors of Films*

[*] This draft abstract is being exposed for a public comment period that will end on August 14, 2009.

SEC Staff Accounting Bulletin 104, Topic 13, *Revenue Recognition*
EITF Issue No. 01-9, "Accounting for Consideration given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"

ISSUE

1. To meet their customers' needs, vendors often provide multiple products, services, rights to use assets, or any combination thereof (hereinafter referred to as "deliverables"). These vendors transfer the deliverables to the customer and performance may occur at different times or over different periods of time and the customer's payments for these deliverables may be fixed, variable, or a combination of fixed and variable.

2. This Issue addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, this Issue addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. In applying this Issue, 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. This Issue also addresses how arrangement consideration shall be measured and allocated to the separate units of accounting in the arrangement.

3. This Issue does not address when the criteria for revenue recognition are met or provide revenue recognition guidance for a given unit of accounting. For example, this Issue 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 depends on the nature of the deliverable(s) composing that unit of accounting and on whether the applicable criteria for revenue recognition have been met.

4. This Issue applies to all deliverables within contractually binding arrangements (whether written, oral, or implied, and hereinafter referred to as "arrangements") in all industries under which a vendor will perform multiple revenue-generating activities, except as follows:

a. A multiple-deliverable arrangement or a deliverable(s) in a multiple-deliverable arrangement may be within the scope of higher-level authoritative literature.[1] That higher-level authoritative literature (including, but not limited to, Statements 13, 45, and 66; Interpretation 45; Technical Bulletin 90-1; and SOPs 81-1, 97-2, and 00-2) (referred to hereinafter as "higher-level literature") may provide guidance with respect to whether and/or how to allocate consideration of a multiple-deliverable arrangement. The following describes the three categories into which that higher-level literature falls and the application of this Issue or the higher-level literature in determining separate units of accounting and allocating arrangement consideration:

i. If higher-level literature 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 deliverable(s) in the arrangement that is within the scope of that higher-level literature shall be accounted for in accordance with the relevant provisions of that literature rather than the guidance in this Issue.

ii. If higher-level literature provides guidance requiring separation of deliverables within the scope of higher-level literature from deliverables not within the scope of higher-level literature, but does not specify how to allocate arrangement consideration to each separate unit of accounting, such allocation shall be based on the relative selling price of the deliverable(s) within the scope of higher-level literature and the deliverable(s) not

[1] Whether a deliverable(s) is within the scope of higher-level authoritative literature is determined by the scope provisions of that literature, without regard to the order of delivery of that item in the arrangement. The term *higher-level literature* refers to categories (a) and (b) of the generally accepted accounting principles (GAAP) hierarchy as defined in Statement 162.

within the scope of higher-level literature.[2,3] Subsequent identification of separate units of accounting and allocation of arrangement consideration to the deliverable(s) not subject to higher-level literature would be governed by the provisions of this Issue.

iii. If higher-level literature provides no guidance regarding the separation of the deliverables within the scope of higher-level literature from those deliverables that are not or the allocation of arrangement consideration to deliverables within the scope of the higher-level literature and to those that are not, then the guidance in this Issue shall be followed for purposes of such separation and allocation.[4] In such circumstances, it is possible that a deliverable subject to the guidance of higher-level literature does not meet the criteria in paragraph 9 of this Issue 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 item(s) within the arrangement. The appropriate recognition of revenue shall then be determined for those combined deliverables as a single unit of accounting.

---

[2] For purposes of the allocation between deliverables within the scope of higher-level literature and deliverables not within the scope of higher-level literature, selling price shall be determined using the guidance as discussed in paragraphs 16 and 17 of this Issue.

[3] For example, leased assets are required to be accounted for separately under the guidance of Statement 13. 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 Statement 13 deliverables and the non-Statement 13 deliverables using the relative selling price method. (Although Statement 13 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 Statement 13 deliverables.) The guidance in Statement 13 would then be applied to separate the maintenance from the leased equipment and to allocate the related arrangement consideration to those two deliverables. This Issue would be applied to further separate any non-Statement 13 deliverables and to allocate the related arrangement consideration.

[4] For example, SOP 81-1 provides separation and allocation guidance (segmentation provisions) for deliverables within its scope. However, SOP 81-1 does not provide separation and allocation guidance between SOP 81-1 deliverables and non-SOP 81-1 deliverables. Consider an arrangement that includes designing complex electronic equipment, manufacturing complex electronic equipment (both SOP 81-1 deliverables), and providing the service of running the equipment for a fixed period of time once the equipment is designed, manufactured, and placed in service (a non-SOP 81-1 deliverable). This Issue would be applied to identify separate units of accounting and to allocate arrangement consideration to those separate units of accounting. If applying the guidance in this Issue results in the separation of the design and manufacture of the equipment from the service of running the equipment, the segmentation provisions of SOP 81-1 would be used to determine if it is appropriate to further segment the design deliverables from the manufacture deliverables in accordance with its segmentation provisions. If this Issue prohibits separation of the SOP 81-1 deliverables from the non-SOP 81-1 deliverables, then the amounts otherwise allocable to the design and manufacture deliverables and to the service of running the equipment should be combined. The appropriate recognition of revenue should then be determined for those combined deliverables as a single unit of accounting.

b. Arrangements that include vendor offers to a customer for either (1) free or discounted products or services that will be delivered (either by the vendor or by another unrelated entity) at a future date if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period or (2) a rebate or refund of a determinable cash amount if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period, are excluded from the scope of this Issue. For a further discussion on these types of arrangements, see Issue 01-9. Additionally, arrangements involving the sale of award credits by broad-based loyalty program operators are excluded from the scope of this Issue.

5. The issues are:

Issue 1—How to determine whether an arrangement with multiple deliverables consists of more than one unit of accounting

Issue 2—If an arrangement consists of more than one unit of accounting, how the arrangement consideration shall be allocated among the separate units of accounting

Issue 3—What effect, if any, certain customer rights due to vendor nonperformance have on the measurement of arrangement consideration and/or the allocation of consideration to the delivered unit(s) of accounting

Issue 4—How to account for direct costs incurred related to an arrangement that (a) are not associated with a specific deliverable or (b) are associated with a specific deliverable but that deliverable is required to be combined with another deliverable (or other deliverables)

Issue 5(a)—The impact, if any, of a customer's ability to cancel a contract and incur a cancellation penalty on the measurement of arrangement consideration

Issue 5(b)—The impact, if any, of consideration that varies as a result of future *customer* actions on the measurement and/or allocation of arrangement consideration

Issue 5(c)—The impact, if any, of consideration that varies as a result of future *vendor* actions on the measurement and/or allocation of arrangement consideration

Issue 6—The impact of a vendor's intent not to enforce its contractual rights in the event of customer cancellation on the measurement and/or allocation of arrangement consideration.

EITF DISCUSSION

6. In an arrangement with multiple deliverables, the Task Force reached a consensus that the principles in paragraph 7 and application guidance in paragraphs 8–18 shall be used to determine (a) how the arrangement consideration shall be measured, (b) whether the arrangement shall be divided into separate units of accounting, and (c) how the arrangement consideration shall be allocated among the separate units of accounting. Examples illustrating the application of the principles and application guidance in this Issue are included in Exhibit 08-1B.

Principles

7. The principles applicable to this Issue are:

- Revenue arrangements with multiple deliverables shall be divided into separate units of accounting if the deliverables in the arrangement meet the criteria in paragraph 9.
- Arrangement consideration shall be allocated among the separate units of accounting based on their relative selling prices (or as otherwise provided in paragraph 13). The amount allocated to the delivered unit(s) of accounting is limited as discussed in paragraph 14.
- Applicable revenue recognition criteria shall be considered separately for separate units of accounting.

Application Guidance

Units of Accounting (Issue 1)

8. A vendor shall evaluate all deliverables in an arrangement to determine whether they

represent separate units of accounting. That evaluation must be performed at the inception of the arrangement and as each item in the arrangement is delivered.

9. In an arrangement with multiple deliverables, the delivered item(s) shall be considered a separate unit of accounting if both of the following criteria are met:

a. The delivered item(s) has value to the customer on a standalone basis. That item(s) has value on a standalone basis if it is 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 that deliverable(s).

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

Refer to the flowchart in Exhibit 08-1A for an illustration of the above 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.

10. A delivered item(s) that does not qualify as a separate unit of accounting within the arrangement shall be combined with the other applicable undelivered item(s) within the arrangement. The allocation of arrangement consideration and the recognition of revenue shall then be determined for those combined deliverables as a single unit of accounting.

Measurement and Allocation of Arrangement Consideration (Issues 2, 3, 5(a), 5(b), 5(c), and 6)

11. The amount of total arrangement consideration must be fixed or determinable other than with respect to the impact of (a) any refund rights or other concessions (hereinafter collectively referred to as "refund rights") to which the customer may be entitled or (b) performance bonuses to which the vendor may be entitled.

12. Arrangement consideration shall be allocated at the inception of the arrangement to all deliverables based on their relative selling price (the relative selling price method), except as specified in paragraphs 13 and 14. 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 16). 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 17) 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.

13. To the extent that any separate unit of accounting in the arrangement is required under 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 paragraph 12.

14. The amount allocable to the delivered unit(s) 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 unit(s) of accounting is the lesser of the amount otherwise allocable in accordance with paragraphs 12 and 13, above, or the noncontingent amount. Additionally, although Statement 48 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 Statement.

15. 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 shall be recorded.

16. Vendor specific objective evidence of selling price is limited to (a) the price charged for a

deliverable when it is sold separately or (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). 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.

17. 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.

18. 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 or third-party evidence of selling price or a vendor's best estimate of selling price.

Accounting for Direct Costs in an Arrangement with Multiple Deliverables (Issue 4)

19. The Task Force agreed not to provide guidance on Issue 4 due to the broad, general nature of the question and its applicability beyond arrangements involving multiple deliverables. As such, this Issue does not address the allocation of direct costs in an arrangement.

Disclosure

20. The objective of this disclosure guidance is to provide both qualitative and quantitative information regarding the significant judgments made in applying this Issue and changes in either those judgments or the application of this Issue 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.

21. A vendor shall disclose 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 why 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.

Transition

22. 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.Earlier application is permitted as of the beginning of a vendor's fiscal year provided the vendor has not previously issued financial statements for any period within that year.

23. For each reporting period in the initial year of adoption, a vendor shall disclose the amount of its revenue recognized subject to the measurement requirements of this Issue and the amount of revenue that would have been recognized if the related transactions were subject to the measurement requirements of Issue 00-21.

Amendments to Other Literature

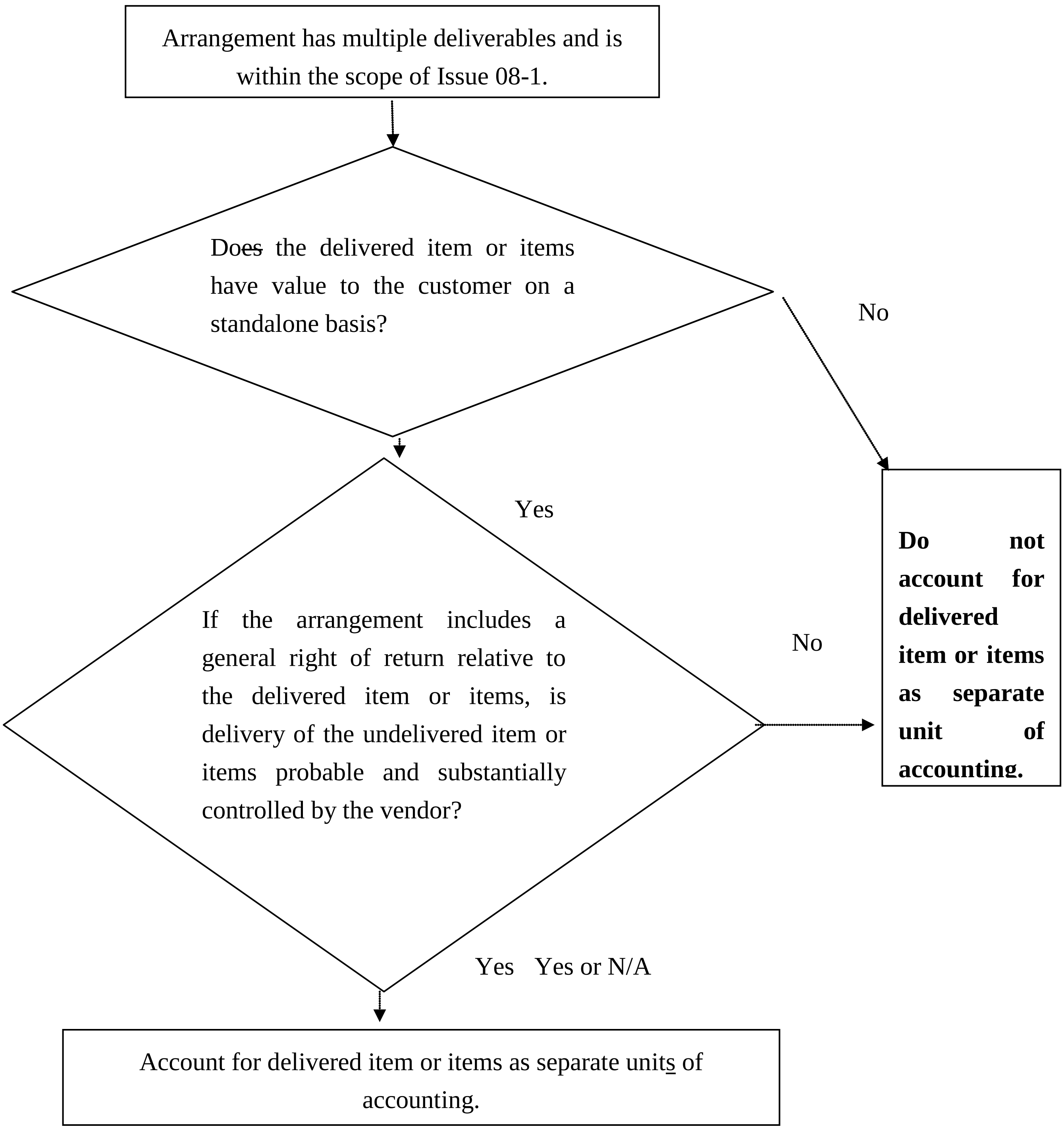
24 Issue 00-21 is superseded by this Issue.

