

FASB Emerging Issues Task Force

Issue No. 09-3

Title: Certain Revenue Arrangements That Include Software Elements[†]

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Previously distributed EITF materials: Issue Summary No. 1, dated March 10, 2009; Issue Summary No. 1, Supplement No. 1, dated June 4, 2009

References:

FASB Accounting Standards Codification Topic 605, *Revenue Recognition* (Topic 605)

FASB Accounting Standards Codification Topic 840, *Leases* (Topic 840)

FASB Accounting Standards Codification Topic 985, *Software* (Topic 985)

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

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

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

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

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

International Accounting Standard 18, *Revenue* (IAS 18)

EITF Issue No. 00-3, "Application of AICPA Statement of Position 97-2 to Arrangements That

[†] Formerly entitled, "Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements."

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

Include the Right to Use Software Stored on Another Entity's Hardware" (currently under Topic 985) (Issue 00-3)

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

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" (currently under Topic 985) (Issue 03-5)

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

Background

1. At the November 13, 2008 EITF meeting, the Task Force reached a consensus-for-exposure on Issue 08-1 that would modify Issue 00-21 to require an entity to use its best estimate of selling price for the undelivered item(s) in an arrangement in situations in which vendor-specific objective evidence (VSOE) or acceptable third-party evidence (TPE) is not available. 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 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 the project 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.

Prior EITF Discussion

2. At the March 19, 2009 meeting, the Task Force reached a tentative conclusion that this Issue should focus on amending the scope of SOP 97-2. 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 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.

3. This tentative conclusion results in the increased separability of deliverables into separate units of accounting. The Task Force discussed the application of the scope modification to 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.

4. 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 conclusion 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 conclusion 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 the tentative conclusion and indicated that the assumptions and examples would help that application.

5. 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. The Task Force also 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.

6. The Task Force also agreed that the draft abstract should include examples and assumptions 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.

7. 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.

8. A combined exposure document containing the draft abstracts of the consensuses-for-exposure for both Issue 09-3 and Issue 08-1 was posted to the FASB website on July 7, 2009, with a comment period that ended August 14, 2009. Comment letters received on the draft abstracts have previously been distributed to Task Force members and are analyzed below. At the September 9-10, 2009 EITF meeting, the Task Force will have the opportunity to consider these comment letters as it redeliberates the consensus-for-exposure. The Task Force will then be asked to affirm its consensus-for-exposure on this Issue as a final consensus. If the Task Force affirms its consensus-for-exposure, the staff will ask the Task Force whether it agrees with the staff recommendations for the proposed changes to the draft abstract.

9. Constituents were specifically requested to provide comments on the following questions relating to Issue 09-3:

a. Do you agree with the Task Force's decision to address this Issue considering potential overlap between this Issue and the FASB and IASB joint revenue recognition project?

b. Do you agree with the Task Force's decision to modify the scope of SOP 97-2 to address software enabled devices rather than to address broadly the measurement and separation criteria within SOP 97-2?

c. Do you agree that the scope modification of Issue 09-3 is operational and can be applied consistently? If not, why not?

d. If your answer to Question (c) is no, is there a better way to modify the scope of SOP 97-2 to improve financial reporting for software enabled devices while retaining the use of SOP 97-2 for software transactions?

e. Do you agree with that this Issue should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after

June 15, 2010 with earlier application permitted provided the vendor elects earlier application in the first reporting period in the vendor's fiscal year?

10. In addition to the questions in paragraph 9, constituents were also asked to provide specific feedback regarding the ongoing disclosures and transition disclosures included in the draft abstract for Issue 09-3. Those disclosures are consistent with those required by Issue 08-1 and the responses received on disclosures are equally applicable to Issue 08-1 and 09-3. Accordingly, the responses to those disclosure questions have been summarized in Issue Summary No. 2, Supplement No. 3, for Issue 08-1, dated August 26, 2009. That Issue Summary will also be discussed at the September 9-10, 2009 EITF meeting.

