

Technical Line

FASB – final guidance

How the new revenue standard affects operating real estate entities

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What you need to know

- ▶ The new revenue standard affects how operating real estate entities account for sales of real estate to and service arrangements with customers.
- ▶ Although leases aren't in the scope of the new revenue standard, operating real estate entities apply the guidance in the revenue standard to allocate consideration to lease and non-lease elements under ASC 840, or non-lease components when they adopt ASC 842.¹ Lessors also apply the revenue standard to account for the portion of consideration allocated to the non-lease elements under ASC 840 or non-lease components under ASC 842 when the lessor transfers goods or services to the lessee that are an output of its ordinary activities.
- ▶ Lessors that elect and qualify for an optional practical expedient in ASC 842 to not separate lease and associated non-lease components account for a combined component under ASC 606, and apply its disclosure requirements, when the non-lease component is determined to be predominant.

Overview

The new revenue recognition standard² issued by the Financial Accounting Standards Board (FASB or Board) requires operating real estate entities to make additional judgments and estimates, such as identifying performance obligations and estimating variable consideration.

This publication highlights key aspects of applying the FASB's standard to an operating real estate entity's contracts with its customers, addresses significant changes to legacy practice and reflects the latest implementation insights. The publication also has been updated to

reflect certain amendments the FASB has made to the leases standard and to address the interaction of the leases and revenue guidance.

As a reminder, the FASB deferred³ the effective date to annual periods beginning after 15 December 2019 and interim periods in annual periods beginning after 15 December 2020, for entities that had not yet issued (or made available for issuance) financial statements that reflected the standard as of 3 June 2020 (i.e., certain private and not-for-profit entities). Early adoption is permitted. The deferral is intended to give these entities more time to implement the standard, given the operational and financial reporting challenges of the COVID-19 pandemic. Public entities, as defined by the standard, and some private and not-for-profit entities were already required to adopt the standard.

This publication, which contains a summary of the standard in the appendix, supplements our Financial reporting developments (FRD) publication, [*Revenue from contracts with customers \(ASC 606\)*](#), and should be read in conjunction with it. The views we express in this publication may continue to evolve as implementation continues and additional issues are identified.

This publication addresses certain considerations for entities that own and/or operate real estate. Our Technical Line publications, [*How the new revenue recognition standard affects homebuilders*](#) and [*How the new revenue standard affects engineering and construction entities*](#), address certain considerations for homebuilders (and real estate land developers) and construction contractors, respectively.

Operating real estate entities should also keep in mind that, when they adopt the new credit impairment standard,⁴ they will need to estimate full lifetime expected credit losses for their accounts receivable and contract assets. As a reminder, they will need to do this after assessing collectibility under the revenue guidance to determine whether they have a contract with a customer. Refer to our FRD publication, [*Credit impairment for short-term receivables under ASC 326*](#), for more information.

Real estate sales

The revenue standard replaced the prescriptive literature in Accounting Standards Codification (ASC) 360-20, *Property, Plant, and Equipment – Real Estate Sales*, with a principles-based approach for sales of real estate. The elimination of the guidance in ASC 360-20 was a major change for all entities that sell real estate properties.

Entities apply ASC 606 to account for sales of real estate to customers. Entities account for sales of real estate (that do not meet the definition of a business) to noncustomers under ASC 610-20, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets*,⁵ which requires the application of certain concepts from ASC 606. This publication only addresses the application of ASC 606. See our FRD publication, [*Gains and losses from the derecognition of nonfinancial assets \(ASC 610-20\)*](#), for a further discussion of ASC 610-20.

Under ASC 606, entities generally recognize the sale of a real estate property, and any associated gain or loss, when control of the property transfers. However, entities will continue to eliminate intra-entity profits or losses for transactions with equity method investees or joint ventures that are in the scope of ASC 606. That is, if the asset being sold is an output of an entity's ordinary activities, an investor or investee will continue to eliminate profit from intra-entity transactions until that profit is realized in a transaction with third parties. See our FRD publication, [*Equity method investments and joint ventures*](#), for a further discussion of ASC 323.⁶

Operating real estate entities should also keep in mind that, when they adopt the new credit impairment standard, they will need to estimate full lifetime expected credit losses for their accounts receivable and contract assets.

Property management services

Many operating real estate entities provide property management services to customers that are either third-party real estate owners or equity method investees. To account for revenue received for providing these services, entities must:

1. Identify the promised services⁷
2. Determine which of the services (or bundle of services) are distinct and, therefore, should be accounted for as separate performance obligations (i.e., the units of accounting for purposes of applying the standard)
3. Determine whether any distinct services that have been identified must be combined (i.e., meet the criteria to be accounted for as a series) and accounted for as a single performance obligation

The following illustrates how a real estate entity might evaluate performance obligations in a property management contract:

Illustration 1 – Identifying performance obligations in a property management contract

Operator G enters into a one-year contract with Owner V to provide property management services for a regional mall. The arrangement does not contain a lease. The contract stipulates that Operator G will manage day-to-day operations of Owner V's mall for a fee of 5% of the property's quarterly lease revenues (i.e., lease revenue received by the owner from third-party lessees).

Analysis of management services

Operator G evaluates the activities that must be performed to manage the day-to-day operations of the property, which include maintenance, janitorial, security, tenant relationship management and back-office support. Operator G assesses the nature of its promise and concludes it is to provide daily management services that are necessary to make sure the property is open and operating as intended. In addition, Operator G concludes that each day of property management service represents a distinct service.

Operator G must then evaluate whether the management services represent a series of distinct services that must be combined into a single performance obligation. Operator G determines that the overall service of property management each day is substantially the same and has the same pattern of transfer (i.e., transfers daily) over the term of the contract. Further, each distinct day of service represents a performance obligation that would be satisfied over time (e.g., over the length of the contract, not at a point in time) and has the same measure of progress (e.g., time elapsed). Therefore, Operator G accounts for the property management services provided to Owner V as a single performance obligation composed of a series of distinct services.

Since property management service contracts are usually composed of multiple underlying activities, significant judgment may be required when applying the revenue standard. For example, a retail property manager may be responsible for identifying and executing leases with seasonal tenants (on behalf of the property owner), attracting on-site events (e.g., automobile tent sales) or placing advertising or promotional signage around the property.

If an entity determines that these activities represent separate performance obligations and the variable consideration allocation exception does not apply (see Step 4 of the Appendix), the transaction price needs to be allocated to the separate performance obligations based on the standalone selling prices of the services. However, if control is transferred for the other

services in the same pattern and concurrently with the property management services, it is not necessary to allocate the transaction price among the services as long as the fees for other services are presented in the same line item in the entity's financial statements. Revenue is recognized when those performance obligations are satisfied.

