**STEP ONE: IDENTIFY THE CONTRACT**

- Delivery of goods without a signed agreement.
- Goods under a customer’s control before an ASC 606 contract exists.

**EXAMPLE:** Satisfying a rush order for an important customer without an agreement.

**STEP TWO: IDENTIFY THE PERFORMANCE OBLIGATIONS**

- Review contract terms for ASC 606 implications, particularly custom arrangements for significant customers.
- Review existing arrangements for service-type warranties, free products or services, and discounts on future sales. These may be separate performance obligations.
  - Warranties: Extended service warranties that can be purchased separately are a separate performance obligation; basic assurance type warranties are not.
  - Certain customer options are deemed to be a material right (and not variable consideration). A material right is a separate performance obligation (customer is in effect paying in advance for it).
- Shipping and handling: Usually not a separate performance obligation. Synthetic FOB arrangements requires a deeper dive.

**EXAMPLES:**
- A customer is offered a 15% discount on a future purchase. This could be considered a separate performance obligation if it is deemed to be a material right.
- An extended warranty that is purchased by the customer.

**STEP THREE: DETERMINE THE TRANSACTION PRICE**

- High quality, probable variable consideration is now considered and included in the transaction price. This includes:
  - Sales/volume discounts
  - Price protection guarantees

**EXAMPLE:** A customer is offered a volume rebate if a cumulative purchase amount is achieved. The probable volume rebate ultimately achieved should be estimated and proportionately allocated to the first sale.
STEP FOUR: ALLOCATE THE TRANSACTION PRICE

☐ This step only applies if there is more than one performance obligation.

EXAMPLE: Allocating the purchase price to an extended warranty which was offered at a discount to an important customer. Must determine the relative standalone selling price for both the goods as well as the warranty, and allocate proportionately.

STEP FIVE: RECOGNIZE REVENUE

☐ Pay attention to the actual terms of the bill of lading in order to determine when control passes to the customer, which may not be the same as the bill of lading date.

☐ Rights of return: Under ASC 606, record an asset for the amount of goods ultimately expected to be returned.

EXAMPLE: 100 units are sold at $60 each, and three units are expected to be returned:

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>DR. COST OF SALES</td>
<td>$5820 ($60*97)</td>
</tr>
<tr>
<td>DR. ASSET</td>
<td>$180 ($60*3)</td>
</tr>
<tr>
<td>CR. INVENTORY</td>
<td>$6000 ($60*100)</td>
</tr>
</tbody>
</table>

☐ Legal title to a good may indicate the party that controls the good. Often, the party with legal title has the ability to direct the use of the asset. When does your legal title pass to your customers?

☐ Bill and hold situations: Physical possession usually is necessary for the customer to control an asset, however ASC 606 requires that certain common sense criteria are met in order for revenue to be recognized (ASC 606-10-55-83). The lack of a fixed delivery schedule would not automatically preclude revenue recognition, unlike today’s guidance.

Email us at info@withum.com for a deeper dive into a sample of revenue transactions.