

If an arrangement (*i.e.*, outside the scope of SOP 81–1) requires the delivery or performance of multiple deliverables, or “elements,” the existence of undelivered elements may affect the conclusion as to whether revenue for a delivered element may be recognized as discussed in EITF Issue 00–21.⁸

In licensing and similar arrangements (*e.g.*, licenses of motion pictures, software, technology, and other intangibles), the staff believes that delivery does not occur for revenue recognition purposes until the license term begins.⁹ Accordingly, if a licensed product or technology is physically delivered to the customer, but the license term has not yet begun, revenue should not be recognized prior to inception of the license term. Upon inception of the license term, revenue should be recognized in a manner

⁸ Paragraph 4 of EITF Issue 00–21 describes the scope of that consensus. As of the January 23, 2003 of the EITF (the EITF subsequently established a working group to revisit the scope of the consensus; accordingly, registrants should consult the current EITF Abstract for the final resolution of the scope of the consensus), paragraph 4 states that “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. To the extent that a deliverable(s) in an arrangement is within the scope of other existing higher-level authoritative literature that provides guidance on whether and/or how to separate multiple-deliverable arrangements and how to allocate value among those separate units of accounting (including, but not limited to, Statements 13, 45, and 66; Technical Bulletin 90–1; and SOPs 81–1, 997–2, and 00–2), that deliverable(s) should be accounted for in accordance with that literature. However, if that arrangement also includes a deliverable(s) that is *not* within the scope of such higher-level literature, this Issue should be applied to determine (1) whether that deliverable(s) represents a separate unit of accounting from the deliverable(s) that is within the scope of other higher-level literature and, if so, (2) how to allocate the arrangement consideration to the separate units of accounting, unless the higher-level literature provides guidance with respect to (1) or (2), above, for the deliverable(s) that is not otherwise in the scope of the higher-level literature. The literature to be applied first is that which is applicable to the first delivered item(s).

b. Arrangements that include vendor offers to a customer for either (1) free or discounted products or services that will be delivered (either by the vendor or by another unrelated entity) at a future date if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period or (2) a rebate or refund of a determinable cash amount if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period, are excluded from the scope of this Issue. Additionally, arrangements involving the sale of award credits by broad-based loyalty program operators are excluded from the scope of this Issue.”

⁹ SOP 00–2, paragraph 7.

consistent with the nature of the transaction and the earnings process.

Question 4

Facts: Company R is a retailer that offers “layaway” sales to its customers. Company R retains the merchandise, sets it aside in its inventory, and collects a cash deposit from the customer. Although Company R may set a time period within which the customer must finalize the purchase, Company R does not require the customer to enter into an installment note or other fixed payment commitment or agreement when the initial deposit is received. The merchandise generally is not released to the customer until the customer pays the full purchase price. In the event that the customer fails to pay the remaining purchase price, the customer forfeits its cash deposit. In the event the merchandise is lost, damaged, or destroyed, Company R either must refund the cash deposit to the customer or provide replacement merchandise.

Question: In the staff’s view, when may Company R recognize revenue for merchandise sold under its layaway program?

Interpretive Response: Provided that the other criteria for revenue recognition are met, the staff believes that Company R should recognize revenue from sales made under its layaway program upon delivery of the merchandise to the customer. Until then, the amount of cash received should be recognized as a liability entitled such as “deposits received from customers for layaway sales” or a similarly descriptive caption. Because Company R retains the risks of ownership of the merchandise, receives only a deposit from the customer, and does not have an enforceable right to the remainder of the purchase price, the staff would object to Company R recognizing any revenue upon receipt of the cash deposit. This is consistent with item two (2) in the Commission’s criteria for bill-and-hold transactions which states that “the customer must have made a fixed commitment to purchase the goods.”

Question 5

Facts: Registrants may negotiate arrangements pursuant to which they may receive nonrefundable fees upon entering into arrangements or on certain specified dates. The fees may ostensibly be received for conveyance of a license or other intangible right or for delivery of particular products or services. Various business factors may influence how the registrant and customer structure the payment terms. For example, in exchange for a greater up-front fee for an intangible right, the registrant may be willing to receive

lower unit prices for related products to be delivered in the future. In some circumstances, the right, product, or service conveyed in conjunction with the nonrefundable fee has no utility to the purchaser separate and independent of the registrant’s performance of the other elements of the arrangement. Therefore, in the absence of the registrant’s continuing involvement under the arrangement, the customer would not have paid the fee. Examples of this type of arrangement include the following:

- A registrant sells a lifetime membership in a health club. After paying a nonrefundable “initiation fee,” the customer is permitted to use the health club indefinitely, so long as the customer also pays an additional usage fee each month. The monthly usage fees collected from all customers are adequate to cover the operating costs of the health club.

- A registrant in the biotechnology industry agrees to provide research and development activities for a customer for a specified term. The customer needs to use certain technology owned by the registrant for use in the research and development activities. The technology is not sold or licensed separately without the research and development activities. Under the terms of the arrangement, the customer is required to pay a nonrefundable “technology access fee” in addition to periodic payments for research and development activities over the term of the contract.

- A registrant requires a customer to pay a nonrefundable “activation fee” when entering into an arrangement to provide telecommunications services. The terms of the arrangement require the customer to pay a monthly usage fee that is adequate to recover the registrant’s operating costs. The costs incurred to activate the telecommunications service are nominal.

Question: When should the revenue relating to nonrefundable, up-front fees in these types of arrangements be recognized?

Interpretive Response: The staff believes that registrants should consider the specific facts and circumstances to determine the appropriate accounting for nonrefundable, up-front fees. Unless the up-front fee is in exchange for products delivered or services performed that represent the culmination of a separate earnings process,¹⁰ the deferral of revenue is appropriate.

¹⁰ See Concepts Statement 5, footnote 51, for a description of the “earning process.”