How we see it

Entities first determine which services in the contract are distinct and, therefore, could represent separate performance obligations. Then, they determine whether the distinct services are substantially the same, have the same pattern of transfer and, therefore, must be combined into one performance obligation composed of a series of distinct services. This evaluation may require significant judgment when a property manager performs activities beyond the day-to-day operation of a property (e.g., leasing services at the same property). The identification of performance obligations may affect when revenue is recognized.

Property managers that apply the series guidance allocate variable consideration to the period in which the related services were performed, if certain criteria are met.

Variable consideration related to property management services is accounted for following the variable consideration allocation exception if certain criteria are met (see Step 4 in the Appendix). In the Background Information and Basis for Conclusions of Accounting Standards Update (ASU) 2014-09,⁸ the Board discussed an example of a contract to provide hotel management services for one year that is a single performance obligation composed of a series of distinct services that are substantially the same and that have the same pattern of transfer to the customer. The consideration for the services is variable and based on the operating results of the property. In this example, the variable consideration (e.g., management fees) relates specifically to the entity's efforts to transfer the services for a certain period within a contract (e.g., a day, a month, a quarter), which are distinct from the services provided in other periods within the contract, and the uncertainty related to the consideration is resolved during the distinct period (i.e., when the operating results are known for each distinct period). The variable consideration is allocated to those distinct periods instead of being spread over the entire performance obligation.

Many property management fees likely will qualify for the variable consideration allocation exception because the variable consideration (e.g., management fees, performance-based fees) relates specifically to the entity's efforts to provide property management services for a certain period within a contract (e.g., a month, a quarter) that are distinct from the services provided in other periods. However, property managers should evaluate any contract with unique payment terms that could suggest the allocation objective would not be met for that contract.

The following illustration depicts the application of this exception by a property manager that determines that the services it is providing represent a series of distinct services that form part of a single performance obligation:

Illustration 2 – Property management fees

Assume the same facts as in Illustration 1. Operator G has concluded that the management services represent a single performance obligation recognized over time because it determines that it is providing a series of distinct services.

Analysis

Operator G determines that the variable consideration related to the management services (i.e., the fee of 5% of the property's quarterly lease revenues) is allocated to each individual quarter because the quarterly management fee relates specifically to the entity's efforts to satisfy the performance obligation during each quarter, and the allocation is consistent with the objective of allocating an amount that depicts the consideration to which the entity expects to be entitled in exchange for transferring the promised services.

Because the variable consideration allocation criteria are met, Operator G would not estimate variable consideration for purposes of recognizing revenue. For example, if the revenue generated by the property were \$2 million in the first quarter of 20X8, Operator G would recognize revenue of \$100,000 (\$2 million x 5%) at 31 March 20X8.

How we see it

Some entities find that applying the variable consideration allocation exception and, therefore, recognizing management fees that relate specifically to the entity's efforts to transfer the services in a distinct period is relatively straightforward.

However, some contracts contain multiple revenue streams that relate to a single performance obligation, so the allocation may be more complex. For example, a contract also could include a fixed fee that would generally be recognized over the term of the contract using the entity's selected measure of progress (e.g., time elapsed), which may differ from the pattern in which the variable consideration is recognized.

Some property management contracts contain incentive fees that are based on the performance of the underlying property over a different period than the base management fees (e.g., annually versus quarterly). An entity should estimate the incentive fee (i.e., variable consideration) at each reporting period and include in the transaction price the estimate or any portion of the estimate for which it is probable that a significant revenue reversal will not occur when the uncertainties related to the variability are resolved. That is, entities must evaluate whether any variable consideration should be constrained. Significant judgment is required when making this assessment. Refer to Step 3 in the Appendix for further discussion of the constraint.

The following illustration depicts the complexity that entities may face and the significant judgment that may be required when recognizing revenues from these contracts:

Illustration 3 – Incentive-based fees

Assume the same facts as in Illustrations 1 and 2 except that Operator G also receives an incentive fee of 2% of the property's annual net operating income (NOI). The shopping center has stabilized occupancy, and no significant tenant vacancies are expected during the term of the agreement. The shopping center is occupied by several retailers with significant variable rent based on a percentage of sales that vary substantially. Assume the variable consideration allocation exception is not met for the incentive fee (the accounting for the base management fee is not repeated in this illustration).

Management fee per the contract	
Base management fee	5% of property's quarterly lease revenues
Incentive fee	2% of the property annual net operating income (NOI)

Analysis

Operator G evaluates variable consideration in the form of the incentive fee. While much of the property's income and operating costs are predictable, Operator G determines that the variability caused by the variable rent can significantly affect the NOI of the property. Because of the potential variability in NOI, Operator G uses the "expected value" approach and concludes that there is a nearly equal likelihood of the property generating NOI of \$1.2 million, \$1.5 million and \$1.8 million.

Based on this approach, Operator G initially estimates that it will earn \$30,000 from the incentive fee, as follows:

Estimate of NOI	Probability of outcome	Weighted average
\$1.2 million	33%	\$ 396,000
\$1.5 million	34%	\$ 510,000
\$1.8 million	33%	\$ 594,000
Estimated NOI using the expected value method		\$ 1,500,000
Incentive fee (2% of the property's annual NOI)		2%
Estimated variable consideration		\$ 30,000

In this case, the incentive fee is based on the annual NOI of the property; however, Operator G must determine whether any of the variable consideration should be recognized when the underlying services are performed (e.g., during the interim periods). Operator G considers whether it is probable that a significant reversal in the incentive fees will not occur upon the resolution of the uncertainty associated with the fees. This assessment requires consideration of the facts and circumstances of the contract.

Operator G evaluates, at contract inception, whether it is probable that a significant reversal of revenue from the incentive fees will not occur because NOI could be significantly affected by the variable rents paid by the retailers. The income of the shopping center fluctuates based on factors that are beyond Operator G's control (e.g., economy, consumer confidence, individual retailer trends). Operator G applies the constraint to the annual incentive fee and determines the fee that would be earned from the estimated outcome of NOI for which it is probable that a reversal in the incentive fee will not occur is \$24,000 ($\$1,200,000 \times 2\%$).



Operator G then evaluates whether the \$6,000 difference between the amount determined using the “expected value” approach (\$30,000) and the amount for which it is probable that a revenue reversal will not occur (\$24,000) is significant when compared to the cumulative revenue from the contract recognized to date. If Operator G concludes that the \$6,000 difference would be significant, if reversed, it would exclude the \$6,000 from the transaction price until it is probable that a significant revenue reversal would not occur. If it is not significant, the \$6,000 would be included in the transaction price and recognized during the annual period using a measure of progress that depicts Operator G's performance in providing the management services.

