Debrief on ASU 2009-13 (EITF 08-1): Revenue Arrangements with Multiple Deliverables

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New Revenue Recognition Guidance modifies EITF 00-21: changes criteria for separation of multiple elements and allows use of estimated "Selling Price"

In October 2009 FASB issued EITF 08-1 in form of the new Accounting Standards Update - ASU 2009-13 not quite a year after it was first published as a draft for comment in December 2008. ASU 2009-13 is superseding EITF Issue 00-21 of the same name: Revenue Arrangements with Multiple Deliverables and includes the following key components:

- Replacing references to "Fair Value" in EITF 00-21 with references to "Selling Prices" to distinguish between measurements in Issue 00-21 and Statement 157.
- Eliminating the requirement for objective-and-reliable-evidence-of-fair value in separating accounting units, permitting instead the use of best estimates where neither Vendor-Specific- Objective Evidence (VSOE) nor Third-Party Evidence (TPE) exists.
- Requiring both quantitative and qualitative disclosures of methodologies and inputs used in estimation processes

Why is this a big deal? Since the existing Issue-00-21 does not allow companies to separate elements in a multiple element arrangement without evidence of fair value for undelivered items – the lack of which is often a major issue -- the use of estimated prices instead would permit many more elements to be recognized as separate accounting units and could accelerate the recognition of revenue for delivered units. Therefore, it would be expected that many companies will adopt ASU 2009-13 as soon as possible.

Key Issues at a Glance

Accounting Standards Update ASU 2009-13 (formerly known as EITF 08-1) introduces a "selling price" hierarchy for multiple-deliverable arrangements and for the first time allows for management selling price estimates in case where no VSOE (Vendor Specific Objective Evidence) or third-party evidence can be determined. This also results in the elimination of the residual method, since now price estimates for all elements of an arrangement are possible. ASU 2009-13 will be effective for fiscal years beginning June 15th 2010 and early adoption is possible.

Scope

ASU 2009-13 covers the same scope as EITF Issue 00-21 of the same name. When the issue was assigned to a working group by the Task Force in March 2008, it was originally named "Revenue Recognition for a Single Unit of Accounting". However it does not address how to actually recognize revenue and was renamed prior to its exposure.

At their meeting in September 2008, the Task Force considered whether to expand the scope of Issue 08-1 to include transactions managed under SOP 97-2: Software Revenue Recognition. Where EITF 00-21/08-1 addresses multiple-element arrangements that don't include software, SOP 97-2 focuses a similar but different set of rules on arrangements that include software and software-related items. The Task Force ultimately decided to keep the scopes of 00-21 and 08-1 the same and to recommend a separate project to examine accounting for revenue arrangements with multiple deliverables under SOP 97-2. That project then resulted in the new ASU 2009-14 (formerly EITF 09-3).

Determining Separate Units of Accounting

In an arrangement that includes multiple deliverables, the vendor must evaluate each deliverable to determine whether it can be treated as a separate unit of accounting or whether it must be combined with other deliverables to create an aggregated group – which is then treated as a single, separate accounting unit. The next step is deciding how to allocate the transaction price for the total arrangement across the now-separated units of accounting. These steps must occur before any consideration of how to recognize revenue for the accounting units in the arrangement.

These two subjects -- when to separate units and how to allocate the price -- are the essence EITF 00-21.

ASU 2009-13 (EITF 08-1) now introduces a small, but key change in the criteria for permitting the separate accounting of delivered units. EITF 00-21 does not allow a company to separate a delivered item in a multiple element arrangement if it doesn't have objective and reliable evidence of the fair value of any item that is undelivered. That often means that a company can't separate items for revenue recognition as they are delivered, but must wait for delivery of the entire arrangement before recognizing revenue. ASU 2009-13 (EITF 08-1) eliminates the fair and objective evidence threshold in 00-21 and permit the delivered items to be treated separately if the following conditions are met:

- The arrangement has multiple deliverables and is within the scope of ASU 2009-13 (EITF 08-1).
- The delivered item has value to the customer on a standalone basis.
- If the arrangement includes a general right of return relative to the delivered item, delivery of the undelivered item is probable and substantially controlled by the entity.

If the answer to all three questions is yes, then the delivered item can be treated as a separate unit of accounting even if objective and reliable evidence of fair value for undelivered items does not exit.

Any delivered item that doesn't pass all three of these "tests" cannot be separated and must be combined with the undelivered items.

Estimation of Selling Prices and Allocation

Once separation of the units has been established, selling prices must be associated with each unit of accounting for allocation. ASU 2009-13 (EITF 08-1) establishes a tiered system of qualified evidence for an item's selling price with vendor specific objective evidence (VSOE) at the top, third party evidence (TPE) of fair value in the next tier down,

and finally, estimated selling prices on the bottom -- such estimates are to be used if, and only if, neither VSOE nor TPE exists. The vendor must consider both market conditions and their own specific factors – such as labor, other time and expenses and gross margin - in deriving an estimated price. ASU offers several estimation examples.

Hierarchy of Evidence for Selling Prices

A Note on VSOE
ASU 2009-13 does not have any effect on products that require VSOE accounting as specified in SOP 97-2. Outside of 97-2 companies now have the opportunity to establish an estimated price for revenue recognition even if they don't have VSOE on a product. Note also the simultaneously issued ASU 2009-14 (formerly EITF 09-3) which changes the scope of SOP 97-2 and excludes tangible products with software elements from this guidance and the VSOE requirement.

Residual Method Eliminated
The introduction of selling price estimates lead to the elimination of the residual method. Since selling price estimates for all elements of an arrangement are now possible, the "fix" the residual method provided for situations where VSOE could not be determined for all elements of an arrangement, are no longer needed.

Disclosures and Transition Dates
ASU 2009-13 (EITF 08-1) requires vendors to disclose both qualitative and quantitative information on an aggregated basis that will enable financial statement users to understand the methodologies and inputs used to develop estimated selling prices.

ASU 2009-13 also requires a parallel reporting process in which vendors have to disclose the amount of revenue reported in each period under existing guidance in 00-21 and under new guidance in ASU 2009-13, until such time as that recognized under 00-21 is no longer material.

ASU 2009-13 will be required for fiscal years beginning June 15th 2010 and early adoption is possible.

Conclusion
ASU 2009-13 may enable companies to recognize revenue for transactions that currently get deferred on the basis of an incremental future deliverable. But, it will also introduce the potential for more complexity in the mechanics of revenue recognition. Many companies that use multi-element agreements may find they have undelivered elements with values derived from all three methods (VSOE, TPE, and ESP), a scenario that will require additional work, judgment, documentation, and a great deal of housekeeping on the part of revenue accountants.

Sources:

FASB ASU 2009-13:
Revenue Recognition (Topic 605)
Multiple-Deliverable Revenue Arrangements
a consensus of the FASB Emerging Issues Task Force

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