Scope

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

Current EITF Discussion

Summary of Comment Letters

12. The thirty-two comment letters received on the draft abstracts are summarized below.

Respondent Profile

Type of Respondent	Number of Letters
Preparers	15
Accounting Firms/Organizations	6
Industry Organizations	2
Users	6
Others	3
Total Number of Letters	32

13. The staff has identified and analyzed the more significant comments in the section that follows. While the staff believes that the Task Force considered a majority of these comments during its initial deliberation of this Issue, the staff recommends that the Task Force consider these comments as it redeliberates this Issue. Note that respondents referenced pre-Codification accounting guidance and the language in the draft abstract when providing their comments. For ease of discussion and reference to the applicable comments, the staff's summary and analysis of these comments also references the pre-Codification guidance and draft abstract. However, any changes the staff is recommending in response to these comments are illustrated in the attached Amendments to the Codification rather than in a revised draft abstract.

Comments -Overall

14. Similar to the responses received on Issue 08-1, most respondents were supportive of the consensus-for-exposure overall; although some respondents did not support certain aspects of the consensus-for-exposure or provided suggested revisions to clarify the Task Force's intent. In general, respondents believed that Issue 09-3 was operational and would significantly improve financial reporting under U.S. GAAP. Most respondents were supportive of the Task Force addressing the issue now rather than waiting for the Board to complete the broader revenue recognition project and were also supportive of the Task Force's decision to pursue modifying the scope of SOP 97-2 rather than broadly addressing its measurement criteria. Several respondents commented that they were supportive of the direction of the Board's project to move towards a single revenue model but that they believed that Issues 08-1 and 09-3 provided significant incremental improvement that warranted immediate action. The following comment from a preparer (CL#8) is representative of many such comments received:

Yes we agree with the Task Force's decision to address this Issue. Although the Board's joint project on revenue recognition will ultimately address these specific issues as well as many others, we do not believe it is prudent to stop all incremental improvements to the current revenue recognition standards. We believe this is a significant improvement that will improve the comparability and usefulness of financial statements.

15. Four respondents, a preparer, two CPA societies, and a consulting firm (CL's #21, #25, #30, and #33), however, were not supportive of the Task Force issuing the guidance in Issue 08-1 and 09-3 because of the overlap with the Board's joint revenue recognition project. These respondents

believed that implementing Issues 08-1 and 09-3 could be costly and require significant system changes. They did not believe it was cost-efficient to pursue these issues now while the Board has an overlapping project that also is addressing these same issues on a broader scale. They expressed concerns that the Board could reach a different conclusion than the Task Force in these Issues, possibly causing preparers to change their accounting and systems twice and, therefore, unnecessarily duplicating the costs associated with such efforts. Another respondent stated that they were supportive of the Task Force pursuing these Issues but only if the Task Force was fairly certain that these decisions would be consistent with the outcome in the Board's project.

16. Five respondents (including three of the respondents noted in paragraph 15) were not supportive of the Task Force's decision to pursue modifying the scope of SOP 97-2 rather than broadly addressing its measurement criteria for all transactions involving software. The following comment from CL #21 is illustrative of the concerns of these respondents and the concerns raised in paragraph 15:

Overall, we agree that the proposed guidance more closely reflects the economic substance of the revenue transactions involving multiple deliverables. However, we are concerned that decisions reached by the Task Force may ultimately be changed upon completion of the FASB/IASB revenue recognition project and should be addressed within that project and only once. Even if the Task Force members believe these views are consistent with the current thinking of the FASB/IASB, there is no guarantee that the views will not ultimately change. These types of interim fixes often are costly to apply and could conceivably reduce the comparability of financial results from period to period. Further, as mentioned in our comment letter dated January 19, 2009, we do not agree with a change in accounting for arrangements with multiple deliverables in the absence of corresponding changes to the accounting for software sales having the same characteristics. We do not believe there is an urgent need to change current practice under EITF 00-21 for undelivered items having no VSOE/TPE, but if the Board believes there is such urgency, then there is likely a similar need to change the accounting for undelivered software accounted for under SOP 97-2 that also lacks VSOE/TPE.