Leasing services⁹

When operating real estate entities provide leasing services on behalf of customers that are third-party real estate owners or equity method investees, the consideration earned is recognized using the guidance in the revenue standard. The terms of leasing services contracts often vary significantly and require the leasing services provider (i.e., operating real estate entity) to carefully evaluate the nature of the promised services, the ways in which consideration is earned and how control of the services is transferred.

Identifying performance obligations

An operating real estate entity acting as a leasing services provider may agree to provide services for a single available space or multiple available spaces within one or more real estate properties. When an operating real estate entity provides leasing services for multiple available spaces within one or more properties, it needs to determine whether it is providing distinct services for each available space or a series of services to maintain the occupancy of a property that, together, comprise a single performance obligation.

The leasing services provider may determine that the leasing services provided are distinct for each available space when those services for a particular available space are separately identifiable from services provided for other available spaces (i.e., they do not customize or modify each other, they are not integrated services and they are not highly interrelated or highly interdependent). This may be the case when the specific nature and extent of services provided for each space vary based on a number of factors (e.g., size of the space, location within the property, number of prospective tenants). The nature and extent of services provided also are affected by the real estate owner's decision to accept or reject each prospective tenant and the associated lease terms negotiated by the leasing services provider (i.e., the leasing services provider's delivery of the promised services ultimately depends on the real estate owner's acceptance thereof).

Further, the leasing services provider also must evaluate whether individual activities necessary to facilitate the execution of a lease (e.g., marketing the available space, evaluating potential tenants, negotiating lease terms) are distinct. The leasing services provider may conclude that none of the individual activities necessary to facilitate the execution of each lease for an available space are distinct and that they should, therefore, be bundled to form a single performance obligation because they are inputs to a combined output of executing a lease of the available space.

The leasing services provider also may provide other services beyond marketing the available space and identifying and procuring tenants. For example, the leasing services provider may assist in drafting and executing legal documents, performing design and architectural services, or coordinating construction of improvements. The leasing services provider needs to carefully evaluate the nature of the services it provides for each available space to determine which of those services are distinct (i.e., capable of being distinct and separately identifiable) and, therefore, should be accounted for as separate performance obligations.

The leasing services provider may determine that activities that occur subsequent to the execution of a lease for each available space (e.g., coordinating construction of the tenant's improvements, assisting the tenant with obtaining local building permits and approvals, facilitating utilities connections) are not individually distinct, but form a distinct bundle of activities separate from the leasing services and other promises in the contract because they are inputs to a combined output of facilitating each tenant's occupancy.

How we see it

The identification of performance obligations in leasing service contracts requires significant judgment, especially when services are provided for multiple available spaces within one or more real estate properties. While, in certain cases, leasing services providers may conclude that services provided for each available space are distinct, the unique terms of each service agreement may cause some leasing services providers to reach different conclusions. The specific services promised for each available space also may affect an entity's conclusions about whether individual services should be bundled to form a separate performance obligation.

Identifying performance obligations in a leasing services contract requires significant judgment.

Determining and allocating the transaction price

The compensation structure in leasing services contracts also varies significantly. Leasing services providers generally receive a variable fee based on the square footage of space leased (e.g., \$5 per leased square foot), which may be capped at a certain square footage. In some contracts, the leasing services provider instead may receive a fixed fee (i.e., retainer) upon engagement, a variable fee based on the tenant's performance (e.g., sales) subsequent to lease commencement or a reimbursement for costs incurred to perform certain services (i.e., no margin is earned for certain services). Further, the fee may be adjusted if the lease is a renewal with an existing tenant.

Contract consideration must be allocated to performance obligations in proportion to their standalone selling prices (i.e., on a relative standalone selling price basis) subject to certain exceptions related to variable consideration and discounts to the extent applicable. Operating real estate entities need to evaluate whether the consideration to which they expect to be entitled in exchange for performing various leasing services is consistent with the standalone selling prices of those services. When the consideration received for each performance obligation is consistent with its standalone selling price, consideration is allocated using the contract prices of the performance obligations, unless one of the allocation exceptions applies. When estimating standalone selling prices, entities need to consider a variety of factors, including market conditions (e.g., competitor pricing, market trends, geographic area) and entity-specific factors (e.g., pricing practices and objectives, internal cost structure).

How we see it

In certain cases, operating real estate entities may conclude that the consideration stated in the contract in exchange for performing various leasing services within a contract is consistent with the standalone selling prices of those services. However, there may be instances where this conclusion is not appropriate. For example, this may occur when the consideration earned by a leasing services provider for executing a lease is consistent with its standalone selling price but the consideration for the other leasing services that are separate performance obligations is not (e.g., services compensated on a cost reimbursement basis). In this instance, the leasing services provider needs to estimate the standalone selling prices of the leasing services and other performance obligations and allocate the transaction price (i.e., contract consideration) on a relative standalone selling price basis.

Recognizing revenue

To recognize the revenue allocated to each performance obligation, the operating real estate entity needs to determine how control of the services within a leasing services contract is transferred to the real estate owner (i.e., customer). An entity transfers control of a service (and recognizes revenue) over time when any of three criteria described in the standard is met (see Step 5 in the Appendix). While two of these criteria¹⁰ are unlikely to be met for some services in leasing services contracts, the other criterion, "the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs," might be satisfied in certain instances.

For example, a leasing services provider that identifies the coordination of the construction of a tenant's leasehold improvements as a performance obligation might determine that the real estate owner simultaneously receives and consumes the benefits of the leasing services provider's performance as it occurs. This is because another entity would not need to substantially reperform the work that the entity completed to date if that other entity were to

fulfill the remaining performance obligation to the customer. That is, the real estate owner benefits from the leasing services provider's ongoing coordination efforts as construction of the tenant's leasehold improvements progresses.

How we see it

It may be difficult for a leasing services provider to assert that control of services that facilitate the execution of a lease of an individual space is transferred over time because the real estate owner does not ultimately consume the benefit of the leasing services provider's performance until the lease is executed. That is, the efforts of the leasing services provider must be reperformed if an agreement cannot be reached with a prospective tenant. Therefore, we believe the leasing services provider often recognizes revenue allocated to a performance obligation related to facilitating the execution of a lease for an individual space at a point in time.

Non-lease components may be accounted for under ASC 606 if the lessor transfers goods or services to the lessee that are an output of its ordinary activities.

Non-lease components in the scope of ASC 606 (after adoption of ASC 842)

Identifying and separating lease and non-lease components

The new leases standard, codified in ASC 842, *Leases*, requires lessors to account for goods and/or services in a lease contract that are transferred separately from the right to use the underlying asset as non-lease components (except when a lessor qualifies for and applies the practical expedient to not separate lease and non-lease components discussed below). The non-lease components are accounted for under other US GAAP, including ASC 606 if the lessor transfers goods or services to the lessee that are an output of its ordinary activities (i.e., when the lessee is the lessor's customer for the non-lease components).