STATUS

25. No further EITF discussion is planned.

Exhibit 08-1A

DETERMINING SEPARATE UNITS OF ACCOUNTING[5]



[5] This diagram represents an overview of the provisions of this Issue with respect to determining the separate units of accounting in an arrangement and should, therefore, be reviewed in conjunction with the entire consensus.

Exhibit 08-1B

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS ON ISSUE 08-1

Note: 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 3, above, this Issue (including the examples below) does *not* address (for any unit of accounting) when the criteria for revenue recognition are met or provide revenue recognition guidance**. The examples illustrate potential application of this Issue based on the limited facts presented. The evaluations and disclosure following the example fact patterns are not intended to represent the only manner in which the guidance in this Issue could be applied. Additional facts would most likely be required in order to fully evaluate the deliverables, the units of accounting, and the presentation issues related to these arrangements.**

Example 1—Cellular Telephone Contract

CellularCo runs a promotion in which new customers who sign a two-year contract receive a "free" phone. 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. CellularCo is considering whether (a) the phone and (b) 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 is delivered first, followed by the phone service (which is provided over the two-year period of the arrangement).

Evaluation: 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 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.

The total arrangement consideration is $1,010. The selling price of the phone service is $960 ($40 × 24 months), the price charged by CellularCo when sold separately. The 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 selling price basis as follows: $112.22 [$1,010 × ($120 ÷ [$120 + $960])] to the phone and $897.78 [$1,010 × ($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 ($897.78 + $62.22).

Example 2—Can Manufacturing Equipment

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 companies do sell the same equipment separately and there is a market for used equipment. Installation is not considered in this example.

Entity C is evaluating whether Equipment X, Y, and Z are separate units of accounting under the following scenario:

> 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 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.

Evaluation: 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 is also met because there is no general right of return in the arrangement. 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.

Example 3—Standard Equipment and Installation

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.

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.

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.

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 (a) the equipment and (b) the installation service are separate units of accounting in the arrangement.

Evaluation: The first condition for separation is met for the equipment. The equipment has standalone value as it is sometimes sold separately. The second condition for separation is also met as there are no general refund rights. Therefore, the equipment and the installation are considered separate units of accounting in the arrangement.

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. The arrangement consideration of $200,000 should be allocated to the separate units of accounting using the relative selling price method. 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.

Example 4—Automobiles Sold with Lifetime Maintenance Services

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 may also 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 separately priced when a customer purchases an automobile from Entity A, they are not within the scope of Technical Bulletin 90-1.

Evaluation: 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 as 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.

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 shall use its best estimate of selling price for the automobile and vendor specific objective evidence of selling price for the maintenance. Additionally, none of the amount allocable to the automobile is contingent upon providing the maintenance services.

Example 5—Sale of Home Appliances with Installation and Maintenance Services

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 who buy Appliance W from other vendors.

Pricing for Appliance W is as follows:

• Appliance W only	$800
• Appliance W with installation service	$850
• Appliance W with maintenance services	$975
• Appliance W with installation and maintenance services	$1,000

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

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

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 Technical Bulletin 90-1. Entity S is evaluating whether Appliance W and the installation service represent separate units of accounting.

Evaluation: The first condition for separation is met for Appliance W because it is sometimes sold separately by Entity S. The second condition for separation is also 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.

Entity S would allocate $175 of the arrangement consideration to the maintenance services based on the guidance in Technical Bulletin 90-1. 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. Vendor specific objective evidence of selling price of Appliance W is its price when sold separately ($800), and the third-party evidence of selling price of the installation service is the amount charged by independent third parties, which approximates $50. Therefore, the amounts 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 only to a refund 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.

Example 6—Human Resources Outsourcing Services

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, and 401(k) administration). Customers may choose a prepackaged bundle of services, may customize an existing bundle of services, or may select the individual services they require. Given the many services provided by Entity HR and the varying needs of its customers, no two arrangements are exactly alike. Entity HR prices its arrangements based on 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.

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.

HR is evaluating whether (a) payroll processing, (b) periodic training, (c) employee handbook development, (d) executive compensation assessment, and (e) training represent separate units of accounting and how to allocate arrangement consideration to the separate units of accounting.

Evaluation: Because no item in the arrangement has been delivered at the inception of the arrangement, Entity HR concludes that there are no units of accounting in the arrangement at that date. However, Entity HR will reassess whether a delivered item(s) should be considered a separate unit(s) of accounting each time it performs under the arrangement.

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.

In estimating the selling price for the deliverables, Entity HR considered its internal costs, its profit objectives, the pricing practices it used to establish the bundled price for its services, and 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.

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 a 26 percent gross profit margin on its payroll processing services, 15 percent gross profit margins on its employee handbook development services and executive compensation assessments, and a 22 percent gross profit margin on its training services before considering any discount on the total arrangement. Those gross profit margins have been developed over time (by a relevant authorized level of management) based on available market data and demand for the services. 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).

Using its internal gross profit margins, and the total estimated costs it will incur to deliver the remaining units of accounting and 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

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

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.

Example 7—Sale of Medical Equipment with Cartridges and Installation

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

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 other vendors do not 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 installations are performed by Entity M within 7–24 days of shipment. Installation is included in the overall sales price of the equipment.

In addition, the customer must pay for cartridges that record images. Entity M is the only manufacturer of the cartridges and it only sells them on a standalone basis to wholesalers 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.

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 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 the equipment represents a separate unit of accounting.

Evaluation: 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 is also 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.

Entity M does not have vendor specific objective evidence of selling price for the equipment as 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 the price 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).

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.

When applying the relative selling price method, Entity M shall 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. Accordingly, without considering whether any portion of the amount allocable to the equipment is contingent upon delivery of the other items, the amount allocable to the equipment, cartridges, and installation is as follows: $371,084 to the equipment [$400,000 × (385,000 ÷ 415,000)], $4,819 to the cartridges [$400,000 × (5,000 ÷ 415,000)], and $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.

Example 8—Sale of Computer System

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 CPU, a monitor, and a keyboard. Solely for purposes of simplifying this illustration of the application of the guidance in this Issue, it is assumed that the CPU does not include software that is more-than-incidental to the products in the arrangement; therefore, the provisions of SOP 97-2 do not apply. On April 30, Entity B delivers the CPU to the customer without the monitor or keyboard. Each of the items is regularly sold separately at a price of $700 for the CPU, $300 for the monitor, and $100 for the keyboard. The CPU 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 CPU represents a separate unit of accounting.

Evaluation: The first condition for separation is met for the CPU, as it is sold separately by Entity B. The second condition for separation is met because there are no general rights of return. Therefore, the CPU should be accounted for as a separate unit of accounting.

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 CPU is contingent upon delivery of the other items, Entity B would allocate the arrangement consideration using the relative selling price method. 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]) is subject to refund if the monitor and keyboard are not delivered. Therefore, the amount allocable to the CPU is limited to $600, which is the amount that is not contingent upon delivery of the monitor and keyboard.

Example 9—Sale of 12 Bolts of Fabric

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. 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 the customer, in addition to having no obligation for bolts of fabric not delivered or not delivered from the appropriate dye lot, will receive a refund for (or will not be obligated to pay for) an equal number of bolts. 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.

In determining the units of accounting under the arrangement, Entity D considered the following scenario:

> 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, 20X2 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 has rarely failed to deliver fabric from the appropriate dye lot under its bulk-sale arrangements.

Evaluation: 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 there are no general rights of return in the arrangement. Therefore, the delivered fabric should be accounted for as a separate unit of accounting.

Without considering whether any portion of the amount allocable to the individual bolts of fabric is 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. Therefore, the portion of the arrangement fee otherwise allocable to each bolt of fabric is $152 ($1,824 ÷ 12). 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, $608 ($152 × 4 bolts of 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.

Example 10—Painting Contract

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.

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.

Evaluation: The first condition for separation is met because the paint is sold separately by other vendors. The second condition for separation is also 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.

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.

Example 11 — Agricultural Equipment

Entity A 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 standard performance indicators and customer specifications prior to shipment.

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, it is assumed that the irrigation equipment is not required to be accounted for in accordance with SOP 81-1. 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.

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.

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.

Evaluation: 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.

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.

Entity A considered the following in estimating the standalone selling price for the irrigation equipment:

- Entity A's cost to produce the customized irrigation equipment is $110,000.
- 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 profit margins within the irrigation product line vary from 10 to 45 percent. Entity A generally receives a higher profit margin on the more specialized or customized products.
- When selling non-customized 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.
- 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.
- 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 those entities' periodic filings.

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

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 based on consideration of the fact that the 30 percent average margin includes lower margin products. Entity A also notes that it believes that it could command higher margins in Asia than the average margin due to the high demand in that market and based on 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.

Entity A did not rely on the $170,000 price of the irrigation equipment that was stated in the arrangement as 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.

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.

Disclosure

The following is an example of the disclosures that might be made in the financial statements of the agricultural equipment manufacturer in the previous example to comply with the disclosure requirements of this Issue.

> We enter into multiple-deliverable revenue arrangements that may include any combination of farm equipment and related service and parts, including tractors, harvesters, integrated agricultural management systems technology, and precision agricultural irrigation equipment. Our arrangements generally do not include any performance-, cancellation-, termination-, or refund-type provisions. Total revenue recognized under multiple-deliverable revenue arrangements totaled $40 million and $35 million in fiscal 20X8 and 20X7, respectively.
>
> Performance under approximately 40 percent of our multiple-deliverable revenue arrangements occurs at the same time or within the same accounting period. These arrangements generally involve the delivery of standard farm equipment and related service parts. Generally, performance under our remaining multiple-deliverable revenue arrangements occurs over a two to six month period and usually involves the manufacture of nonstandard products.
>
> We allocate arrangement consideration to each deliverable in an arrangement based on its relative selling price. We determine selling price using vendor specific objective evidence (VSOE), if it exists, otherwise third-party evidence (TPE). If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP). We normally determine selling price using VSOE or ESP.
>
> We determine VSOE of selling price based on our normal pricing and discounting practices for the specific product or service when sold separately. If a product or service is seldom sold separately, it is unlikely that we can determine selling price for that item using VSOE. While industry averages and competitor prices may provide valuable information to determine the price at which we may sell a product or service on a standalone basis, such information is not considered in our determination of VSOE. In most cases, VSOE of selling

price is an average price of recent actual transactions that are priced within a reasonable range. In performing this assessment, we require that a sufficient concentration of the selling price for a product or service fall within a narrow range. In addition, we consider the type or size of the customer, variances in territories, and other environmental or marketing variables in determining the selling prices to be used in a specific analysis.

TPE of selling price is determined based on our competitor prices for similar deliverables when sold separately. We generally do not use TPE in the determination of our selling prices because we are normally unable to obtain sufficient information on competitor pricing to substantiate TPE.

If we are unable to establish selling price using VSOE or TPE, we will use ESP in our allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. The use of ESP is generally limited to new or highly customized products.

Our determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the arrangement. Because of the nature of our business and our history with manufacturing farm equipment, we typically set prices for new products by estimating the per unit cost to manufacture the equipment plus a profit margin and then perform studies to determine market reaction to the new product at the projected price point and consider other factors to determine our projected pricing for new equipment. Accordingly, to determine ESP we generally begin our assessment with a consideration of the cost to manufacture the product or perform the service plus an estimated gross profit margin. Our cost to manufacture a product includes a consideration of current labor rates, utilization rates, and efficiency variances. The gross profit margin initially used in our assessment will be obtained from the average gross profit margins for the related product line and adjusted based on geographic and divisional considerations, including any direct competition we may encounter that could affect the price we are able to obtain in the specific market.

We compare our initial calculation of ESP with several different sources of information, if known, including: (a) gross profit margins achieved by our competitors for similar products or services, (b) the aggregate selling prices for individual components when sold on a standalone basis, (c) the selling prices for similar products, adjusted for any enhanced functionality included in the deliverable, (d) ongoing pricing strategy, and (e) whether any enhanced functionality of the product should be considered in its pricing.

We analyze the selling prices used in our allocation of arrangement consideration at a minimum on an annual basis. Selling prices are analyzed on a more frequent basis if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices, such as those in highly competitive pricing environments.

Each deliverable within our multiple-deliverable revenue arrangements is accounted for as a separate unit of accounting under the guidance of Issue 08-1 if both of the following criteria are met:

- The delivered item or items have value to the client on a standalone basis
- For an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the company.

For the approximately 40 percent of our multiple-deliverable arrangements for which performance of all obligations occurs at the same time or within the same accounting period, the determination of whether a deliverable can be accounted for separately (as a unit of accounting) is generally limited to an assessment of whether the arrangement includes a general right of return. For the remaining approximately 60 percent of the multiple-deliverable arrangements, our assessment of whether a deliverable can be accounted for separately (as a unit of accounting) will include a consideration of both criteria listed above. Our consideration of standalone value generally involves a consideration of whether the deliverable, or one similar to it, is sold separately by us or another vendor or could be resold by the customer. Because of the nature of our products and services, we are usually able to conclude that the deliverable is sold separately by us or another vendor or could easily be resold by our customer. In limited instances, we may provide a customer with a product that only functions with our other products, which are still to be delivered. In those instances, the delivered product may not meet the criteria for being a separate unit of accounting as it does not have standalone value.