17. One respondent, an accounting firm (CL #16), was concerned that prescribing different accounting for software-enabled devices compared to software could create competitive issues. The following highlights that concern:

We also expect that the currently proposed scope change, when combined with the changes proposed in Issue 08-1, will create some competitive issues for certain companies. We can think of a number of instances where “pure” software companies compete directly with companies offering a joint hardware-software product, and it would appear that the joint hardware-software companies could have a significant competitive advantage under the proposed changes. For example, we believe those companies would have much greater latitude to offer specified software upgrades or additional future products to customers, which is a practice that most existing software companies do not do based on the existing accounting requirement to separate elements based on VSOE. We believe accounting standards should be designed to minimize inconsistencies in application among competing companies.

Staff Analysis and Recommendation

18. The staff recommends that the Task Force continue to pursue addressing this Issue separate from the Board’s joint revenue recognition project. The staff also recommends that the Task Force affirm its previous decision to pursue a modification of the scope of SOP 97-2 rather than a broad modification of the measurement criteria for all software transactions. The staff notes that a large majority of the respondents was supportive of these decisions including all six user respondents. Further, the staff received unsolicited informal comments from three users who were also supportive of these decisions. Each of these users as well as most of the preparers, accounting firms, and others believed that this guidance would significantly improve financial reporting and that this improvement was necessary and needed as soon as possible. These respondents appeared to believe that the benefits of improved financial reporting outweighed both the costs to apply the new guidance and the risk that the Board may reach a different conclusion in its joint project. There also does not appear to be broad support from respondents to pursue modifying the measurement criteria in this project. This is consistent with the feedback the staff previously received from software users who were not supportive of broadly modifying the measurement criteria for all software transactions. The staff does not believe any additional information was received from respondents that was not already considered during the Task Force’s deliberations on this Issue or that would warrant a change to the previous decisions.

Question 1 – Does the Task Force agree with the staff recommendation to continue with the scope approach for this Issue and not pursue modification of the measurement criteria for software transactions?

Comment – Scope Principle

19. Most respondents believed that the scope principle in paragraph 4 of the draft abstract is operational and would improve financial reporting. Many of the respondents also commented that the principle, along with the assumptions and examples, provided clear guidance on how to apply the consensus. Several respondents, however, asked for clarity on or revision to certain aspects of the guidance. One respondent (CL #25) who was not supportive of the Task Force continuing to pursue this Issue, suggested that if a scope modification was pursued, the assessment should be based on the significance of the product’s value that is derived from the software included as a component of the product. Another respondent, a consulting firm, (CL #28) was supportive of the scope approach but also favored a value-based approach.

Staff Analysis

20. The staff believes that the following comments relating to the principle specifically warrant the attention of the Task Force:

- a. Use of the term “always” in paragraph 5(a) of the draft abstract
- b. Intent of Example 7, which illustrates a change in business practice

21. Several respondents thought that paragraph 5(a) of the draft abstract should be modified. Paragraph 5(a) states that 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. These respondents stated that they did not believe it was the intent of the Task Force to create a rigid line such that an occasional sale of the product without the software would result in the software being considered non-essential to the functionality of the product. Others were concerned that this was too absolute of an approach and was not consistent with a principles based approach.