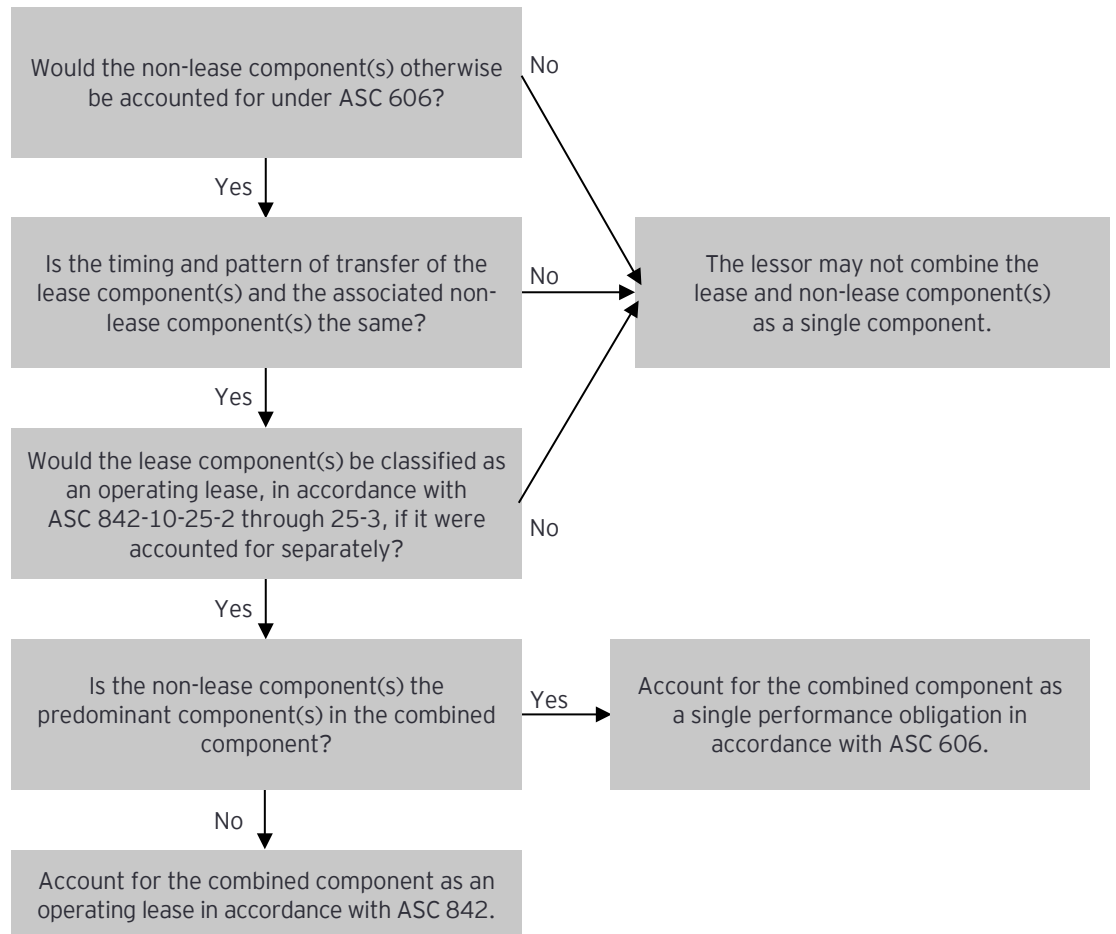
For example, under ASC 842, maintenance activities, including common area maintenance, or CAM (e.g., cleaning the lobby of a building, removing snow from a parking lot), and other goods or services transferred to the lessee (e.g., providing utilities or trash removal) are considered non-lease components. This is a significant change from ASC 840, *Leases*, that considered lease-related executory costs, including maintenance, to be part of the lease component (or lease element) when lease and non-lease elements are separated.

Practical expedient to not separate non-lease and associated lease components

Under the new leases standard, lessors may elect an optional practical expedient, by class of underlying asset, to not separate lease and related non-lease components if the non-lease components otherwise would be accounted for in accordance with the revenue standard and the following criteria are met:

- The timing and pattern of transfer of the lease component and the associated non-lease component(s) are the same.
- The lease component would be classified as an operating lease if it were accounted for separately.¹¹

The decision tree below summarizes the evaluation of whether a lessor can apply the practical expedient not to separate lease and non-lease components:



As shown above, a lessor that concludes the above criteria are met then evaluates whether the lease or non-lease component(s) is the predominant component. A lessor that determines that the non-lease component(s) associated with the lease component is the predominant component in the contract is required to account for the combined component as a single performance obligation under ASC 606 and provide ASC 606 disclosures.

Refer to section 1.4.2.4 of our FRD publication, [Lease accounting: Accounting Standards Codification 842, Leases](#), which we refer to as our Lease accounting FRD, for further discussion.

How we see it

The “timing and pattern of transfer” criterion is often met in real estate arrangements because lease components and associated services are generally transferred on a straight-line basis over the same time period.

Determining whether a lease or non-lease component is the predominant component is straightforward in most real estate arrangements. For example, we believe most real estate entities will determine that the lease component is the predominant component in a typical arrangement involving leased property and CAM.

