Interpretation of the Emerging Accounting Issues Working Group

INT 04-18: EITF 00-21: Revenue Arrangements with Multiple Deliverables

ISSUE NULLIFIED BY ASU 2009-13, WHICH WAS REJECTED IN MARCH 2010 AS NOT APPLICABLE TO STATUTORY ACCOUNTING

INT 04-18 Dates Discussed

December 5, 2004; March 13, 2005

INT 04-18 References

SSAP No. 22—Leases (SSAP No. 22)
SSAP No. 40—Real Estate Investments (SSAP No. 40)
SSAP No. 77—Real Estate Sales – An Amendment to SSAP No. 40, Real Estate Investments (SSAP No. 77)
SSAP No. 81—Software Revenue Recognition (SSAP No. 81)

INT 04-18 Issue

1. EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21) discusses how to account for arrangements under which the company will perform multiple revenue-generating activities. Specifically, this Issue addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. Integral to this Issue is the concept that separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. This concept can be overcome if there is sufficient evidence to the contrary. In addition, this Issue discusses how to measure and allocate arrangement consideration to the separate units of accounting. NAIC staff noted that this Issue does not discuss when the criteria for appropriate revenue recognition are met or provide guidance on the appropriate revenue recognition principles.

2. EITF 02-21 contains a useful decision diagram, which is included as Exhibit A. Per EITF 00-21, the applicability of this item to leases, software arrangements and sales of real estate as well as a listing of all Issues are as follows:

> 4. This Issue applies to all deliverables (that is, products, services, or rights to use assets) within contractually binding arrangements (whether written, oral, or implied, and hereinafter referred to as "arrangements") in all industries under which a vendor will perform multiple revenue-generating activities, except as follows:
>
> a. A multiple-deliverable arrangement or a deliverable(s) in a multiple-deliverable arrangement may be within the scope of higher-level authoritative literature.[1] That higher-level authoritative literature (including, but not limited to, Statements 13, 45, and 66; Interpretation 45; Technical Bulletin 90-1; and SOP48 Tw 13.885 0 ddeG0.699 513 Td[m tD]TJ90-1)6(;)3(

deliverable arrangement. The following describes the three categories into which that higher-level literature falls and the application of this Issue or the higher-level literature in determining separate units of accounting and allocating arrangement consideration:

Superseded SSAPs and Nullifie

• Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values (or as otherwise provided in paragraph 12). The amount allocated to the delivered item(s) is limited as discussed in paragraph 14.

• Applicable revenue recognition criteria should be considered separately for separate units of accounting.

Application Guidance

Units of Accounting (Issue 1)

8. A vendor should evaluate all deliverables in an arrangement to determine whether they represent separate units of accounting. That evaluation must be performed at the inception of the arrangement and as each item in the arrangement is delivered.

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

a. The delivered item(s) has value to the customer on a standalone basis. That item(s) has value on a standalone basis if it is sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), the Task Force observed that this criterion does not require the existence of an observable market for that deliverable(s).

b. There is objective and reliable evidence of the fair value of the undelivered item(s).

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

Refer to the flowchart in Exhibit 00-21A for an illustration of the above criteria. The criteria for dividing an arrangement into separate units of accounting should be applied consistently to arrangements with similar characteristics and in similar circumstances.

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

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

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

12. If there is objective and reliable evidence of fair value (as discussed in paragraph 16) for all units of accounting in an arrangement, the arrangement consideration should be allocated to the separate units of accounting based on their relative fair values (the relative fair value method), except as specified in paragraph 13. However, there may be cases in which there is objective and reliable evidence of the fair value(s) of the undelivered item(s) in an arrangement but no such evidence for the delivered item(s). In those cases, the residual method should be used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered item(s) equals the total arrangement consideration less the aggregate fair value of the undelivered item(s). The "reverse" residual method (that is, using a residual method to determine the fair value of an undelivered item) is not an acceptable method of allocating arrangement consideration to the separate units of accounting, except as described in paragraph 13.

13. To the extent that any separate unit of accounting in the arrangement (including a delivered item) is required under GAAP to be recorded at fair value (and marked to

market each reporting period thereafter), the amount allocated to that unit of accounting should be its fair value. Under those circumstances, the remainder of arrangement consideration should be allocated to the other units of accounting in accordance with the requirements in paragraph 12.

14. The amount allocable to a delivered item(s) is limited to the amount that is not contingent upon the delivery of additional items or meeting other specified performance conditions (the non-contingent amount). That is, the amount allocable to the delivered item(s) is the lesser of the amount otherwise allocable in accordance with paragraphs 12 and 13, above, or the non-contingent amount.