22. The staff agrees with the points raised. The staff believes that the intent of this paragraph was to communicate that if the product normally contained the software when the product was sold, then the software would be presumed to be essential to the functionality of the product. The staff agrees that the term “always” may appear to remove judgment from the essential to the functionality assessment, which the staff does not believe was the intent of the Task Force. The staff does not believe it was the Task Force’s intent for one-off transactions to “taint” a larger pool of transactions. The staff considered various alternative language to clarify this point, such as the tangible product is “typically,” “normally,” “usually,” or “predominantly” sold with the software. The staff is concerned that such terms could be interpreted to mean a lower threshold than was intended in this presumption. For example, some might interpret those terms to mean the majority of the transactions. The staff believes that the intent of this paragraph was that infrequent sales of the product without the software should not impact the assumption. Accordingly, the staff proposes the following revisions to paragraph 5(a) in the draft abstract to address those concerns (shown as paragraph A4 in the attached Amendments to the Codification):

Software elements are presumed to be essential to the functionality of the tangible product if sales of the tangible product without the software elements are infrequent.

23. Some respondents stated that they were confused by the intent of Example 7 in the draft abstract, which illustrates a change in business practice, and thought this example was not consistent with the substance of the Task Force’s decision. The following from CL #10 highlights this concern:

We are also concerned with the application guidance provided in Example 7 in Issue 09-3. In our view, a change in business practice that is potentially driven by a desired change in accounting is inappropriate and not consistent with the EITF’s objective in this Issue. While we support the scope change for “true” software enabled devices, we do not believe that the device can function solely as a “delivery mechanism” for the software and result in the deliverable being excluded from the scope of SOP 97-2.

24. The staff agrees with these observations. The staff believes that the intent of Example 7 was to illustrate that the technology landscape is evolving and some companies that have historically typically sold “pure” software products could morph into selling software enabled devices as their business continues to evolve. The staff believes that it is inherent in the overriding principle in paragraph 4 of the draft abstract that both the software and the hardware aspects of a tangible device need to substantively contribute to the functionality of the product in order for the scope exception to apply. The staff has revised the language in Example 7 (shown in the attached amendments to the Codification – Case L) in order to clarify these points. In addition, the staff believes that the following consideration should be added to paragraph A4 of the Codification Amendments to further emphasize that the hardware aspect of the arrangement also needs to be substantive:

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

25. The staff believes that the suggestion in CL#31 that the scope exception be based on value rather than functionality was previously discussed by the Task Force and the Working Group as a potential option. The staff notes that the consensus of both Working Group and Task Force members was that a value-based approach would not be operable. There was significant concern that such an approach would be extremely difficult to apply considering the continuing integration of software into tangible devices. Additionally, concerns were raised that a value-based approach would not address the fundamental issue relating to the perceived disconnect between the financial reporting and economics for software-enabled device transactions. For those reasons, the staff does not recommend that a value-based approach be pursued.

Question 2 – Does the Task Force agree with the staff recommendation for revising the language of the principle, assumptions, and examples to address the concerns discussed in paragraphs 19-24 of this Issue Summary?

Comments – Other

26. Several respondents included comments of an editorial nature or requested that language be clarified. The staff also received several informal comments of this nature. The staff has not highlighted those comments in this Issues Summary but has included a revised draft of the Amendments to the Codification that highlights the staff's suggested changes to address those comments.

Disclosures

27. Comments received relating to disclosures on Issue 09-3 were consistent with those received on Issue 08-1. The staff recommends that any decisions reached by the Task Force in deliberating the comments relating to Issue 08-1 should also apply to Issue 09-3.

Transition and Effective Date

28. Comments relating to transition and effective date on Issue 09-3 were consistent with those received on Issue 08-1. The staff recommends that any decisions reached by the Task Force in deliberating the comments relating to Issue 08-1 should also apply to Issue 09-3.

Appendix 09-3A

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

Introduction

A1. The following are amendments to the Accounting Standards Codification as a result of this proposed Update. Terms from the Master Glossary are in **bold** type. Added text is underlined and deleted text is struck out. This appendix outlines how this Issue affects the *FASB Accounting Standards Codification*[™].