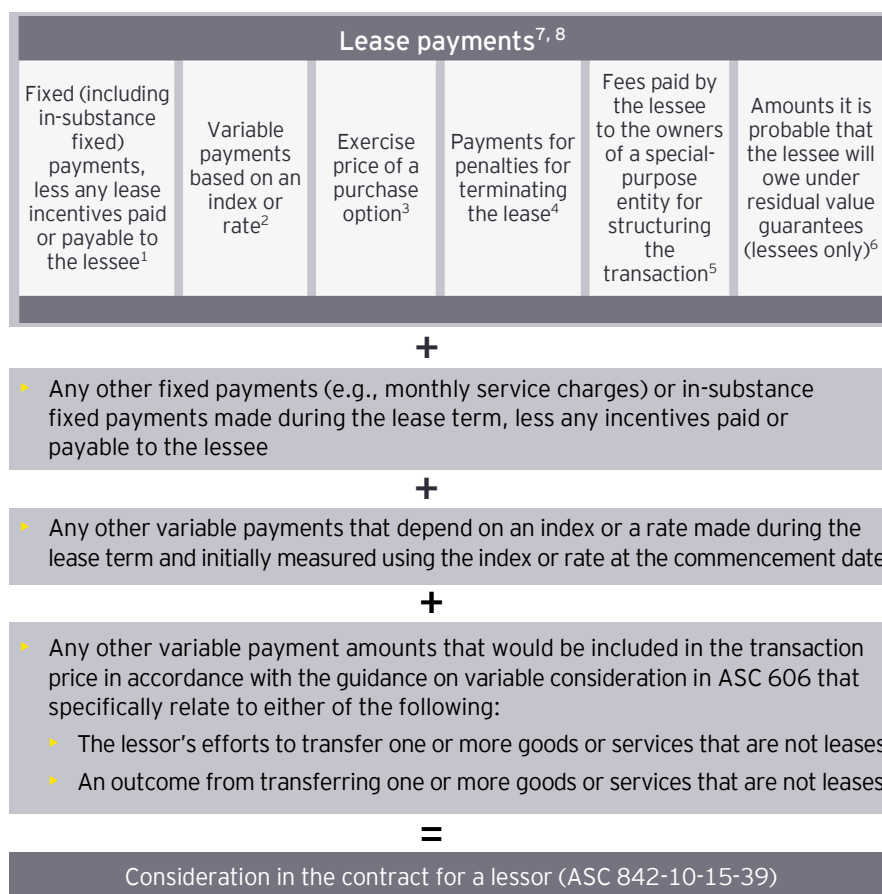
However, this assessment may be challenging for some arrangements that include service elements other than CAM. For example, lessors that operate senior living facilities that provide both residential and health care services have to determine whether the lease component or the combined non-lease component is predominant.

This evaluation is important because it determines if the arrangement will be accounted for under the new leases standard or the revenue standard.

Determining and allocating the consideration in the contract

Determining the consideration in the contract

The following illustration shows the types of payments that a lessor includes as consideration in the contract. References herein refer to our Lease accounting FRD.



¹ Refer to section 2.4.1, *Fixed (including in-substance fixed) lease payments and lease incentives*.

² Refer to section 2.4.2, *Variable lease payments that depend on an index or rate*.

³ Refer to section 2.4.3, *The exercise price of a purchase option*. Include only if reasonably certain of exercise.

⁴ Refer to section 2.4.4, *Payments for penalties for terminating a lease*. Include only if the lease term reflects the lessee exercising an option to terminate the lease.

⁵ Refer to section 2.4.5, *Fees paid by the lessee to the owners of a special-purpose entity for structuring the transaction*.

⁶ Refer to section 2.4.6, *Amounts it is probable that a lessee will owe under residual value guarantees – lessees only*.

⁷ Refer to section 2.4.7, *Payments made by a lessee prior to the beginning of the lease term*.

⁸ In some cases, a lessee may incur costs or make payments (e.g., to the lessor or a third party) for lessor assets (e.g., improvements to the leased property). These payments are treated in the same manner as making a cash payment to the lessor and are accounted for as either fixed or variable payments. Determining whether the payments are fixed or variable depends on the terms and conditions of the contract. Refer to section 2.4.1, *Fixed (including in-substance fixed) lease payments and lease incentives*, and section 2.4.2, *Variable lease payments that depend on an index or rate*.

Allocating the consideration in the contract

Lessors allocate the consideration in the contract, as defined by ASC 842, to the separate lease and non-lease components generally on a relative standalone selling price basis, consistent with the guidance in ASC 842-10-15-38. The leases guidance requires a lessor to apply ASC 606-10-32-28 through 32-41 to allocate the consideration in the contract to lease and separate non-lease components if they (1) do not make an accounting policy election (by class of underlying asset) to use the optional practical expedient to not separate lease and associated non-lease components or (2) make the accounting policy election but have at least one non-lease component that does not qualify for the expedient. The guidance in this section assumes the entity has separate lease and non-lease components to which consideration must be allocated.

Allocating variable payments

Variable payments that depend on an index or rate and other variable payments that relate to the transfer of or the outcome from transferring one or more goods or services that are not leases are included as consideration in the contract. Variable payments that do not relate, even partially, to a lease component must be estimated, after considering the constraint, at contract inception.

Under the leases standard, variable payments included as consideration in the contract are allocated to the lease and non-lease components unless allocating the variable payments entirely to the non-lease components to which they relate is consistent with the transaction price allocation objective in ASC 606-10-32-28 (i.e., the variable payments would be allocated entirely to the non-lease components if doing so depicts the amount of consideration to which the lessor expects to be entitled in exchange for transferring the non-lease components). If the variable consideration allocation exception is met, the variable consideration (e.g., CAM payments received) is allocated to a specific part of the contract to which the consideration relates (e.g., a distinct month of services). See Step 4 of the revenue model in the Appendix for the criteria.

Variable payments that do not depend on an index or rate that relate, even partially, to a lease component are excluded from consideration in the contract. When the changes in facts and circumstances on which the variable payment is based occurs, a lessor allocates those payments to the lease and non-lease components of the contract generally on a relative standalone selling price basis.²

The amount of variable payments allocated to the lease component is recognized as income in profit or loss in accordance with ASC 842, and the amount allocated to the non-lease component is recognized in accordance with other guidance, such as ASC 606 if the non-lease component is a good or service provided to a customer.

Refer to section 1.4 of our Lease accounting FRD for further discussion of the guidance on identifying and separating lease and non-lease components, the accounting for lease components and application of the practical expedient.

Components accounted for under the revenue standard

Lessors apply the guidance in the revenue standard when the lessor:

- ▶ Does not elect the optional lessor practical expedient to not separate lease and associated non-lease components described above, and the non-lease components are an output of the lessor's ordinary activities. The lessor accounts for the lease component under the leases standard and the non-lease component under the revenue standard.
- ▶ Elects the optional lessor practical expedient to not separate lease and associated non-lease components and concludes the non-lease component is the predominant component. The lessor accounts for the combined component under the revenue standard.

Lessors allocate the consideration in the contract, as defined by ASC 842, to the separate lease and non-lease components generally on a relative standalone selling price basis.

- ▶ Elects the optional lessor practical expedient to not separate lease and associated non-lease components and identifies a non-lease component that does not qualify for the expedient (i.e., the criteria to elect the practical expedient are not met). The lessor accounts for the combined qualifying component as an operating lease under the leases standard if the lease component is predominant or under the revenue standard if the combined qualifying non-lease component is the predominant component. The lessor accounts for the non-lease component that does not qualify for the expedient under the revenue standard if that component is an output of the lessor's ordinary activities.

For components that are accounted for under the revenue standard, lessors evaluate the criteria in ASC 606 to determine whether the goods or services identified (e.g., utilities, construction services) are distinct (by themselves or as part of a bundle of goods and services) and, therefore, performance obligations. The goods or services are distinct if they are both capable of being distinct and distinct within the context of the contract.