With the exception of installation services, our revenue arrangements generally do not include a general right of return relative to delivered products. For installation services, we are able to conclude that delivery or performance is considered probable and substantially in our control based on our history of providing the installation service.

Deliverables not meeting the criteria for being a separate unit of accounting are combined with a deliverable that does meet that criterion. The appropriate allocation of arrangement consideration and recognition of revenue is then determined for the combined unit of accounting. When one or more deliverables are accounted for together, our revenue recognition for that unit of accounting will generally follow the pattern of performance for the last deliverable provided to the customer. For example, in those instances in which we may deliver a product to a customer that only functions with our other products that are yet to be delivered, we will generally combine that deliverable with the product to which it relates. Revenue recognition for the combined unit of accounting will generally occur when the last deliverable in that unit of accounting is delivered to the customer.

During the period, we increased the selling price used in the allocation of arrangement consideration for certain of our products in our harvester product line by approximately 10 percent. That change results from recent price increases we have realized as a result of our go-to market strategy in our AsiaPac segment. Because of that increase, we expect to experience an overall increase in our revenue from multiple deliverable arrangements, including an increase in the amount of arrangement consideration allocated to the harvester products within those arrangements. Revenue is generally recognized for our harvester products at or shortly after the inception of our multiple-deliverable arrangements. Total revenue recognized on our harvester product line from multiple-deliverable arrangements in our AsiaPac segment was $28 million during the period ended December 31, 20X8.

Other than the change discussed in the prior paragraph, there were no significant changes to our selling prices or methods used to determine selling price during the period. However, we may modify our pricing practices in the future, which could result in changes in selling prices, including both VSOE and ESP. As a result, our future revenue recognition for multiple element arrangements could differ significantly from our historical results.

For a full discussion of the Company's revenue recognition policies, refer to footnote 2, Accounting Policies.

Example 12—Biotech License, Research and Development, and Contract Manufacturing Agreement

The entity, Biotech, enters into an agreement with Pharmaceutical Company (Pharma). The agreement includes (a) Biotech licensing certain rights to Pharma and (b) Biotech providing research and development services to Pharma. Additional details on those aspects of the agreement follow.

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 below.

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.

Compensation under the arrangement is as follows:

- Biotech receives $5 million up-front upon signing the agreement
- Biotech receives $250,000 per year for each full-time equivalent employee who performs research and development activities.

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.

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).

Evaluation: There are two deliverables in this arrangement that should be considered for separation: (a) license and (b) research and development activities. The license deliverable does not meet the first criterion for separation since 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.

Appendix 08-1B

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™
(DRAFT CODIFICATION UPDATE INSTRUCTIONS)

Introduction

A1. This appendix outlines how this Issue affects the *FASB Accounting Standards Codification*™.

A2. This Issue amends Topic 605, Revenue Recognition.

Amendments to the Codification

A3. Amend paragraphs **605-25-05-1 through 05-2**, with no link to a transition paragraph as follows:

605-25-05-1 This Subtopic addresses ~~certain~~ some 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~~ shall be measured and allocated to the separate units of accounting in the arrangement.

605-25-05-2 ~~Many entities offer multiple solutions to~~ To meet their customers' needs, vendors often provide~~. Those solutions may involve the delivery or performance of~~ multiple products, services, ~~or~~ rights to use assets, or any combination thereof. These vendors transfer the deliverables to the customer and performance may occur at different times or over different periods of time, and the customer's~~. 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 for these deliverables may be fixed, variable~~ based on future performance~~, or a combination of fixed and variable~~ payment amounts~~.

A4. Amend paragraph **605-25-15-3A(b),** with a link to transition paragraph **605-25-65-1** as follows:

605-25-15-3A

b. Other Topics address~~es~~ 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 f~~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~~ selling price shall be determined using the guidance as discussed in paragraphs 605-25-30-6A~~8~~ through 30-6B~~30-9~~.) Subsequent ~~accounting (~~identification of separate units of accounting and allocation of arrangement consideration ~~value thereto) for the value allocated~~ to the deliverables not subject to that Topic would be governed by the provisions of this Subtopic.

A5. Amend paragraph **605-25-15-4,** with no link to a transition paragraph 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~~ 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.

A6. Amend paragraph **605-25-25-2**, with a link to transition paragraph **605-25-65-1** as follows:

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~~s~~ 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.

A7. Amend paragraph **605-25-25-5,** with a link to transition paragraph **605-25-65-1** as follows:

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. [Not used]~~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.

A8. Amend paragraph **605-25-25-6**, with a link to transition paragraph **605-25-65-1** as follows:

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.

A9. Amend paragraph **605-25-30-2,** with a link to transition paragraph **605-25-65-1** as follows:

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 based on 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 605-25-30-6A). 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 605-25-30-6B) 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.

A10. Delete paragraph **605-25-30-3,** with a link to transition paragraph **605-25-65-1** as follows:

605-25-30-3 [Not used]~~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.~~

A11. Amend paragraphs **605-25-30-4 through 30-5,** with no link to a transition paragraph 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 paragraph~~s~~ 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~~ 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.

A12. Amend paragraph **605-25-30-7**, with a link to 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 or third-party evidence of selling price 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.~~

A13. Delete paragraphs **605-25-30-8 through 30-9**, with a link to transition paragraph **605-25-65-1** as follows:

605-25-30-8 [Not used]~~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 [Not used]~~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.~~

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

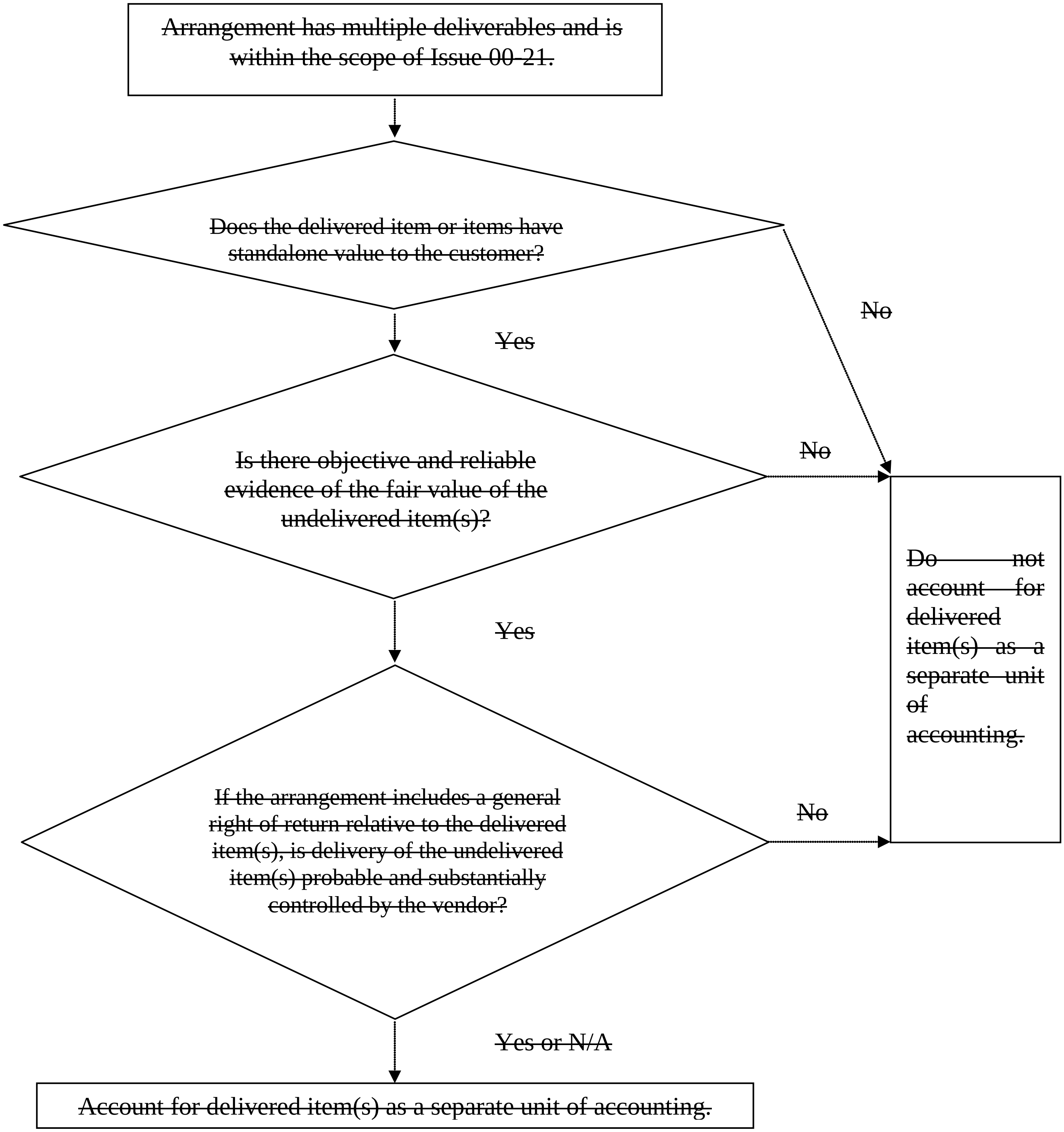
605-25-50-1 ~~A vendor shall disclose both of the following:~~ The objective of this disclosure guidance is to provide both qualitative and quantitative information regarding the significant judgments made about the application of this Issue and changes in those judgments or in the application of this Issue 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.

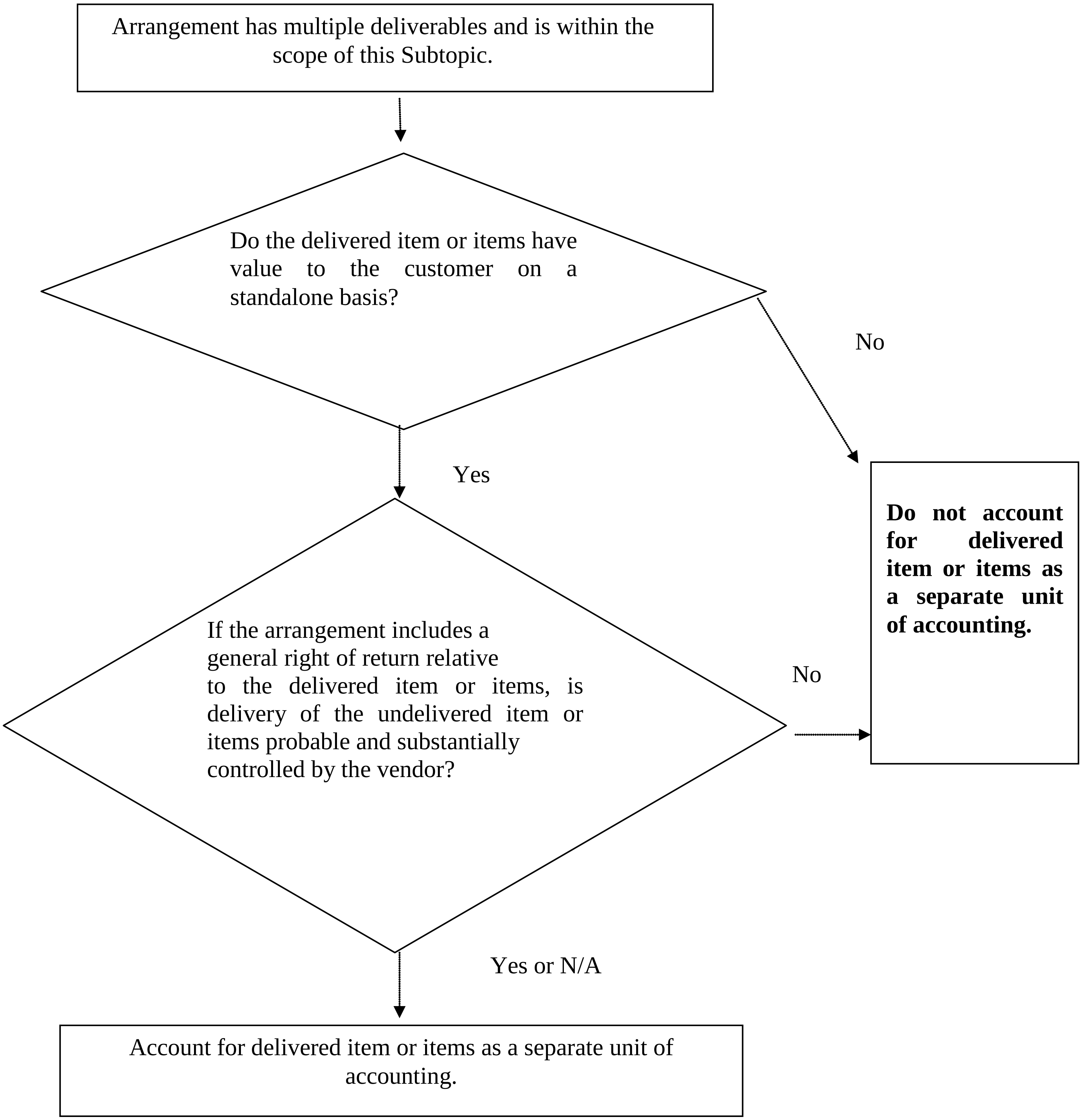
~~a. Its accounting policy for recognition of revenue from multiple-deliverable arrangements (for example, whether deliverables are separable into units of accounting)~~

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

A15. Amend paragraph **605-25-55-1**, with a link to 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 controlled by the vendor?~~
~~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 of the undelivered item or items probable and substantially controlled by the vendor?
No
Yes or N/A
Account for delivered item or items as a separate unit of accounting.