15. The Task Force reached a consensus that the measurement of revenue per period should be limited to the measurement that results from assuming that cancellation of the arrangement will not occur. Theonount al

b. Change references from FASB Statement No. 66, *Accounting for Sales of Real Estate* (Statement 66) to SSAP No. 40 and SSAP No. 77;

c. Change references from AICPA SOP 97-2, *Software Revenue Recognition* (SOP 97-2) to SSAP No. 81;

d. FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (Interpretation 45) has not been reviewed for applicability to statutory accounting as of the date of INT 04-18; and

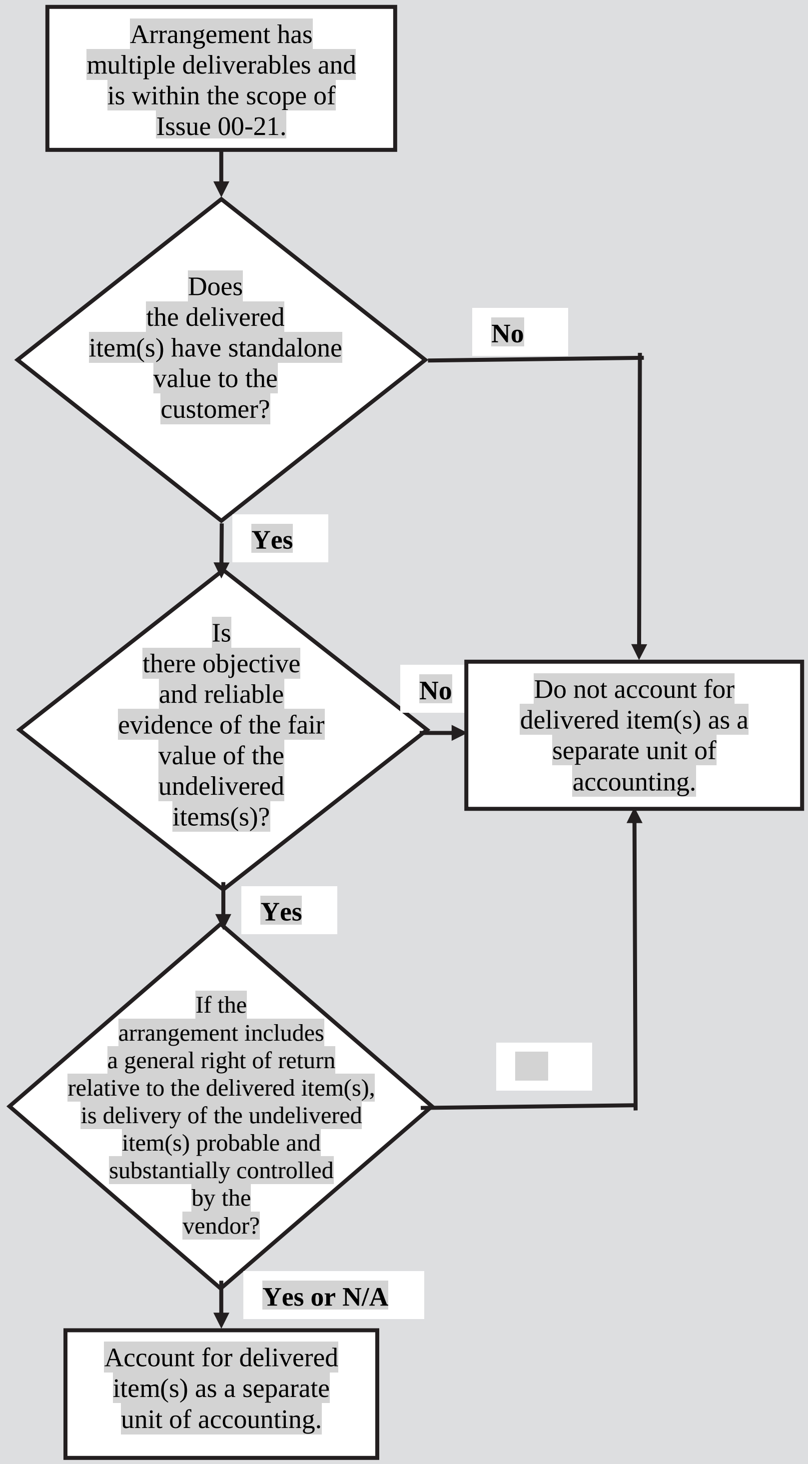
e. References to FASB Statement No. 45, *Accounting for Franchise Fee Revenue* (Statement 45); FASB Technical Bulletin No. *90-1, Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts* (Technical Bulletin 90-1); AICPA SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP 81-1) and AICPA SOP 00-2, *Accounting by Producers or Distributors of Films* (SOP 00-2) are not applicable to statutory accounting.

INT 04-18 Status

5. No further discussion is planned.

Exhibit A

DETERMINING SEPARATE UNITS OF ACCOUNTING [5]



[5] Issue No. 00-21 Footnote 5—This diagram represents an overview of the provisions of this Issue with respect to determining the separate units of accounting in an arrangement and should; therefore, be reviewed in conjunction with the entire consensus.