Distinct goods or services that meet certain criteria, including that they are "substantially the same and have the same pattern of transfer" to the lessee, must be accounted for as a single performance obligation under the series guidance.

See the discussion of Step 2 of the revenue model in the Appendix. As noted above, lease and non-lease component(s) that meet the criteria for the lessor practical expedient must be accounted for as a single performance obligation under the revenue guidance when the lessor elects the expedient and determines the non-lease component is the predominant component.

Lessors recognize the consideration in the contract (and any other variable payments not included as consideration in the contract under ASC 842) allocated to the non-lease component(s) in accordance with the guidance on the satisfaction of performance obligations in ASC 606-10-25-23 through 25-37. Under the guidance, payments allocated to the non-lease component(s) are recognized as the lessor transfers control¹³ of the services (i.e., as it provides the services) to the customer.

Entities also are required to apply the presentation and disclosure guidance in the revenue standard to the non-lease components accounted for under the revenue standard (discussed below).

Non-lease elements in the scope of ASC 606 (before adoption of ASC 842)

Identifying and separating lease and non-lease elements and allocating arrangement consideration in the contract

ASC 840 requires non-lease elements (i.e., substantial services) in a lease contract to be separated from the lease element at lease inception or upon a reassessment of the arrangement. Reimbursements the lessor receives for lease-related executory costs (e.g., insurance, maintenance, taxes) are considered part of the lease element under this guidance.

The guidance in ASC 840-10-15-19 requires a lessor to allocate the arrangement consideration between the lease and non-lease elements generally on a relative standalone selling price basis, consistent with the guidance in ASC 606-10-15-4 and ASC 606-10-32-28 through 32-41. Consideration allocated to the non-lease elements transferred to a customer (i.e., substantial services) is accounted for under the guidance in the revenue standard, while consideration allocated to the lease element is accounted for under ASC 840.

Revenue recognition for non-lease elements

Lessors must evaluate the criteria in the revenue standard to determine whether the goods or services identified as non-lease elements that are transferred to a customer are distinct (by themselves or as part of a bundle of goods and services) and, therefore, performance obligations.

The goods or services are distinct if they are both capable of being distinct and distinct within the context of the contract. Distinct goods or services that meet certain criteria, including that they are “substantially the same and have the same pattern of transfer” to the lessee, must be accounted for as a single performance obligation under the series guidance in the revenue standard. See the discussion of Step 2 of the new revenue model in the Appendix. Real estate entities recognize revenue for each performance obligation either over time or at a point in time as or when control of the underlying goods or services is transferred to the customer. See the discussion of Step 5 in the Appendix.

Entities also are required to apply the presentation and disclosure guidance in the revenue standard to the non-lease elements accounted for under the revenue standard (discussed below).

How we see it

Real estate entities need to carefully evaluate their lease contracts to identify substantial services that are in the scope of the revenue standard. Entities may not have historically focused on identifying lease and non-lease elements because the accounting for an operating lease and a related service contract was often the same. This may require more robust processes to identify the lease and non-lease elements of contracts so they could comply with the expanded presentation and disclosure requirements of the revenue standard.

Lessors with non-lease components in the scope of the revenue standard are required to make significantly more disclosures than they did under the legacy revenue guidance.

Presentation and disclosure

Lessors with arrangements in the scope (or partially in the scope) of the revenue standard are required to make significantly more disclosures in their interim and annual financial statements than they did under the legacy revenue guidance. Public entities, as defined in the revenue standard, must provide a comprehensive set of disclosures that include disaggregated revenues and qualitative and quantitative information about contracts with customers, significant judgments made in applying the standard and costs to obtain or fulfill a contract. Nonpublic entities can choose to provide the same or streamlined disclosures. The new quantitative disclosures real estate entities need to make include the following:

- ▶ Disclose (or present in the statement of comprehensive income) the amount of revenue recognized from contracts with customers separately from other sources of revenue (e.g., income from leases)
- ▶ Disclose (or present separately in the financial statements) all of the following:
 - ▶ The opening and closing balances of receivables, contract assets and contract liabilities¹⁴ from contracts with customers
 - ▶ Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period
 - ▶ Revenue recognized in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods

In addition, a lessor that elects and applies the optional lessor practical expedient to combine non-lease and associated lease components after adoption of ASC 842, including a lessor that accounts for the combined component entirely in accordance with ASC 606, is required to make additional disclosures in accordance with ASC 842. Refer to our Lease accounting FRD for further discussion.

How we see it

Because the revenue standard requires entities to separately disclose contract balances from contracts with customers, it is necessary for entities that have material receivables from non-ASC 606 contracts to separate these balances for disclosure purposes. For example, a real estate operating entity may have accounts receivable relating to leasing contracts that need to be disclosed separately from accounts receivable related to contracts with customers. Entities that elect the optional practical expedient for lessors in the new leases standard also need to make additional required disclosures. This may require new systems, policies and procedures, and internal controls to collect and disclose the required information.

Endnotes:

- ¹ The new leases standard was effective for public business entities and certain not-for-profit (NFP) entities and employee benefit plans for annual periods beginning after 15 December 2018 and interim periods within those years. The standard is effective for private companies and most NFP entities for annual periods beginning after 15 December 2021 and interim periods beginning after 15 December 2022. For NFPs that have issued or are conduit bond obligors for securities listed, traded or quoted on an exchange or over-the-counter market and that have not yet issued (or made available for issuance) financial statements that reflect the new standard as of 3 June 2020, the standard is effective for annual periods beginning after 15 December 2019 and interim periods within those annual reporting periods. Early adoption is permitted.
- ² ASC 606, *Revenue from Contracts with Customers*, as amended, and created by ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and various amendments.
- ³ ASU 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*
- ⁴ ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.
- ⁵ ASC 610-20, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets*, as created by ASU 2014-09 and amended by ASU 2017-05, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*.
- ⁶ ASC 323, *Investments – Equity Method and Joint Ventures*.
- ⁷ The revenue standard requires that the entity identify the promised goods or services in the contract. For purposes of simplifying this discussion of property management services, we assumed that the contract does not contain any promised goods (i.e., only services are promised) and have eliminated any references to the evaluation thereof. Paragraph BC285 of ASU 2014-09.
- ⁸ The discussion on leasing services only applies when the service provider is performing services on behalf of the lessee or lessor and is not a lessee or lessor in the arrangement. Prior to the adoption of ASU 2016-02, *Leases (Topic 842)*, lessees and lessors must apply the guidance in ASC 840 to their lease arrangements. After the adoption of ASU 2016-02, lessees and lessors must apply the guidance in ASC 842 to their lease arrangements.
- ⁹ The two criteria not likely to be met are “the entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced” and “the entity’s performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.”
- ¹⁰ The Basis for Conclusions of ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, says, “The Board emphasized that determining whether the lease component (if accounted for separately) would be classified as an operating lease generally should not require a detailed quantitative analysis but, rather, can often be determined using a reasonable qualitative assessment.”
- ¹¹ If the terms of these variable payment amounts relate to the lease component, even partially, lessors allocate those payments to the lease and non-lease components when the changes in facts and circumstances on which the variable payments are based occur unless the variable payment meets the criteria in ASC 606-10-32-40 to be allocated only to the lease component(s). Refer to section 1.4.4.3 of our Lease accounting FRD for further discussion.
- ¹² As described in the Appendix, the revenue standard sets three criteria for evaluating whether control of a good or service is transferred over time. Contracts to provide services (e.g., CAM) will generally meet the criteria that “the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs,” but an entity needs to evaluate each arrangement to reach this conclusion. Consideration from arrangements that do not meet the criteria for over-time recognition is recognized at a point in time.
- ¹³ ASC 606 defines a contract asset as “an entity’s right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity’s future performance)” and a contract liability as “an entity’s obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer.”