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

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 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.) The guidance in ~~that~~ Subtopic 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 would be applied to further separate any deliverables not subject to the guidance in ~~that~~ Subtopic 840 and to allocate the related arrangement consideration.

A17. Amend paragraphs **605-25-55-7 through 55-8,** with a link to 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 in order 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.

A18. Amend paragraph **605-25-55-9,** with a link to transition paragraph **605-25-65-1** as follows:

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.

A19. Amend paragraphs **605-25-55-11 through 55-12,** with a link to transition paragraph **605-25-65-1** as follows:

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 ×~~x~~ 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.

A20. Amend paragraph **605-25-55-15,** with a link to transition paragraph **605-25-65-1** as follows:

605-25-55-15 Entity C is evaluating ~~revenue recognition~~ whether Equipment X, Y, and Z may be accounted for separately under the following scenario.

A21. Amend paragraph **605-25-55-17,** with a link to transition paragraph **605-25-65-1** as follows:

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.

A22. Amend paragraph **605-25-55-19,** with a link to 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 paragraphs 605-25-30-2 ~~through 30-3~~.

A23. Amend paragraphs **605-25-55-23 through 55-26,** with a link to transition paragraph **605-25-65-1** as follows:

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 as there~~. 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. <u>Entity E has either vendor specific objective evidence or third-party evidence of selling price for all units of accounting in the arrangement.</u> ~~Therefore, consideration in the arrangement would be allocated on a relative fair value basis. In this case, t~~<u>T</u>he arrangement consideration of $200,000 ~~would~~ <u>should</u> be allocated to the separate units of accounting <u>using the</u> ~~based on their~~ relative<u> selling price method</u> ~~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 <u>allocation guidance in paragraph</u> ~~residual method allocation in paragraph~~ 605-25-30-<u>2</u>~~3~~.

A24. Amend paragraphs **605-25-55-27 through 55-30,** with a link to transition paragraph **605-25-65-1** as follows:

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 <u>priced when a customer purchases an automobile from</u> ~~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~~. 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,~~ as 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 shall 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.

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~~s~~ 605-25-30-2~~ through 30-3~~.

A25. Amend paragraph **605-25-55-32,** with no link to a transition paragraph as follows:

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.

A26. Amend paragraphs **605-25-55-34 through 55-36,** with a link to transition paragraph **605-25-65-1** as follows:

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.

A27. Amend paragraphs **605-25-55-37 through 55-47** and preceding related heading with a link to 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 605-25-30-6B 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~~the combined unit-of-accounting method in paragraph 605-25-25-6~~. ~~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 choose a prepackaged bundle of services, may customize an existing bundle of services, or may 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 based on 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. Biotech licensing certain rights to Pharma~~

~~b. Biotech providing research and development services to Pharma~~

~~c. 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 (a) payroll processing, (b) periodic training, (c) employee handbook development, (d) executive compensation assessment, and (e) training represent separate units of accounting and how to allocate arrangement consideration to the separate units of accounting. ~~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 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 its internal costs, its profit objectives, the pricing practices it used to establish the bundled price for its services, and 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 a 26 percent gross profit margin on its payroll processing services, 15 percent gross profit margins on its employee handbook development services and executive compensation assessments, and a 22 percent gross profit margin on its training services before considering any discount on the total arrangement. Those gross profit margins have been developed over time (by a relevant, authorized level of management) based on available market data and demand for the services. 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, 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 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.~~

A29. Delete paragraphs **605-25-55-48 through 55-50,** with a link to transition paragraph **605-25-65-1** as follows:

605-25-55-48 [Not used]~~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 [Not used]~~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 [Not used]~~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.~~

A30. Amend paragraphs **605-25-55-51 through 55-54,** with a link to 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 companies 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. ~~m~~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~~ 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.

A31. Amend paragraphs **605-25-55-56 through 55-58,** with a link to transition paragraph **605-25-65-1** as follows:

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.

605-25-55-57 When applying the relative selling price method, Entity M shall 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 x 20] - $20,000)~~ $371,084 to the equipment ($400,000 × [$385,000 ÷ 415,000])

b. ~~$5,000 to the cartridges ($250 x 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.

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~~s~~ 605-25-30-2 ~~through 30-3~~, and the limitation in paragraph 605-25-30-5 to noncontingent amounts.

A32. Amend paragraphs **605-25-55-59 through 55-61,** with a link to transition paragraph **605-25-65-1** as follows:

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 (CPU), 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 CPU does not include software that is more-than-incidental to the products in the arrangement; therefore, the provisions of Subtopic 985-605 do not apply. On April 30, Entity B delivers the CPU 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 CPU, $300 for the monitor, and $100 for the keyboard. The CPU 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 CPU 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 CPU, 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 CPU would be accounted for as a separate unit of accounting.

605-25-55-61 Entity B has objective and reliable 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 CPU 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 CPU is limited to $600, which is the amount that is not contingent upon delivery of the monitor and keyboard.

A33. Amend paragraphs **605-25-55-68 through 55-69** with a link to transition paragraph **605-25-65-1** as follows:

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 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). 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, \$608 (\$152 × 4 bolts of 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.

A34. Amend paragraph **605-25-55-73,** with no link to a transition paragraph as follows:

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.

A35. Add paragraphs **605-25-30-6A through 30-6B**, with a link to transition paragraph **605-25-65-1** as follows:

605-25-30-6A Vendor specific objective evidence of selling price is limited to (a) the price charged for a deliverable when it is sold separately or (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). 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.

605-25-30-6B 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.

A36. Add paragraphs **605-25-55-56A through 55-56B,** with no link to a transition paragraph as follows:

605-25-55-56A Entity M does not have vendor specific objective evidence of selling price for the equipment as 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 the price 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.

A37. Add paragraphs **605-25-55-75 through 55-108**, with a link to transition paragraph **605-25-65-1** as follows:

> > Example 11: Agricultural Equipment

605-25-55-75 Entity A 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 prior to shipment.

605-25-55-76 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.

605-25-55-77 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.

605-25-55-78 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.

605-25-55-79 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.

605-25-55-80 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.

605-25-55-81 Entity A considered 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 those entities' 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 prior to customization at $155,000.

605-25-55-82 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 based on consideration of the fact that the 30 percent average margin includes lower margin products. Entity A also notes that it believes that it could command higher margins in Asia than the average margin due to the high demand in that market and based on 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.

605-25-55-83 Entity A did not rely on the $170,000 price of the irrigation equipment that was stated in the arrangement as 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.

605-25-55-84 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]). Additionally, none of the amount allocable to the tractor is limited by the amount of payment contingent upon delivery of the irrigation equipment.

> > Disclosure

605-25-55-85 The following is an example of the disclosures that might be made in the financial statements of the agricultural equipment manufacturer in this example.

605-25-55-86 We enter into multiple-deliverable revenue arrangements that may include any combination of farm equipment and related service and parts, including tractors, harvesters, integrated agricultural management systems technology, and precision agricultural irrigation equipment. Our arrangements generally do not include any performance-, cancellation-, termination-, or refund-type provisions. Total revenue recognized under multiple-deliverable revenue arrangements totaled $40 million and $35 million in fiscal 20X8 and 20X7, respectively.

605-25-55-87 Performance under approximately 40 percent of our multiple-deliverable revenue arrangements occurs at the same time or within the same accounting period. These arrangements generally involve the delivery of standard farm equipment and related service parts. Generally, performances under our remaining multiple-deliverable revenue arrangements occur over a two to six month period and usually involves the manufacture of nonstandard products.

605-25-55-88 We allocate arrangement consideration to each deliverable in an arrangement based on its relative selling price. We determine selling price using vendor specific objective evidence, if it exists, otherwise third-party evidence. If neither vendor specific objective evidence nor third-party evidence of selling price exists for a unit of accounting, we use estimated selling price. We normally determine selling price using vendor specific objective evidence or estimated selling price.

605-25-55-89 We determine vendor specific objective evidence of selling price based on our normal pricing and discounting practices for the specific product or service when sold separately. If a product or service is seldom sold separately, it is unlikely that we can determine selling price for that item using vendor specific objective evidence. While industry averages and competitor prices may provide valuable information to determine the price at which we may sell a product or service on a standalone basis, such information is not considered in our determination of vendor specific objective evidence. In most cases, vendor specific objective evidence of selling price is an average price of recent actual transactions that are priced within a reasonable range. In performing this assessment, we require that a majority of the selling price for a product or service fall within a narrow range. In addition, we consider the type or size of the customer, variances in territories, and other environmental or marketing variables in determining the selling prices to be used in a specific analysis.

605-25-55-90 Third-party evidence of selling price is determined based on our competitor prices for similar deliverables when sold separately. We generally do not use third-party evidence in the determination of our selling prices because we are normally unable to obtain sufficient information on competitor pricing to substantiate third-party evidence.

605-25-55-91 If we are unable to establish selling price using vendor specific objective evidence or third-party evidence, we will use estimated selling price in our allocation of arrangement consideration. The objective of estimated selling price is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. The use of estimated selling price is generally limited to new or highly customized products.

605-25-55-92 Our determination of estimated selling price involves a weighting of several factors based on the specific facts and circumstances of the arrangement. Because of the nature of our business and our history with manufacturing farm equipment, we typically set prices for new products by estimating the per unit cost to manufacture the equipment plus a profit margin and then perform studies to determine market reaction to the new product at the projected price point and consider other factors to determine our projected pricing for new equipment. Accordingly, to determine estimated selling price we generally begin our assessment with a consideration of the cost to manufacture the product or perform the service plus an estimated gross profit margin. Our cost to manufacture a product includes a consideration of current labor rates, utilization rates, and efficiency variances. The gross profit margin initially used in our assessment will be obtained from the average gross profit margins for the related product line and adjusted based on geographic and divisional considerations, including any direct competition we may encounter that could affect the price we are able to obtain in the specific market.

605-25-55-93 We compare our initial calculation of estimated selling price with several different sources of information, if known, including: (a) gross profit margins achieved by our competitors for similar products or services, (b) the aggregate selling prices for individual components when sold on a standalone basis, (c) the selling prices for similar products, adjusted for any enhanced functionality included in the deliverable, (d) ongoing pricing strategy, and (e) whether any enhanced functionality of the product should be considered in its pricing.

605-25-55-94 We analyze the selling prices used in our allocation of arrangement consideration at a minimum on an annual basis. Selling prices are analyzed on a more frequent basis if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices, such as those in highly competitive pricing environments.

605-25-55-95 Each deliverable within our multiple-deliverable revenue arrangements is accounted for as a separate unit of accounting under the guidance of Issue 08-1 if both of the following criteria are met:

a. The delivered item or items have value to the client on a standalone basis

b. For an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the company.

605-25-55-96 For the approximately 40 percent of our multiple-deliverable arrangements for which performance of all obligations occurs at the same time or within the same accounting period, the determination of whether a deliverable can be accounted for separately (as a unit of accounting) is generally limited to an assessment of whether the arrangement includes a general right of return. For the remaining approximately 60 percent of the multiple-deliverable arrangements, our assessment of whether a deliverable can be accounted for separately (as a unit of accounting) will include a consideration of both criteria listed above. Our consideration of standalone value generally involves a consideration of whether the deliverable, or one similar to it, is sold separately by us or another vendor or could be resold by the customer. Because of the nature of our products and services, we are usually able to conclude that the deliverable is sold separately by us or another vendor or could easily be resold by our customer. In limited instances, we may provide a customer with a product that only functions with our other products, which are still to be delivered. In those instances, the delivered product may not meet the criteria for being a separate unit of accounting as it does not have standalone value.

605-25-55-97 With the exception of installation services, our revenue arrangements generally do not include a general right of return relative to delivered products. For installation services, we are able to conclude that delivery or performance is considered probable and substantially in our control based on our history of providing the installation service.

605-25-55-98 Deliverables not meeting the criteria for being a separate unit of accounting are combined with a deliverable that does meet that criterion. The appropriate allocation of arrangement consideration and recognition of revenue is then determined for the combined unit of accounting. When one or more deliverables are accounted for together, our revenue recognition for that unit of accounting will generally follow the pattern of performance for the last deliverable provided to the customer. For example, in those instances in which we may deliver a product to a customer that only functions with our other products that are yet to be delivered, we will generally combine that deliverable with the product to which it relates. Revenue recognition for the combined unit of accounting will generally occur when the last deliverable in that unit of accounting is delivered to the customer.

605-25-55-99 During the period, we increased the selling price used in the allocation of arrangement consideration for certain of our products in our harvester product line by approximately 10 percent. That change results from recent price increases we have realized as a result of our go-to market strategy in our AsiaPac segment. Because of that increase, we expect to experience an overall increase in our revenue from multiple deliverable arrangements, including an increase in the amount of arrangement consideration allocated to the harvester products within those arrangements. As a result, we do not expect the change in selling price to materially affect the allocation of arrangement consideration to the other units of accounting in our multiple-deliverable revenue arrangements. Total revenue recognized on our harvester product line from multiple-deliverable arrangements in our AsiaPac segment was $28 million during the period ended December 31, 20X8.

605-25-55-100 Other than the change discussed in the prior paragraph, there were no significant changes to our selling prices or methods used to determine selling price during the period. However, we may modify our pricing practices in the future, which could result in changes in selling prices, including both vendor specific objective evidence and estimated selling price. As a result, our future revenue recognition for multiple element arrangements could differ significantly from our historical results.

605-25-55-101 For a full discussion of the Entity's revenue recognition policies, refer to footnote 2, Accounting Policies.

> > Example 12—Biotech License, Research and Development, and Contract Manufacturing Agreement

605-25-55-102 The entity, Biotech, enters into an agreement with a pharmaceutical entity, Pharma. The agreement includes (a) Biotech licensing certain rights to Pharma and (b) Biotech providing research and development services to Pharma. Additional details on those aspects of the agreement follow.