~~A2. This Issue amends Topic 985, Software.~~

Amendments to the Codification Topic 985

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 that include software that is more than incidental to services as a whole, the guidance in this Subtopic applies to the software and software-related elements in the arrangement. 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 elements components and non-software elements 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 elements components and non-software elements components that function together to interdependently deliver the product's essential functionality, an entity shall consider the following:

1. Software elements are presumed to be essential to the functionality of the tangible product if sales of the tangible product without the software elements are infrequent. 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 of similar products. 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 the purpose of evaluating [1].
3. An entity may sell software on a standalone basis. The entity may also sell a tangible product containing that same software. The separate sale of the software shall not cause a presumption that the software is not essential to the functionality of the tangible product should not affect this evaluation.
4. Software elements ~~components~~ do not need to be embedded within the tangible product to be considered essential to the tangible product's functionality.
5. The non-software elements of the tangible product must substantively contribute to the tangible product's essential functionality. For example, the tangible product should not simply provide a mechanism to deliver the software to the customer.

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 (software deliverables) and deliverables that are not within the scope of this Subtopic (non-software deliverables), an entity shall allocate arrangement consideration to each separate unit of accounting for the non-software deliverables, and to the software deliverables as a group, in accordance with paragraph 605-25-15-3A. The non-software deliverables may include software deliverables that are considered essential to the functionality of a tangible product. If the arrangement includes more than one software deliverable, the portion of the arrangement consideration allocated to the software deliverables as a group pursuant to the guidance in paragraph 605-25-15-3A would be further subject to the separation and allocation guidance of this Subtopic.

If a tangible product contains software that is not essential to the product's functionality, that nonessential software and any other deliverables within the arrangement 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 elements ~~components~~ and non-software elements ~~components~~ that function together to deliver the tangible product's essential functionality as discussed in paragraph 985-605-15-3. The cases are:

- a. Computer with ~~and~~ operating system ~~always~~ included (Case A)
- b. Computer with ~~and~~ operating system ~~not always~~ included ~~more than infrequently~~ (Case B)
- c. Computer and multiple operating systems (Case C)
- d. Computer with additional software products ~~and operating system always included~~ included (Case D~~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 included (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 rarely~~ 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 More Than Infrequently

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 ~~on a regular basis 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 ~~on a regular basis~~, 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 ~~rarely~~ ~~always~~ sells the personal computer without 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 – Additional Software Products Included

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 regularly 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 more than infrequently. 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 does not impact ~~is not~~ a consideration in the conclusion in this example.

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 in this example 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. 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 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 Included

985-605-55-228 Consider the same fact pattern as in Case ~~DA~~, 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 ~~D4C~~. 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~~ rarely sells the Model 200 without the music player software. The music player software is not included on Model 100 but customers can separately purchase the software for use on Model 100. There is no substantive difference in the other hardware or software components of the two models.

985-605-55-233 Vendor would need to assess whether the two models are the same product or different products. If they are the same product, then the music player software would not be considered essential to the functionality of Model 200. Because there is no substantive difference between the two models other than the inclusion of the music player software, Vendor determines that the two models are the same product. When 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. ~~As a result of technological developments, Vendor decides to change its business model such that its software is now included on an integrated workstation device. The device offers several advanced features including voice command and touch screen design capabilities. Vendor does not sell the workstation device without the engineering software and the software is not sold separately from the device because the workstation is needed for the software to function. Vendor continues to sell the previous version of its engineering software separately but its market strategy is to transition customers to its advanced technology. no longer sells the engineering software separate from the device. The vendor typically sells the workstation device along with post customer support on the included 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 workstation 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's ~~changes its business model changes 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 would likely was not be~~ 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 **985-605-25-65-1**, as follows:

985-605-50-1 For multiple-element arrangements that include deliverables within the scope of this Subtopic and deliverables that are not within the scope of this Subtopic, 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 Revenue 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. 2009-X, "~~Applicability of AICPA Statement of Position 97-2 to Certain Revenue 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. An entity shall not elect early application of this pending content unless an entity also elects early application of the pending content in paragraph 605-25-65-1.

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.