Appendix: The five-step revenue model and contract costs

The standard's core principle is that an entity recognizes revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer. That principle is applied using five steps that require entities to exercise judgment when considering the terms of their contract(s) and all relevant facts and circumstances. Entities have to apply the requirements of the standard consistently to contracts with similar characteristics and in similar circumstances. This table summarizes the new revenue model and the guidance for contract costs.

Step 1: Identify the contract(s) with the customer
<p><i>Definition of a contract</i></p> <p>An entity must first identify the contract, or contracts, to provide goods and services to customers. A contract must create enforceable rights and obligations to fall within the scope of the model in the standard. Such contracts may be written, oral or implied by an entity's customary business practices but must meet the following criteria:</p> <ul style="list-style-type: none"> ▶ The parties to the contract have approved the contract (in writing, orally or based on their customary business practices) and are committed to perform their respective obligations. ▶ The entity can identify each party's rights regarding the goods or services to be transferred. ▶ The entity can identify the payment terms for the goods or services to be transferred. ▶ The contract has commercial substance (i.e., the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract). ▶ It is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. <p>If these criteria are not met, an entity would not account for the arrangement using the model in the standard and would recognize any nonrefundable consideration received as revenue only when certain events have occurred.</p> <p><i>Contract combination</i></p> <p>The standard requires entities to combine contracts entered into at or near the same time with the same customer (or related parties of the customer) if they meet any of the following criteria:</p> <ul style="list-style-type: none"> ▶ The contracts are negotiated as a package with a single commercial objective. ▶ The amount of consideration to be paid in one contract depends on the price or performance of another contract. ▶ The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation. <p><i>Contract modifications</i></p> <p>A contract modification is a change in the scope and/or price of a contract. A contract modification is accounted for as a new contract separate from the original contract if the modification adds distinct goods or services at a price that reflects the standalone selling prices of those goods or services. Contract modifications that are not accounted for as separate contracts are considered changes to the original contract and are accounted for as follows:</p> <ul style="list-style-type: none"> ▶ If the goods and services to be transferred after the contract modification are distinct from the goods or services transferred on or before the contract modification, the entity should account for the modification as if it were the termination of the old contract and the creation of a new contract. ▶ If the goods and services to be transferred after the contract modification are not distinct from the goods and services already provided and, therefore, form part of a single performance obligation that is partially satisfied at the date of modification, the entity should account for the contract modification as if it were part of the original contract. ▶ A combination of the two approaches above: a modification of the existing contract for the partially satisfied performance obligations and the creation of a new contract for the distinct goods and services

Step 2: Identify the performance obligation(s) in the contract

An entity must identify the promised goods and services within the contract and determine which of those goods and services (or bundles of goods and services) are separate performance obligations (i.e., the unit of accounting for purposes of applying the standard). An entity is not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract.

A promised good or service represents a performance obligation if (1) the good or service is distinct (by itself or as part of a bundle of goods or services) or (2) the good or service is part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer.

A good or service (or bundle of goods or services) is distinct if both of the following criteria are met:

- ▶ The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e., the good or service is capable of being distinct).
- ▶ The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e., the promise to transfer the good or service is distinct within the context of the contract).

In assessing whether an entity's promise to transfer a good or service is separately identifiable from other promises in the contract, entities need to consider whether the nature of the promise is to transfer each of those goods or services individually or to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate two or more promises to transfer goods or services are not separately identifiable include, but are not limited to, the following:

- ▶ The entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represents the combined output or outputs for which the customer has contracted.
- ▶ One or more of the goods or services significantly modify or customize, or are significantly modified or customized by, one or more of the other goods or services promised in the contract.
- ▶ The goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract.

If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct.

Series guidance

Goods or services that are part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer must be combined into one performance obligation. To meet the same pattern of transfer criterion, each distinct good or service in the series must represent a performance obligation that would be satisfied over time and would have the same measure of progress toward satisfaction of the performance obligation (both discussed in Step 5), if accounted for separately.

Customer options for additional goods or services

A customer's option to acquire additional goods or services (e.g., an option for free or discounted goods or services) is accounted for as a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).

Principal versus agent considerations

When more than one party is involved in providing goods or services to a customer, an entity must determine whether it is a principal or an agent in these transactions by evaluating the nature of its promise to the customer. An entity is a principal and, therefore, records revenue on a gross basis if it controls the specified good or service before transferring that good or service to the customer. An entity is an agent and records as revenue the net amount it retains for its agency services if its

role is to arrange for another entity to provide the specified goods or services. Because it is not always clear whether an entity controls a specified good or service in some contracts (e.g., those involving intangible goods and/or services), the standard also provides indicators of when an entity may control the specified good or service as follows:

- ▶ The entity is primarily responsible for fulfilling the promise to provide the specified good or service.
- ▶ The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (e.g., if the customer has a right of return).
- ▶ The entity has discretion in establishing the price for the specified good or service.

Step 3: Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. When determining the transaction price, entities need to consider the effects of all of the following:

Variable consideration

An entity needs to estimate any variable consideration (e.g., amounts that vary due to discounts, rebates, refunds, price concessions, bonuses) using either the expected value method (i.e., a probability-weighted amount method) or the most likely amount method (i.e., a method to choose the single most likely amount in a range of possible amounts). An entity's method selection is not a "free choice" and must be based on which method better predicts the amount of consideration to which the entity will be entitled. To include variable consideration in the estimated transaction price, the entity has to conclude that it is probable that a significant revenue reversal will not occur in future periods. This "constraint" on variable consideration is based on the probability of a reversal of an amount that is significant relative to cumulative revenue recognized for the contract. The standard provides factors that increase the likelihood or magnitude of a revenue reversal, including the following: the amount of consideration is highly susceptible to factors outside the entity's influence, the entity's experience with similar types of contracts is limited or that experience has limited predictive value, or the contract has a large number and broad range of possible outcomes. The standard requires an entity to estimate variable consideration, including the application of the constraint, at contract inception and update that estimate at each reporting date.