605-25-55-103 *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 below.

605-25-55-104 *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.

605-25-55-105 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.

605-25-55-106 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.

605-25-55-107 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).

605-25-55-108 Based on an evaluation of the circumstances, there are two deliverables in this arrangement that should be considered for separation: (a) license and (b) research and development activities. The license deliverable does not meet the first criterion for separation since 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.

A38. Add paragraph **605-25-50-2**, with a link to transition paragraph **605-25-65-1** as follows:

605-25-50-2 A vendor shall disclose 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 th~~os~~e 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 th~~os~~e significant deliverables in the arrangements qualify as separate units of accounting~~,~~ and the reasons why 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.

A39. Add paragraph **605-25-65-1** and preceding heading as follows:

> > Transition and Effective Date Related to Accounting Standards Update No. 2009-X, "Revenue Arrangements with Multiple Deliverables"

605-25-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2009-X, "Revenue Arrangements with Multiple Deliverables":

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.

b. Earlier application is permitted as of the beginning of a vendor's fiscal year provided the vendor has not previously issued financial statements for any period within that year.

c. For each reporting period in the initial year of adoption, a vendor shall disclose:

1. The amount of its revenue recognized subject to the measurement requirements of this Subtopic
2. The amount of revenue that would have been recognized if the related transactions that were subject to the measurement requirements of this Subtopic had not changed.

Issue No. 08-9

Title: Milestone Method of Revenue Recognition

Dates Discussed: November 13, 2008; March 19, 2009; June 18, 2009

References: FASB Statement No. 5, *Accounting for Contingencies*

FASB Statement No. 13, *Accounting for Leases*

FASB Statement No. 154, *Accounting for Changes and Error Corrections*

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*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

AICPA Statement of Position 00-2, *Accounting by Producers or Distributors of Films*

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

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables"

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

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.

Current EITF Discussion

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.

Effective Date and Transition

25. At the June 18, 2009 EITF meeting, Task Force members discussed whether the adoption of the milestone method by an entity that has previously made an alternate accounting policy election should be considered a change in accounting principle subject to the preferability requirement of Statement 154. Some Task Force members observed that an entity may not have elected to apply the milestone method previously because the entity was unsure whether it was an allowable method under existing accounting literature. Other Task Force members commented that if the facts and circumstances supported the use of the milestone method, then an entity should be able to prove preferability. As a result, Task Force members did not support providing an exception to the preferability guidance in Statement 154.

26. Task Force members also discussed whether the guidance in this Issue is clear that an entity that previously applied a milestone method that did not comply with the guidance of this Issue would be required to comply with the preferability requirements of Statement 154, including the need for retrospective application of the milestone method as provided for by this Issue. Task Force members discussed whether it was necessary to clarify the transition guidance to clarify that retrospective application would be required in the above instance. Other Task Force members questioned whether an entity that had previously applied a milestone method that was considered to be an appropriate application of U.S. GAAP should be required to apply the guidance in this Issue through retrospective application.

27. The Task Force is expected to further discuss transition provisions for this Issue based on the analysis of the types of transactions that may be within the scope of this Issue and how this Issue may affect those transactions. The Task Force did not discuss the effective date and was not asked to reach a conclusion on transition.

Status

28. Further discussion is expected at a future meeting.

Issue No. 09-1

Title: Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing

Dates Discussed: March 19, 2009; June 18, 2009

References: FASB Statement No. 123 (revised 2004), *Share-Based Payments*

FASB Statement No. 128, *Earnings per Share*

FASB Statement No. 129, *Disclosure of Information about Capital Structure*

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*

FASB Staff Position FAS 129-1, *Disclosure Requirements under FASB Statement No. 129 Relating to Contingently Convertible Securities*

FASB Staff Position APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*

APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*

EITF Issue No. 85-1, "Classifying Notes Received for Capital Stock"

EITF Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services"

EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments"

EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios"

EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"

EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments"

EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock"

Introduction

1. As a result of market conditions and the need for financing, a number of entities for which the cost to an investment banking firm (investment bank) or third-party investors (investors) of borrowing their shares is prohibitive (for example, due to a lack of liquidity or extensive open short positions in the shares) may enter into share-lending arrangements that are executed separately but in connection with a convertible debt offering. Although the convertible debt instrument is ultimately sold to investors, the share-lending arrangement is an agreement between the entity (share lender) and an investment bank (share borrower) and is intended to facilitate the ability of the investors to hedge the conversion option in the entity's convertible debt.

2. The share-lending arrangement is entered into with the investment bank underwriting the offering. The terms of the share-lending arrangement require the entity to issue shares (loaned shares) to the investment bank in exchange for a nominal loan processing fee. Although the loaned shares are legally outstanding, the nominal loan processing fee is typically equal to the par value of the common stock, which is significantly less than the fair value of the loaned shares or the share-lending arrangement. Generally, upon maturity or conversion of the convertible debt, the investment bank is required to return the loaned shares to the entity for no additional consideration. That is, the share-lending arrangement requires physical settlement. Loaned shares that are issued by the entity subject to these share-lending arrangements are legally outstanding, and the holders of those shares are entitled to receive dividends and to vote on shareholder matters. However, the terms of these share-lending arrangements stipulate that over the period the shares are loaned to the investment bank (the loan period), the investment bank is required to (a) reimburse the entity for any dividends paid on the loaned shares, even if the investment bank has sold the loaned shares into the market, and (b) not vote on any matters submitted to a vote of the entity's shareholders to the extent the investment bank is the owner of record. Although most share-lending arrangements do not require the investment bank to post collateral during the loan period, a collateral provision does exist in some of the arrangements.

Issues

3. The issues are:

Issue 1— How an entity should account for a share-lending arrangement that is entered into in contemplation of a convertible debt offering

Issue 2— The effect the share-lending arrangement has on the calculation of earnings per share.

Scope

4. This Issue applies to entities that enter into share-lending arrangements on their own shares in contemplation of a convertible debt offering or other financing.

Prior EITF Discussion

5. At the March 19, 2009 EITF meeting, the Task Force reached a consensus-for-exposure on Issue 1 that at the date of issuance, a share-lending arrangement entered into on an entity's own shares in contemplation of a convertible debt offering or other financing is required to be measured at fair value and recognized as a debt issuance cost in the financial statements of the entity. The debt issuance cost shall be amortized using the effective interest method over the life of the financing arrangement as interest cost.

6. The share-lending arrangement should be considered in conjunction with other applicable generally accepted accounting principles (for example, Statement 150 and Issue 00-19) in determining the classification of the share-lending arrangement in the financial statements of the entity.

7. The Task Force reached a consensus-for-exposure on Issue 2 that the loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in the basic and diluted earnings per share calculation. Any amounts, including contractual (accumulated) dividends and participation rights in undistributed earnings, attributable to the loaned shares shall be deducted in computing income available to common shareholders, consistent with the two-class method set forth in paragraph 61 of Statement 128.

Disclosure

8. The Task Force reached a consensus-for-exposure that the following disclosures, in addition to the disclosures required by Statement 129, be made in annual financial statements for any period in which a share-lending arrangement is outstanding.

> An entity is required to disclose (a) a description of any outstanding share-lending arrangements on an entity's own stock and all significant terms of the share-lending arrangement including the number of shares, the term, the circumstances under which cash settlement would be required, and any requirements for the counterparty to provide collateral; (b) the entity's reason for entering into the share-lending arrangement; (c) the fair value of the outstanding loaned shares as of the balance sheet date; (d) the treatment of the share-lending arrangement for the purposes of calculating earnings per share; (e) the unamortized amount and classification of the debt issuance costs associated with the share-lending arrangement at the balance sheet date; and (f) the amount of interest cost recognized relating to the amortization of the debt issuance cost associated with the share-lending arrangement for the reporting period.

Effective Date and Transition

9. The Task Force reached a consensus-for-exposure that this Issue shall be effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years. Early adoption is not permitted. This consensus requires retrospective application for all

arrangements outstanding as of the beginning of the fiscal year in which this Issue is initially applied.

10. The transition disclosures of paragraphs 17 and 18 of Statement 154 shall be provided.

11. At the April 1, 2009 meeting, the Board ratified the consensus-for-exposure reached by the Task Force in this Issue and approved the issuance of a draft abstract for a public comment period. The public comment period ended on May 5, 2009.

Current EITF Discussion

12. At the June 18, 2009 EITF meeting, the Task Force discussed the informal comments received on the draft abstract. The following issues were discussed:

Issue 1—Whether to amend the scope to clarify that this Issue only applies to share-lending arrangements that are classified as equity

Issue 2—Whether to clarify that the fair value of the share-lending arrangement should be accounted for as issuance costs in accordance with applicable generally accepted accounting principles

Issue 3—Whether the share lender is required to recognize an expense upon default of the share-lending agreement, and whether to describe when the expense is incurred and how it is measured

Issue 4—Whether to amend the earnings-per-share guidance in the draft abstract to be consistent with Statement 128 as it relates to contingently returnable shares and clarify whether the two-class method of computing earnings per share is required by this Issue.

13. The Task Force reached a consensus on Issue 1 that the scope should be amended to clarify that this Issue only applies to share-lending arrangements that are classified as equity in the financial statements of the share lender. Arrangements that are classified as an asset or liability are required to be accounted for under other applicable guidance.

14. On Issue 2, the Task Force reached a consensus that the reference to "debt issuance cost" in the draft abstract be amended to "issuance cost."

15. On Issue 3, the Task Force reached a consensus that the share lender is required to recognize an expense in its financial statements when counterparty default is probable. The share lender is required to recognize an expense equal to the then fair value of the unreturned shares, net of the fair value of probable recoveries. The share lender is required to remeasure the fair value of the unreturned shares, net of the fair value of probable recoveries, each reporting period through earnings until the arrangement consideration payable by the counterparty becomes fixed. Subsequent changes in the amount of probable recoveries should also be recognized in earnings. Some Task Force members observed that equity-classified instruments do not generally result in expense charges. However, the Task Force concluded that an expense was appropriate in this situation because it relates to a counterparty default and not changes in the entity's share price.

16. The Task Force discussed Issue 4 and clarified that the loaned shares should be excluded from basic and diluted earnings per share until default of the share-lending arrangement occurs. Upon default, the loaned shares shall be included in the basic and diluted earnings-per-share calculations. The Task Force agreed with the staff that the loaned shares are similar to contingently issuable or returnable shares. Accordingly, the guidance in paragraph 10 of Statement 128 is applicable to the determination of when the loaned shares should be included in the earnings-per-share calculation.

17. The Task Force also clarified that the two-class method is not required to be applied to the shares subject to the share-lending arrangement. However, if dividends on the loaned shares are not reimbursed to the entity, the amounts attributable to the shares subject to the share-lending arrangement should be deducted in computing earnings available to common shareholders. The Task Force observed that this is consistent with the treatment of a physically-settled forward contract pursuant to paragraph 25 of Statement 150, and consistent with the two-class method set forth in paragraph 61 of Statement 128.

18. Task Force members suggested certain other clarifying edits to the draft abstract, which are reflected in the attached abstract in Appendix 09-1A (added text is underlined and deleted text is ~~struck out~~).

Disclosure

19. The Task Force reached a consensus that the disclosures are required for both annual and interim period financial statements and should be amended to include (a) any amounts of dividends paid related to the loaned shares that will not be reimbursed, (b) in the period in which the entity concludes that it is probable that the counterparty to its share-lending arrangement will default, the amount of expense recorded in the statement of earnings related to the default, (c) in any subsequent period, any material subsequent changes in the amount of expense as a result of changes in the fair value of the entity's shares or the probable recoveries, and (d) in any period in which it is probable that the counterparty to a share-lending arrangement will default but prior to default occurring, the number of additional shares that would have been included in the basic and diluted earnings-per-share calculation if default were to occur.

Effective Date and Transition

20. The Task Force reached a consensus to amend the effective date of this Issue making it effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. This Issue requires retrospective application for all arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009.

21. The Task Force also reached a consensus that this Issue shall be effective for interim or annual periods beginning on or after June 15, 2009, for share-lending arrangements entered into in those periods.

22. The Task Force observed that arrangements that had been terminated as a result of counterparty default prior to the effective date of this Issue but for which the entity had not reached a final settlement as of the effective date would be within the scope of this Issue.

23. The Task Force affirmed as a consensus the decisions reached at the March 19, 2009 EITF meeting subject to the additional revisions noted above. Appendixes 09-1A and 09-1B reflect changes made to the draft abstract and the Codification Update Instructions as a result of the above decisions (added text is underlined and deleted text is ~~struck out~~).

Board Ratification

24. At the July 1, 2009 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

25. No further EITF discussion is planned.

Appendix 09-1A

EITF ABSTRACTS[*]

Issue No. 09-1

Title: Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing

Dates Discussed: March 19, 2009; ~~[~~June 18, 2009~~]~~

References: FASB Statement No. 128, *Earnings per Share*

FASB Statement No. 129, *Disclosure of Information about Capital Structure*

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

FASB Staff Position FAS 129-1,~~:~~ *Disclosure Requirements under FASB Statement No. 129 Relating to Contingently Convertible Securities*

EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"

EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments"

EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock"

Objective

1. The objective of this Issue is to clarify how an entity should account for an own-share lending arrangement that is entered into in contemplation of a convertible debt offering or other financing.

All paragraphs in this Issue have equal authority.

Paragraphs in bold set out the main principles.

