ASC 606 Revenue Recognition Checklist

Objective: Ensure the company's revenue recognition process aligns with the five-step model under ASC 606.

Contents

---

1. Identify the Contract(s) with a Customer

- **Review Questions**:
  - Is there a legally enforceable contract (written or oral) with the customer?
  - Are both parties committed to fulfilling their obligations?
  - Can the rights and payment terms be identified?
  - Does the contract have commercial substance (i.e., will it affect the company's financial position)?
  - Is it probable that the company will collect the consideration to which it expects to be entitled?
- **Evidence/Documentation**:
  - Written contracts, purchase orders, or service agreements.
  - Customer correspondence, amendments, and credit evaluations.
  - Documentation of contract enforceability and commercial substance.
- **Red Flags**:
  - Informal or missing contracts.
  - Terms and conditions not clearly documented.
  - Customer creditworthiness not considered.
  - Lack of proof that collection is probable.

---

2. Identify the Performance Obligations in the Contract

- **Review Questions**:
  - Are distinct performance obligations (goods or services) explicitly identified in the contract?
  - Can each good or service be separated and benefit the customer independently (i.e., is it distinct)?
  - Are there bundled goods/services, and if so, can they be separated?
  - Are warranties, customer options for additional goods/services, or contract modifications considered separate performance obligations?
- **Evidence/Documentation**:
  - Contract documentation outlining deliverables.
  - Product or service descriptions.
  - Pricing and terms for bundled services or optional purchases.
  - Contract modifications or amendments.
- **Red Flags**:
  - Incomplete identification of separate performance obligations.
  - Improper classification of warranties, discounts, or options.
  - Performance obligations that are interdependent but incorrectly separated.

---

3. Determine the Transaction Price

- **Review Questions**:
    - Is the transaction price clear and determinable?
    - Does the contract include variable consideration (e.g., discounts, rebates, performance bonuses)?
    - Are significant financing components (e.g., long-term payment terms) considered when determining the transaction price?
    - Are non-cash considerations (e.g., barter arrangements) properly valued?
    - Are consideration payable to the customer (e.g., discounts, rebates, commissions) properly accounted for?
- **Evidence/Documentation**:
    - Pricing terms in contracts or purchase orders.
    - Details of variable considerations (performance bonuses, discounts).
    - Payment schedules showing any significant financing components.
    - Documentation for non-cash consideration or customer discounts.
- **Red Flags**:
    - Inconsistent or incomplete documentation of variable considerations.
    - Lack of consideration for significant financing components.
    - Over- or underestimating non-cash consideration.

---

4. Allocate the Transaction Price to the Performance Obligations

- **Review Questions**:
  - Is the transaction price allocated to each performance obligation based on their standalone selling prices?
  - For goods or services that don't have an observable price, are estimates (adjusted market assessment, expected cost plus margin, etc.) used appropriately to allocate the price?
  - Are discounts, variable considerations, or performance bonuses allocated to specific performance obligations, if applicable?
- **Evidence/Documentation**:
  - Standalone selling prices for each good or service (observable prices or estimation method used).
  - Contracts showing how price is allocated across obligations.
  - Documentation of allocation methods for bundled services or products.
- **Red Flags**:
  - Misallocation of discounts or variable considerations across performance obligations.
  - Arbitrary or unsupported estimates for performance obligations without observable selling prices.
  - No clear rationale for allocated transaction prices.

---

5. Recognize Revenue When (or as) the Entity Satisfies a Performance Obligation

- **Review Questions**:
    - Is revenue recognized at a point in time (when control transfers) or over time (as the performance obligation is satisfied)?
    - For revenue recognized over time, are the appropriate methods used (e.g., output or input methods such as milestones reached, hours worked, or resources consumed)?
    - Are contract fulfillment costs (e.g., costs to obtain or fulfill a contract) capitalized and amortized properly?
    - Does the company use proper indicators to determine the transfer of control (e.g., customer acceptance, legal title transfer, physical possession, or risks/rewards)?
- **Evidence/Documentation**:
    - Recognition methods (point-in-time or over-time).
    - Milestones, delivery records, or completion certificates.
    - Output or input methods calculations (e.g., progress reports, timesheets, cost incurred).
    - Customer acceptance records, shipping logs, legal transfer documents.
- **Red Flags**:
    - Revenue recognized too early or delayed.
    - Misapplication of output/input methods.
    - Lack of clear criteria for determining transfer of control.
    - Missing or inaccurate documentation of performance completion.

---

6. Review of Specific Situations

- **Licenses of Intellectual Property**:
    - Does the license grant a right to use (point-in-time recognition) or a right to access (over-time recognition)?
- **Action Steps**:
    - Review contracts that involve IP or technology licensing.
    - Determine whether the contract language indicates ongoing support or updates (access), or a one-time sale (use).
- **Warranties**:
    - Are warranties accounted for as a separate performance obligation, or are they considered an assurance-type warranty that doesn't affect revenue recognition?
- **Action Steps**:
    - Review warranty terms and conditions for all product-related contracts.
- **Principal vs. Agent Consideration**:
    - Is the company acting as the principal (controlling the goods/services) or as an agent (arranging for another party to provide the goods/services)?
- **Action Steps**:
    - Examine if the company records revenue as gross (principal) or net (agent), and confirm consistency with ASC 606.

---

7. Disclosures

- **Review Questions**:
  - Are the required revenue-related disclosures present in the financial statements (e.g., disaggregation of revenue, contract balances, significant judgments)?
  - Are disclosures transparent regarding the timing of revenue recognition, significant judgments in applying ASC 606, and methods used for estimating variable consideration?
- **Evidence/Documentation**:
  - Financial statement notes with detailed revenue disclosures.
  - Documentation of significant judgments (e.g., performance obligation identification, pricing allocation).
  - Disclosure of contract assets and liabilities.
- **Red Flags**:
  - Missing or inadequate revenue disclosures.
  - Lack of explanation for variable consideration or pricing estimates.
  - Insufficient detail on how revenue is disaggregated (e.g., by geography, product line, or customer type).

---

8. Cross-Checks and Substantive Tests

- **Action Steps**:
  - Reconcile GL accounts related to **Sales Revenue**, **Deferred Revenue**, **Contract Assets**, and **Contract Liabilities**.
  - Test revenue recognition for a sample of contracts by tracing them through the five-step model.
  - Cross-check accrued revenue with actual performance completion data (e.g., project or service milestones).
- **Red Flags**:
  - Mismatches between revenue recognition entries and supporting documentation.
  - Deferred revenue balances that don't decrease as performance obligations are fulfilled.