Significant financing component

An entity needs to adjust the transaction price for the effects of the time value of money if the timing of payments agreed to by the parties to the contract provides the customer or the entity with a significant financing benefit. As a practical expedient, an entity can elect not to adjust the transaction price for the effects of a significant financing component if the entity expects at contract inception that the period between payment and performance will be one year or less.

Noncash consideration

When an entity receives, or expects to receive, noncash consideration (e.g., property, plant or equipment; a financial instrument), the fair value of the noncash consideration at contract inception is included in the transaction price.

Consideration paid or payable to the customer

Consideration payable to the customer includes cash amounts that an entity pays, or expects to pay, to the customer, credits or other items (vouchers or coupons) that can be applied against amounts owed to the entity or equity instruments granted in conjunction with selling goods or services. An entity should account for consideration paid or payable to the customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service. However, if the payment to the customer exceeds the fair value of the distinct good or service received, the entity should account for the excess amount as a reduction of the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract

For contracts that have multiple performance obligations, the standard generally requires an entity to allocate the transaction price to the performance obligations in proportion to their standalone selling prices (i.e., on a relative standalone selling price basis). When allocating on a relative standalone selling price basis, any discount within the contract generally is allocated proportionately to all of the performance obligations in the contract. However, there are two exceptions.

One exception requires variable consideration to be allocated entirely to a specific part of a contract, such as one or more (but not all) performance obligations or one or more (but not all) distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation, if both of the following criteria are met:

- ▶ The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service.
- ▶ Allocating the variable consideration entirely to the performance obligation or the distinct good or service is consistent with the objective of allocating consideration in an amount that depicts the consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

The other exception requires an entity to allocate a contract's entire discount to only those goods or services to which it relates if certain criteria are met.

To allocate the transaction price on a relative standalone selling price basis, an entity must first determine the standalone selling price of the distinct good or service underlying each performance obligation. The standalone selling price is the price at which an entity would sell a good or service on a standalone (or separate) basis at contract inception. Under the model, the observable price of a good or service sold separately in similar circumstances to similar customers provides the best evidence of standalone selling price. However, in many situations, standalone selling prices will not be readily observable. In those cases, the entity must estimate the standalone selling price by considering all information that is reasonably available to it, maximizing the use of observable inputs and applying estimation methods consistently in similar circumstances. The standard states that suitable estimation methods include, but are not limited to, an adjusted market assessment approach, an expected cost plus a margin approach or a residual approach (if certain conditions are met).

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

An entity recognizes revenue only when (or as) it satisfies a performance obligation by transferring control of the promised good(s) or service(s) to a customer. The transfer of control can occur over time or at a point in time.

A performance obligation is satisfied at a point in time unless it meets one of the following criteria, in which case it is satisfied over time:

- ▶ The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- ▶ The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
- ▶ The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.

The transaction price allocated to performance obligations satisfied at a point in time is recognized as revenue when control of the goods or services transfers to the customer. If the performance obligation is satisfied over time, the transaction price allocated to that performance obligation is recognized as revenue as the performance obligation is satisfied. To do this, the standard requires an entity to select a single revenue recognition method (i.e., measure of progress) that faithfully depicts the pattern of the transfer of control over time (i.e., an input method or an output method).

Licenses of intellectual property

The standard provides guidance on the recognition of revenue for licenses of intellectual property (IP) that differs from the model for other promised goods and services. The nature of the promise in granting a license of IP to a customer is either:

- ▶ A right to access the entity's IP throughout the license period (a right to access)
- ▶ A right to use the entity's IP as it exists at the point in time in which the license is granted (a right to use)

To determine whether the entity's promise is to provide a right to access its IP or a right to use its IP, the entity should consider the nature of the IP to which the customer will have rights. The standard requires entities to classify IP in one of two categories:

- ▶ **Functional:** This IP has significant standalone functionality (e.g., many types of software; completed media content, such as films, television shows and music). Licenses of functional IP generally grant a right to use the entity's IP, and revenue for these licenses generally is recognized at the point in time when the IP is made available for the customer's use and benefit. This is the case if the functionality is not expected to change substantially as a result of the licensor's ongoing activities that do not transfer an additional promised good or service to the customer. If the functionality of the IP is expected to substantively change because of activities of the licensor that do not transfer additional promised goods or services, and the customer is contractually or practically required to use the latest version of the IP, revenue for the license is recognized over time. However, we expect licenses of functional IP to meet the criteria to be recognized over time infrequently, if at all.
- ▶ **Symbolic:** This IP does not have significant standalone functionality (e.g., brands, team and trade names, character images). The utility (i.e., the ability to provide benefit or value) of symbolic IP is largely derived from the licensor's ongoing or past activities (e.g., activities that support the value of character images). Licenses of symbolic IP grant a right to access an entity's IP, and revenue from these licenses is recognized over time as the performance obligation is satisfied (e.g., over the license period).

Revenue cannot be recognized from a license of IP before both (1) an entity provides (or otherwise makes available) a copy of the IP to the customer and (2) the beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the IP.

The standard specifies that sales and usage-based royalties on licenses of IP are recognized when the later of the following events occurs: (1) the subsequent sales or usage occurs or (2) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied). This guidance must be applied to the overall royalty stream when the sole or predominant item to which the royalty relates is a license of IP (i.e., these types of arrangements are either entirely in the scope of this guidance or entirely in the scope of the general variable consideration constraint guidance).

Contract costs

ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers*, specifies the accounting for costs an entity incurs to obtain and fulfill a contract to provide goods and services to customers. The incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) are recognized as an asset if the entity expects to recover them. ASC 340-40 cites commissions as a type of incremental costs that may require capitalization. The standard provides a practical expedient that permits an entity to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less.

An entity accounts for costs incurred to fulfill a contract with a customer that are within the scope of other authoritative guidance (e.g., inventory; property, plant and equipment; internal-use software) in accordance with that guidance. If the costs are not in the scope of other accounting guidance, an entity recognizes an asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:

- ▶ The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify.
- ▶ The costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future.
- ▶ The costs are expected to be recovered.

Any capitalized contract costs are amortized, with the expense recognized as an entity transfers the related goods or services to the customer. Any asset recorded by the entity is subject to an impairment assessment.