[*] ~~This draft abstract is being exposed for a public comment period that will end on May 5, 2009.~~

Background

2. An entity for which the cost to an investment banking firm (investment bank) or third-party investors (investors) of borrowing its shares is prohibitive (for example, due to a lack of liquidity or extensive open short positions in the shares) may enter into share-lending arrangements that are executed separately but in connection with a convertible debt offering. Although the convertible debt instrument is ultimately sold to investors, the share-lending arrangement is an agreement between the entity (share lender) and an investment bank (share borrower) and is intended to facilitate the ability of the investors to hedge the conversion option in the entity's convertible debt.

3. The terms of a share-lending arrangement require the entity to issue shares (loaned shares) to the investment bank in exchange for a nominal loan processing fee. Although the loaned shares are legally outstanding, the nominal loan processing fee is typically equal to the par value of the common stock, which is significantly less than the fair value of the loaned shares or the share lending arrangement. Generally, upon maturity or conversion of the convertible debt, the investment bank is required to return the loaned shares to the entity for no additional consideration.

4. Other terms of a share-lending arrangement typically require the investment bank to reimburse the entity for any dividends paid on the loaned shares. Typically, the arrangement precludes the investment bank from voting on any matters submitted to a vote of the entity's shareholders to the extent the investment bank is the owner of the shares.

Scope

5. This Issue applies to an equity-classified share-lending arrangement on an entity's own shares when executed in contemplation of a convertible debt offering or other financing.

Glossary

6. The following term is defined.

Probable

The future event or events are likely to occur.

Measurement

7~~6~~. **At the date of issuance, a share-lending arrangement entered into on an entity's own shares in contemplation of a convertible debt offering or other financing is required to be measured at fair value and recognized as an ~~debt~~ issuance cost in the financial statements of the entity with an offset to additional paid-in capital.** ~~The debt issuance cost is amortized under the effective interest method over the life of the financing arrangement as interest cost.~~

~~The share lending arrangement should be considered in conjunction with other applicable generally accepted accounting principles (for example, Statement 150 and Issue 00-19) in determining the classification of the share lending arrangement in the financial statements of the entity~~.

Subsequent Measurement

8. If it becomes **probable** that the counterparty to a share-lending arrangement will default, the issuer of the share-lending arrangement shall recognize an expense equal to the then fair value of the unreturned shares, net of the fair value of probable recoveries, with an offset to additional paid-in capital. The issuer of the share-lending arrangement shall remeasure the fair value of the unreturned shares each reporting period through earnings until the arrangement consideration payable by the counterparty becomes fixed. Subsequent changes in the amount of probable recoveries should also be recognized in earnings.

Other Presentation Matters

9~~8~~. The loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in the basic~~common~~ and diluted earnings-per-share calculation.

10. If dividends on the loaned shares are not reimbursed to the entity, ~~A~~any amounts, including contractual (accumulated) dividends and participation rights in undistributed earnings, attributable to the loaned shares shall be deducted in computing income available to common shareholders, consistent with the two-class method set forth in paragraph 61 of Statement 128.

Disclosure

11~~9~~. The following disclosures are required by entities that enter into a share lending arrangement on their own shares in contemplation of a convertible debt offering or other financing. The disclosures must be made on an annual and interim basis in any period in which a share-lending arrangement is outstanding.

> An entity is required to disclose (a) a description of any outstanding share-lending arrangements on an entity's own stock and all significant terms of the share-lending arrangement including the number of shares, the term, the circumstances under which cash settlement would be required, and any requirements for the counterparty to provide collateral; (b) the entity's reason for entering into the share lending arrangement; (c) the fair value of the outstanding loaned shares as of the balance sheet date; (d) the treatment of the share lending arrangement for the purposes of calculating earnings per share; (e) the unamortized amount and classification of the ~~debt~~ issuance costs associated with the share lending arrangement at the balance sheet date; ~~and~~ (f) the amount of interest cost recognized relating to the amortization of the ~~debt~~ issuance cost associated with the share lending arrangement for the reporting period; and (g) any amounts of dividends paid related to the loaned shares that will not be reimbursed.

12~~0~~. Disclosures required by Statement 129 are applicable to entities that enter into a share lending arrangement on their own shares in contemplation of a convertible debt offering or other financing.

13. In the period in which the entity concludes that it is probable that the counterparty to its share-lending arrangement will default, the entity shall disclose the amount of expense recorded in the statement of earnings related to the default. The entity shall disclose in any subsequent period any material changes in the amount of expense as a result of changes in the fair value of the entity's shares or the probable recoveries. If default is probable but has not yet occurred, the entity shall disclose the number of shares related to the share-lending arrangement that will be reflected in basic and diluted earnings per share when the counterparty default does occur.

Transition

14~~1~~. This Issue is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. ~~Early adoption is not permitted.~~ This Issue requires retrospective application for all arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009~~in which this Issue is initially applied~~. 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.

15~~2~~. Share lending arrangements that have been terminated as a result of counterparty default prior to the effective date of this Issue but for which the entity has not reached a final settlement as of the effective date are within the scope of this Issue.

16. The transition disclosures in paragraphs 17 and 18 of Statement 154 shall be provided.

The provisions of this Issue need not be applied to immaterial items.

Appendix 09-1B

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™
(DRAFT CODIFICATION UPDATE INSTRUCTIONS)

Introduction

A1. This appendix outlines how this proposed Issue would affect the FASB Accounting Standards Codification™.

A2. This proposed Issue would amend and add additional guidance to Subtopic 470-20, Debt – Debt with Conversion and Other Options.

Amendments to the Codification

A3. Amend paragraph **470-20-05-1**, with a link to transition paragraph **470-20-65-3**, as follows:

470-20-05-1 This Subtopic provides accounting and reporting guidance for debt (and certain preferred stock) with specific conversion features and other options as follows:

a. Debt instruments with detachable warrants
b. Convertible securities—general
c. Beneficial conversion features
d. Interest forfeiture
e. Induced conversions
f. Conversion upon issuer's exercise of call option
g. Convertible instruments issued to nonemployees for goods and services~~.~~
h. Own-share lending arrangements issued in contemplation of convertible debt issuance.

A4. Add paragraphs **470-20-05-14 through 05-16** and preceding heading, with a link to transition paragraph **470-20-65-3**, as follows:

> Own-Share Lending Arrangements Issued in Contemplation of Convertible Debt Issuance or Other Financing

470-20-05-14 An entity for which the cost to an investment banking firm (investment bank) or third-party investors (investors) of borrowing its shares is prohibitive (for example, due to a lack of liquidity or extensive open short positions in the shares) may enter into share-lending arrangements that are executed separately but in connection with a convertible debt offering. Although the convertible debt instrument is ultimately sold to investors, the share-lending arrangement is an agreement between the entity (share lender) and an investment bank (share borrower) and is intended to facilitate the ability of the investors to hedge the conversion option in the entity's convertible debt.

470-20-05-15 The terms of a share-lending arrangement require the entity to issue shares (loaned shares) to the investment bank in exchange for a nominal loan processing fee. Although the loaned shares are legally outstanding, the nominal loan processing fee is typically equal to the par value of the common stock, which is significantly less than the fair value of the loaned shares or the share-lending arrangement. Generally, upon maturity or conversion of the convertible debt, the investment bank is required to return the loaned shares to the entity for no additional consideration.

470-20-05-16 Other terms of a share-lending arrangement typically require the investment bank to reimburse the entity for any dividends paid on the loaned shares. Typically, the arrangement precludes the investment bank from voting on any matters submitted to a vote of the entity's shareholders to the extent the investment bank is the owner of the shares.

A5. Amend paragraph **470-20-15-2**, with a link to transition paragraph **470-20-65-3**, as follows:

> Transactions

470-20-15-2 The guidance in this Subtopic applies to all debt instruments. The guidance on beneficial conversion features and conversion features that reset applies also to convertible preferred stock. The guidance in the General Subsections does not apply to those instruments within the scope of the Cash Conversion Subsections. The guidance on own-share lending arrangements applies to an equity-classified share-lending arrangement on an entity's own shares when executed in contemplation of a convertible debt offering or other financing.

A6. Add the following Master Glossary term in Section **470-20-20**, with a link to transition paragraph **470-20-65-3**, as follows:

> <u>Probable</u>

<u>The future event or events are likely to occur.</u>

A7. Amend paragraph **470-20-25-1**, with a link to transition paragraph **470-20-65-3**, as follows:

> Overall

470-20-25-1 The guidance in this Section shall be considered after consideration of the guidance in the Fair Value Options Subsections of Subtopic 825-10 and the guidance in Subtopic 815-15 on bifurcation of embedded derivatives, as applicable. The guidance in this Section is organized as follows:

a. Debt instruments with detachable warrants

b. Beneficial conversion features

c. Conversion features that reset

d. Conversion features that are not beneficial

e. Convertible instruments issued to nonemployees for goods and services

f. Own-share lending arrangements issued in contemplation of convertible debt issuance.

A8. Add paragraph **470-20-25-20A** and preceding heading, with a link to transition paragraph **470-20-65-3**, as follows:

<u>> Own-Share Lending Arrangements Issued in Contemplation of Convertible Debt Issuance</u>

<u>**470-20-25-20A** At the date of issuance, a share-lending arrangement entered into on an entity's own shares in contemplation of a convertible debt offering or other financing is required to be measured at fair value (in accordance with Topic 820) and recognized as an issuance cost, with an offset to additional paid in capital in the financial statements of the entity.</u>

A9. Add paragraph **470-20-30-32** and preceding heading, with a link to transition paragraph **470-20-65-3**, as follows:

<u>> Own-Share Lending Arrangements Issued in Contemplation of Convertible Debt Issuance</u>

<u>**470-20-30-32** At the date of issuance, a share-lending arrangement entered into on an entity's own shares in contemplation of a convertible debt offering or other financing is required to be measured at fair value in accordance with Topic 820.</u>

A10. Add paragraph **470-20-35-21** and preceding heading, with a link to transition paragraph **470-20-65-3**, as follows:

<u>> Own-Share Lending Arrangements Issued in Contemplation of Convertible Debt Issuance</u>

<u>**470-20-35-21** If it becomes **probable** that the counterparty to a share lending arrangement will default, the issuer of the share lending arrangement shall recognize an expense equal to the then fair value of the unreturned shares, net of the fair value of probable recoveries, with an offset to additional paid in capital. The issuer of the share lending arrangement shall remeasure the fair value of the unreturned shares each reporting period through earnings until the arrangement consideration payable by the counterparty becomes fixed. Subsequent changes in the amount of the probable recoveries should also be recognized in earnings.</u>

A11. Add paragraph **470-20-45-4** and preceding heading, with a link to transition paragraph **470-20-65-3**, as follows:

<u>> Own-Share Lending Arrangements Issued in Contemplation of Convertible Debt Issuance</u>

<u>**470-20-45-4** The loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in the basic and diluted earnings-per-share calculation. If dividends on the loaned shares are not reimbursed to the entity, any amounts including contractual (accumulated) dividends and participation rights in undistributed earnings, attributable to the loaned shares shall be deducted</u>

in computing income available to common shareholders, consistent with the two-class method set forth in paragraph 260-10-45-60B.

A12. Add paragraphs **470-20-50-**7 **through 50-**9 and preceding heading, with a link to transition paragraph **470-20-65-3**, as follows:

> Own-Share Lending Arrangements Issued in Contemplation of Convertible Debt Issuance

470-20-50-7 The following disclosures are required by entities that enter into a share-lending arrangement on their own shares in contemplation of a convertible debt offering or other financing. The disclosures must be made on an annual and interim basis in any period in which a share-lending arrangement is outstanding.

a. A description of any outstanding share-lending arrangements on an entity's own stock and all significant terms of the share-lending arrangement including the number of shares, the term, the circumstances under which cash settlement would be required, and any requirements for the counterparty to provide collateral

b. The entity's reason for entering into the share-lending arrangement

c. The fair value of the outstanding loaned shares as of the balance sheet date

d. The treatment of the share-lending arrangement for the purposes of calculating earnings per share

e. The unamortized amount and classification of the issuance costs associated with the share-lending arrangement at the balance sheet date

f. The amount of interest cost recognized relating to the amortization of the issuance cost associated with the share-lending arrangement for the reporting period

g. Any amounts of dividends paid related to the loaned shares that will not be reimbursed.

470-20-50-8 Disclosures required by Topic 505 are applicable to entities that enter into a share-lending arrangement on their own shares in contemplation of a convertible debt offering or other financing.

470-20-50-9 In the period in which the entity concludes that it is probable that the counterparty to its share-lending arrangement will default, the entity shall disclose the amount of expense recorded in the statement of earnings related to the default. The entity shall disclose in any subsequent period any material changes in the amount of expense as a result of changes in the fair value of the entity's shares or the probable recoveries. If default is probable but has not yet occurred, the entity shall disclose the number of shares related to the share-lending arrangement that will be reflected in basic and diluted earnings per share when the counterparty default does occur.

A13. Add paragraph **470-20-65-3** and preceding heading, as follows:

> Transition and Effective Date Related to Accounting Standards Update No. 2009-X, "Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing"

470-20-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2009-X, "Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing:"

a. The pending content that links to this paragraph is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. Share lending arrangements that have been terminated as a result of counterparty default prior to the effective date of this Topic but for which the entity has not reached a final settlement as of the effective date are within the scope of this Topic.

b. The pending content that links to this paragraph requires retrospective application for all arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009.

c. The pending content that links to this paragraph is effective for arrangements entered into on or after the beginning of the first reporting period that begins on or after June 15, 2009.

d. The transition disclosures required in paragraphs 250-10-50-1 through 50-3 shall be provided.

e. The pending content that links to this paragraph is prohibited from being applied early.

A14. Add paragraph **260-10-45-70B** and preceding heading, with a link to transition paragraph **470-20-65-3** as follows:

> Own-Share Lending Arrangements Issued in Contemplation of Convertible Debt Issuance or Other Financing

260-10-45-70B Paragraph 470-20-45-4 provides guidance on calculating basic and diluted earnings per share if an entity has entered into own-share lending arrangements issued in contemplation of convertible debt issuance or other financing.

Issue No. 09-2

Title: Research and Development Assets Acquired in an Asset Acquisition

Dates Discussed: March 19, 2009; June 18, 2009

References: FASB Statement No. 2, *Accounting for Research and Development Costs*

FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*

FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 141 (revised 2007), *Business Combinations*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

FASB Statement No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*

FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*

FASB Interpretation No. 6, *Applicability of FASB Statement No. 2 to Computer Software*

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

FASB Highlights, *Computer Software: Guidance on Applying Statement 86*, February 1986

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Statement of Position 93-7, *Reporting on Advertising Costs*

AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*

International Accounting Standard 36, *Impairment of Assets*

International Accounting Standard 38, *Intangible Assets*

International Financial Reporting Standard 3, *Business Combinations*

EITF Issue No. 96-6, "Accounting for the Film and Software Costs Associated with Developing Entertainment and Educational Software Products"

EITF Issue No. 96-7, "Accounting for Deferred Taxes on In-Process Research and Development Activities Acquired in a Purchase Business Combination"

EITF Issue No. 98-11, "Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations"

EITF Issue No. 99-5, "Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements"

EITF Issue No. 00-2, "Accounting for Web Site Development Costs"

EITF Issue No. 07-1, "Accounting for Collaborative Arrangements"

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

EITF Issue No. 08-6, "Equity Method Investment Accounting Considerations"

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 Statement 2, 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 Statement 142. In addition to Statement 2, 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 Statement 2.

2. Statement 141(R) amends Statement 2 and other accounting literature related to Statement 2 for 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.

Scope

3. The scope of this Issue includes all tangible and intangible research and development assets acquired (either individually or with a group of other assets) 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.

4. 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

5. At the March 19, 2009 EITF meeting, the Task Force discussed the following issues:

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.

6. 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 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 FASB staff noted that if the contingent consideration meets the definition of a derivative, Statement 133 would require that it be recognized at fair value. 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, 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 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 paragraph 17 of Statement 142. 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 Statement 142. 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 28 of Statement 144, 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.

Current EITF Discussion

9. At the June 18, 2009 EITF meeting, the Task Force discussed this Issue but was not asked to reach a conclusion. The issues presented at that meeting were:

Issue 3— How an entity should account for contingent consideration related to an acquisition of tangible and intangible research and development assets in an asset acquisition

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

10. Some Task Force members observed that Issue 3 could have broader implications than only addressing the accounting for contingent consideration in an acquisition of research and development assets. It was noted that this Issue could require the Task Force to consider addressing the accounting for contingent consideration in any acquisition of assets that is not a business combination.

Status

11. Further discussion is expected at a future meeting.

Issue No. 09-3

Title: Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements

Dates Discussed: March 19, 2009; June 18, 2009

References: FASB Statement No. 13, *Accounting for Leases*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

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"

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables"

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"

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 contain both software and hardware elements.

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.

Current EITF Discussion

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.

Board Ratification

15. At the July 1, 2009 meeting, the Board ratified the consensus-for-exposure reached by the Task Force in this Issue and approved the issuance of a draft abstract for a public comment period.

Status

16. The draft abstract will be posted to the FASB website no later than July 7, 2009. Comments on the draft abstract are due by August 14, 2009. Further discussion is expected at a future meeting.

Appendix 09-3A

***DRAFT ABSTRACT* (DRAFT*)**

Issue No. 09-3

Title: Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements

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

References: FASB Statement No. 13, *Accounting for Leases*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

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"

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables"

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"

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

Objective

1. The objective of this Issue is to determine how arrangement consideration should be allocated to deliverables in a multiple-deliverable revenue arrangement that includes a tangible product and software that is more than incidental to the product.

* This draft abstract is being exposed for a public comment period that will end on August 14, 2009.

Background

2. 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 can result in an uneconomic pattern of revenue recognition.

Scope

3. The Issue applies to multiple-deliverable revenue arrangements that include tangible products and software that is more than incidental to the tangible products.

4. **Tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality, are excluded from the scope of SOP 97-2.**

5. An entity shall consider the following when evaluating whether the software components and non-software components function together to deliver a product's essential functionality:

a. If the tangible product always contains the software components when the product is sold, the software components are considered essential to the functionality of the product.
b. An entity may sell products that provide similar functionality (for example, different models). If the only substantive 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 evaluating item (a).
c. An entity may sell a product containing software that it also sells on a standalone basis separate from the product. The separate sale of the software should not affect this evaluation.
d. Software components do not need to be embedded within the product to be considered essential to the product's functionality.

6. A multiple-deliverable revenue arrangement may include undelivered software elements that relate to a tangible product (including software that is essential to the product's functionality) that is excluded from the scope of SOP 97-2. In such arrangements, the undelivered software elements are also excluded from the scope of SOP 97-2. If a product contains software that is not essential to the product's functionality, that nonessential software and any other deliverables within the arrangement that relate to that nonessential software are within the scope of SOP 97-2. If an undelivered element relates to a deliverable within the scope of SOP 97-2 and a deliverable excluded from the scope of SOP 97-2, the undelivered element shall be bifurcated into a software deliverable and a non-software deliverable. The software deliverable is within the scope of SOP 97-2 and the non-software deliverable is not within the scope of SOP 97-2.

Recognition

7. If an arrangement includes deliverables that are within the scope of SOP 97-2 and deliverables that are not within the scope of SOP 97-2, an entity shall allocate arrangement consideration to each separate unit of accounting in accordance with Issue 08-1.

Disclosure

8. An entity shall provide the disclosures in Issue 08-1 for multiple-deliverable revenue arrangements affected by this Issue.

Transition

9. 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. Earlier application is permitted as of the beginning of a vendor's fiscal year provided the vendor has not previously issued financial statements for any period within that year. An entity shall not elect early application of this Issue unless it also elects early application of Issue 08-1.

10. For each reporting period in the initial year of adoption, a vendor shall disclose the amount of its revenue recognized subject to the measurement requirements of this Issue and the amount of revenue that would have been recognized if the related transactions were subject to the measurement requirements of SOP 97-2. A vendor shall also provide the disclosures in paragraphs 17 and 18 of Statement 154.

Exhibit 09-3A

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS ON ISSUE 09-3

Note: The following examples provide guidance *only* with respect to determining the appropriate literature to apply for purposes of allocating arrangement consideration in a multiple-deliverable revenue arrangement that includes a tangible product and software. This Issue (including the examples below) does *not* address (for any unit of accounting) when the criteria for revenue recognition are met or provide revenue recognition guidance. The examples illustrate potential application of this Issue based on the limited facts presented. The evaluations following each of the example fact patterns are not intended to represent the only manner in which the guidance in this Issue could be applied. Additional facts would most likely be required in order to fully evaluate the deliverables, the units of accounting, and the presentation issues related to these arrangements.

Example 1 – Computer

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. There are no undelivered elements in this arrangement. The vendor never sells the personal computer without the operating system and never sells the operating system without the personal computer.

Evaluation

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 SOP 97-2.

Example 1a – Computer – Operating System Not Always Included

Consider the same fact pattern as in Example 1, except that the vendor sells the personal computer with and without an operating system.

Evaluation

Because the vendor sells the personal computer without an operating system, the operating system is not considered essential to the functionality of the personal computer. Therefore, the computer would be excluded from the scope of SOP 97-2 and the operating system would be considered a separate deliverable that is within the scope of SOP 97-2.

Example 1b – Computer – Multiple Operating Systems

Consider the same fact pattern as in Example 1 except that the vendor also sells the personal computer with a different operating system. The different operating system provides essentially the same functionality as the operating system included in Example 1.

Evaluation

The vendor always sells the personal computer with an operating system, which indicates that an operating system is essential to the functionality of the vendor's personal computer. All deliverables would be excluded from the scope of SOP 97-2.

Example 1c – Computer with Additional Software Products

Assume the same fact pattern as in Example 1 except that the vendor includes a productivity software bundle with the personal computer that allows users to create, edit, and use documents, spreadsheets, and presentations. The vendor sells the same computer 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.

Evaluation

The productivity software would not be considered necessary for the computer to provide its essential functionality. The productivity software is one type of software that is able to be used on the computer but is not always included on the computer. While the operating system is essential to deliver the personal computer's basic functionality, the productivity software is not. This is further demonstrated by the fact that the computer is sold with and without the productivity software. The computer and operating system would be considered one deliverable that is excluded from the scope of SOP 97-2. The productivity software would remain within the scope of SOP 97-2.

Example 1d – Personal Data Assistant

Vendor sells a personal data assistant (PDA). The PDA provides several functions, such as phone, camera, and computing functionality, that allow the user to access and use various software programs, such as e-mail and games. The PDA 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 always included on the PDA but the e-mail and game software are not always included. The phone, camera, and e-mail software are not sold separately but the game software is sold separately.

Evaluation

The PDA hardware, operating system, phone, and camera software are essential to the functionality of the PDA device and would be considered one deliverable that is outside the scope of SOP 97-2. The e-mail and game software would be considered software deliverables within the scope of SOP 97-2 since the product is also sold without this software device. Whether the software is sold separately is not a consideration in the conclusion.

Example 1e – Computer, Operating System Sold Separately

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. There are no undelivered elements in this arrangement. The 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.

Evaluation

The same accounting would result as in Example 1 since the vendor determines that the operating system is necessary to deliver the computer's essential functionality. Accordingly, the computer and operating system would be considered one deliverable that is excluded from the scope of SOP 97-2. Whether the software is sold separately in a different transaction does not impact the assessment under this Issue. The critical assessment is whether the computer and the operating system in one transaction are both necessary to provide the computer's essential functionality. Refer to Example 3 for an illustration of how an entity would account for the separate sale of the operating system without the computer.

Example 2 – Computer – Undelivered Software Elements

Consider the same fact pattern as in Example 1 except that the vendor also provides a specified upgrade right for the next version of its operating system along with PCS, including when and if available upgrades of the operating system.

Evaluation

Because the computer and operating system are determined to be a single non-software deliverable that is excluded from the scope of SOP 97-2, all deliverables related to that non-software deliverable are also considered non-software deliverables and excluded from the scope of SOP 97-2. Accordingly, the PCS and specified upgrade right for the operating system would be non-software deliverables excluded from the scope of SOP 97-2.

Example 3 – Standalone Sale of an Operating System

Vendor releases a new upgraded version of its computer operating system. The vendor sells the upgraded operating system in a standalone transaction to a customer that had previously purchased a computer that contained the vendor's prior operating system version. The 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 non-software deliverable that is outside the scope of SOP 97-2.

Evaluation

The separate sale of the operating system would be within the scope of SOP 97-2. Even though this software would be considered a non-software deliverable if it were sold with the computer, this Issue only applies to arrangements that include the sale of a tangible product. This Issue would not apply because the customer is not purchasing the computer.

Example 4 – Computer with Nonessential Software and PCS

Assume the same fact pattern as in Example 1c except that the vendor provides PCS for both the computer (including the operating system) and productivity software.

Evaluation

The combined computer and operating system product is considered to be a single non-software deliverable and the productivity software is considered to be a software deliverable consistent with Example 1c. Because the PCS relates to deliverables within the scope of SOP 97-2 and deliverables outside the scope of SOP 97-2 it must be bifurcated into software and non-software related components. PCS relating to the productivity software would be a deliverable within the scope of SOP 97-2. PCS relating to the computer (including the operating system) would be a non-software deliverable that is outside the scope of SOP 97-2.

Example 5 – Networking Equipment

Vendor sells networking equipment that provides its energy company customers with the ability to remotely monitor and manage their customers' energy usage. The 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 the vendor. The equipment does not have functionality without the software and the software does not have functionality without the equipment. The vendor's customers will initially purchase all of these components together; however, they can also separately purchase replacement or expansion equipment or updated versions of the software at a subsequent time.

Evaluation

The equipment and software would all be considered non-software elements outside of the scope of SOP 97-2. The essential functionality of the monitoring and relay equipment is to allow the energy company to access and analyze its customer's usage data. The vendor cannot access the functionality of the equipment without the software. Although the 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 acquire the software previously in order for the replacement equipment to function.

Example 6 – Similar products

Vendor sells two models of PDA devices, Model 100 and Model 200. Model 100 (including the software delivered on Model 100) is considered to be a non-software deliverable excluded from the scope of SOP 97-2 when applying this Issue. The difference between the two models is that the vendor always includes music player software on Model 200. 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.

Evaluation

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 the vendor sells Model 200, it considers the music player software to be a software deliverable within the scope of SOP 97-2 when allocating the arrangement consideration because the software is not always included on the product when the vendor sells the product.

Example 7 – Change in Business Practice

Vendor sells engineering software that it always sells with PCS. The vendor does not have VSOE for PCS and applies SOP 97-2 when accounting for the arrangement, which results in the software and PCS being combined into one unit of accounting. The vendor typically sells the software and PCS for consideration of $120,000. The software can be used on various computer systems. The vendor decides to change its business model such that it now sells a computing device that includes the engineering software. Vendor does not sell the computing device without the engineering software and no longer sells the engineering software separate from the device. The vendor typically sells the device along with PCS on the engineering software for $125,000. The software is no longer usable on and cannot be transferred to another device.

Evaluation

Vendor determined that the hardware components of the device along with the engineering software are necessary in order to provide the product's essential functionality. Both the device and the PCS relating to the engineering software are now considered non-software deliverables and are excluded from the scope of SOP 97-2.

When a vendor changes its business practice, judgment will be necessary to determine whether the software on a tangible product is essential to the product's functionality. For example, if the vendor also continued to sell the software separately and the device does not provide substantive functionality beyond that provided by the software, the vendor may have determined that the software was not essential to the functionality of the device. In that case, the software and PCS would continue to be included within the scope of SOP 97-2.

Appendix 09-3B

AMENDMENTS TO THE *FASB ACCOUNTING STANDARDS CODIFICATION*™
(DRAFT CODIFICATION UPDATE INSTRUCTIONS)

Introduction

A1. This appendix outlines how this Issue affects the *FASB Accounting Standards Codification*™.

A2. This Issue amends Topic 985, Software.

Amendments to the Codification

A3. Amend paragraph **985-605-15-3**, with a link to transition paragraph **985-605-25-65-1** 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. 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. Other arrangements for products or services that include software that is more-than-incidental to the products or services as a whole. Indicators of software that is more-than-incidental to 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, t~~The guidance in this Subtopic applies to the software and software-related elements. 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. 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, that requires significant production, modification, or customization of software (See Subtopic 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.

A4. Amend paragraph **985-605-15-4**, with a link to transition paragraph **985-605-25-65-1** 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 property, plant, or equipment, if the software is incidental to the property, plant, or equipment as a whole

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

e. Undelivered elements that relate to software that is essential to the tangible product's functionality in [d].

In determining whether a product contains software components and non-software components that function together to deliver the product's essential functionality, an entity shall consider the following:

1. If the tangible product always contains the software components when the product is sold, the software components are considered essential to the functionality of the product.
2. An entity may sell products that provide similar functionality such as different models. If the only 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 evaluating [1].

3. <u>An entity may sell a product containing software that it also sells on a standalone basis separate from the product. The separate sale of the software should not affect this evaluation.</u>

4. <u>Software components do not need to be embedded within the product to be considered essential to the product's functionality.</u>

A5. Amend paragraph **985-605-25-10**, with a link to transition paragraph **605-25-65-1** 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 and deliverables that are not within the scope of this Subtopic, an entity shall allocate arrangement consideration to each separate unit of accounting in accordance with paragraph 605-25-15-3A.

If a product contains software that is not essential to the product's functionality, that nonessential software and any other deliverables within the arrangement 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 non-software deliverable. The software deliverable is within the scope of this Subtopic and the non-software deliverable is not within the scope of this Subtopic.

A6. Add paragraphs **985-605-55-211** through **55-236**, with a link to transition paragraph **985-605-25-65-1** as follows:

Example 13—Computer

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-deliverable revenue arrangement that includes a tangible product and software. The cases illustrate whether a product contains software components and non-software components that function together to deliver the product's essential functionality as discussed in paragraph 985-605-15-3. The cases are:

a. Computer and operating system always included (Case A)

b. Computer and operating system not always included (Case B)

c. Computer and multiple operating systems (Case C)

d. Computer and operating system always included (Case F)

e. Personal data assistant (Case E)

f. Computer and 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 post customer support (Case I)

j. Networking equipment (Case J)

k. Similar products (Case K)

l. Change in business practice (Case L).

Case A: Computer – Operating System Always 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. There are no undelivered elements in this arrangement. The vendor never sells the personal computer without the operating system and never sells the operating system without the personal computer.

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 – Operating System Not Always Included

985-605-55-214 Consider the same fact pattern as in Case A, except that the vendor sells the personal computer with and without the operating system but never sells the operating system without the personal computer.

985-605-55-215 Because the vendor sells the personal computer without an operating system, 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 – Multiple Operating Systems

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

985-605-55-217 The vendor always sells the personal computer with an operating system, which indicates that an operating system is essential to the functionality of the vendor's personal computer. All deliverables would be excluded from the scope of this Subtopic.

Case D: Computer with Additional Software Products

985-605-55-218 Consider the same fact pattern as in Case A, except that the vendor also includes a productivity software bundle with the personal computer that allows users to create, edit, and use documents, spreadsheets, and presentations. The vendor sells the same computer 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. The productivity software is one type of software that is able to be used on the computer but is not always included on the computer. While the operating system is essential to deliver the personal computer's basic functionality, the productivity software is not. This is further demonstrated by the fact that the computer is sold 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 Data Assistant

985-605-55-220 Vendor sells a personal data assistant. The personal data assistant provides several functions, such as phone, camera, and computing functionality, that allow the user to access and use various software programs, such as email and games. The personal data 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 always included on the personal data assistant but the email and game software are not always included. The phone, camera, and email software are not sold separately but the game software is sold separately.

985-605-55-221 The personal data assistant hardware, operating system, phone, and camera software are essential to the functionality of the personal data assistant and would be considered one deliverable that is outside the scope of this Subtopic. The email and game software would be considered software deliverables within the scope of this Subtopic because the product also is sold without this software device. Whether the software is sold separately is not a consideration in the conclusion.

Case F: Computer, 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. There are no undelivered elements in this arrangement. The 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 Since the vendor determines that the operating system is necessary to deliver the computer's essential functionality, the arrangement would be excluded from the scope of this Subtopic. 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 assessment under this Subtopic. The critical assessment is whether the computer and the operating system in one transaction are both necessary to provide the computer's essential functionality.

Case G: Computer – Undelivered Software Elements

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

985-605-55-225 Because the computer and operating system are determined to be a single non-software deliverable that is excluded from the scope of this Subtopic, all deliverables related to that non-software deliverable are also considered non-software deliverables and excluded from the scope of this Subtopic. Accordingly, the post customer support and specified upgrade right for the operating system would be non-software deliverables excluded from the scope of this Subtopic. See paragraph **985-605-55-227** for an illustration of how an entity would account for the separate sale of the operating system without the computer.

Case H: Standalone Sale of an Operating System

985-605-55-226 Vendor releases a new upgraded version of its computer operating system. The vendor sells the upgraded operating system in a standalone transaction to a customer that had previously purchased a computer that contained the vendor's prior operating system version. The 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 non-software deliverable that is outside 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 non-software deliverable if it were sold with the computer, this Subtopic only applies to arrangements that include the sale of a tangible product. This Subtopic would not apply because the customer is not purchasing the computer.

Case I: Computer with Nonessential Software and Post Customer Support

985-605-55-228 Consider the same fact pattern as in Case A, except that the vendor also provides post 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 non-software deliverable and the productivity software is considered to be a software deliverable consistent with Case 1C. Because the post 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 non-software related components. Post customer support relating to the productivity software would be a deliverable within the scope of this Subtopic. Post customer support relating to the computer (including the operating system) would be a non-software 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 usage. The 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 the vendor. The equipment does not have functionality without the software and the software does not have functionality without the equipment. The vendor's customers will initially purchase all of these components together; however, they can also 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 non-software elements outside the scope of this Subtopic. The essential functionality of the monitoring and relay equipment is to allow the energy company to access and analyze its customer's usage data. The vendor cannot access the functionality of the equipment without the software. Although the 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 acquire the software previously for the replacement equipment to function.

Case K: Similar Products

985-605-55-232 Vendor sells two models of personal data assistant devices, Model 100 and Model 200. Model 100 (including the software delivered on Model 100) is considered to be a non-software deliverable excluded from the scope of this Subtopic when applying this Subtopic. The difference between the two models is that the vendor always includes music player software on Model 200. 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 the 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 because the software is not always included on the product when the vendor sells the product.

Case L: Change in Business Practice

985-605-55-234 Vendor sells engineering software that it always sells with post customer support. The vendor does not have vendor-specific objective evidence for post customer support and applies this Subtopic when accounting for the arrangement, which results in the software and post customer support being combined into one unit of accounting.Vendor typically sells the software and post customer support for consideration of $120,000. The software can be used on various computer systems. Vendor decides to change its business model such that it now sells a computing device that includes the engineering software. Vendor does not sell the computing device without the engineering software and no longer sells the engineering software separate from the device. The vendor typically sells the device along with post customer support on the engineering software for $125,000. The software is no longer usable on and cannot be transferred to another device.

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

985-605-55-236 When a vendor changes its business practice, judgment will be necessary to determine whether the software on a tangible product is essential to the product's functionality. For example, if the vendor also continued to sell the software separately and the device does not provide substantive functionality beyond that provided by the software, the vendor may have determined that the software was not essential to the functionality of the device. In that case, the software and post customer support would continue to be included within the scope of this Subtopic.

A8. Add paragraph **985-605-50-1**, with no link to a transition paragraph 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, an entity shall provide the disclosures in paragraphs 605-25-50-1 through 605-25-50-2.

A9. Add paragraph **985-605-65-1** and preceding heading as follows:

> > Transition and Effective Date Related to Accounting Standards Update No. 2009-X, "Applicability of AICPA Statement of Position 97-2 to Certain Arrangements that Include Software Elements"

985-605-25-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 09-X, "Applicability of AICPA Statement of Position 97-2 to Certain Arrangements that Include Software Elements."

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.

b. Earlier application is permitted provided the vendor elects earlier application in the first reporting period in the vendor's fiscal year.

c. For each reporting period in the initial year of adoption, a vendor shall disclose the amount of its revenue recognized subject to the measurement requirements of this Subtopic and the amount of revenue that would have been recognized if the related transactions that were subject to the measurement requirements of this Subtopic had not changed.

d. A vendor also shall provide the disclosures in paragraphs 250-10-50-1 through 250-10-50-3.

Issue No. 09-4

Title: Seller Accounting for Contingent Consideration

Date Discussed: June 18, 2009

References: FASB Statement No. 5, *Accounting for Contingencies*

FASB Statement No. 141 (revised 2004), *Business Combinations*

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 160, *Noncontrolling Interest in Consolidated Financial Statements*

AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements*

IAS 39, *Financial Instruments: Recognition and Measurement*

Introduction

1. Statement 141(R) requires that a buyer recognize the acquisition-date fair value of contingent consideration, as defined by Statement 141(R), as part of the consideration transferred to the seller in exchange for the acquiree. In addition, Statement 141(R) requires a buyer 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 subsequent reporting period.

2. While Statement 141(R) does not provide guidance on seller accounting for a business combination, Statement 160, which was issued concurrent with Statement 141(R), amends the guidance in ARB 51, to provide the seller's accounting for the deconsolidation of a subsidiary. Deconsolidation is required in the event that a parent ceases to have a controlling financial interest in a subsidiary (including the sale of a subsidiary). Paragraph 36 of ARB 51 requires that the gain or loss recognized upon deconsolidation of a subsidiary be measured as the difference between (a) the *fair value of any consideration received,* (b) the fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated, (c) the carrying amount of any noncontrolling interest in the former subsidiary at the date the subsidiary is deconsolidated, and (d) the carrying amount of the former subsidiary's assets and liabilities. As a result, questions have arisen on the initial and subsequent measurement requirements for the seller's right to additional consideration received in the deconsolidation of a subsidiary.

Issues

3. The issues are:

Issue 1— Whether the seller should subsequently remeasure contingent consideration that is not accounted for as a derivative at fair value through current period earnings

Issue 2— What the required disclosures of seller contingent consideration should be.

Current EITF Discussion

4. At the June 18, 2009 EITF meeting, some Task Force members questioned whether this Issue should be expanded to address the initial measurement of seller contingent consideration. Those Task Force members observed that while one interpretation of Statement 160 could be that contingent consideration should initially be recorded at fair value, that Statement did not amend the guidance in Statement 5 for the recognition of gain contingencies. Accordingly, those Task Force members did not believe that the initial measurement of seller-contingent consideration was clear under Statement 160. 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.

5. 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 Issues 1 and 2 until a future meeting.

6. 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 financial instruments: improvement to recognition and measurement. 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 Board project.

7. The Task Force also determined that the scope of this Issue is limited to contingent consideration arrangements that are within the scope of Statement 160.

Status

8. Further discussion is expected at a future meeting.

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 September 9–10, 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
08-1	Revenue Arrangements with Multiple Deliverables	1/08	3/08, 6/08, 9/08, 11/08, 3/09, 6/09	9/09	Uhl	Maples/ Elsbree	The FASB staff will prepare an Issue Supplement for a future meeting	Draft abstract comment period closes August 14, 2009 September 9-10, 2009 EITF meeting
08-9	Milestone Method of Revenue Recognition	10/08	11/08, 3/09, 6/09	9/09	Uhl	Maples/ Elsbree	The FASB staff will prepare an Issue Supplement for a future meeting	September 9-10, 2009 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
09-2	Research and Development Assets Acquired In an Asset Acquisition	1/09	3/09, 6/09	9/09	Hauser	Mayer/ Anderson	The FASB staff will prepare an Issue Supplement for a future meeting	September 9-10, 2009 EITF meeting
09-3	Application of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements	11/08	3/09, 6/09	9/09	Pippolo	Bonn/ Maples	The FASB staff will prepare an Issue Supplement for a future meeting	Draft abstract comment period closes August 14, 2009 September 9-10, 2009EITF meeting
09-4	Seller Accounting for Contingent consideration	5/09	6/09	9/09	Hanson	Homant/ Inzano	The FASB staff will prepare an Issue Summary for a future meeting	September 9-10, 2009EITF meeting
09-B	Consideration of an Insurer's Accounting for Majority-Owned Investments When the Ownership Is through a Separate Account	1/09		9/09	TBD	TBD	The FASB staff will prepare an Issue Summary for a future meeting	September 9-10, 2009 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
09-D	Application of the AICPA Audit and Accounting Guide, *Investment Companies*, by Real Estate Investment Companies	2/09		9/09	TBD	TBD	The FASB staff will prepare an Discussion document for a future Working Group meeting	Working Group meeting to be held prior to the September 9-10, 2009 EITF meeting
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	TBD	TBD	The FASB staff will prepare an Issue Summary for a future meeting	September 9-10, 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**
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