Impact of New Revenue Recognition Standards on Public Companies

Part II: Analyzing Adoption Progress

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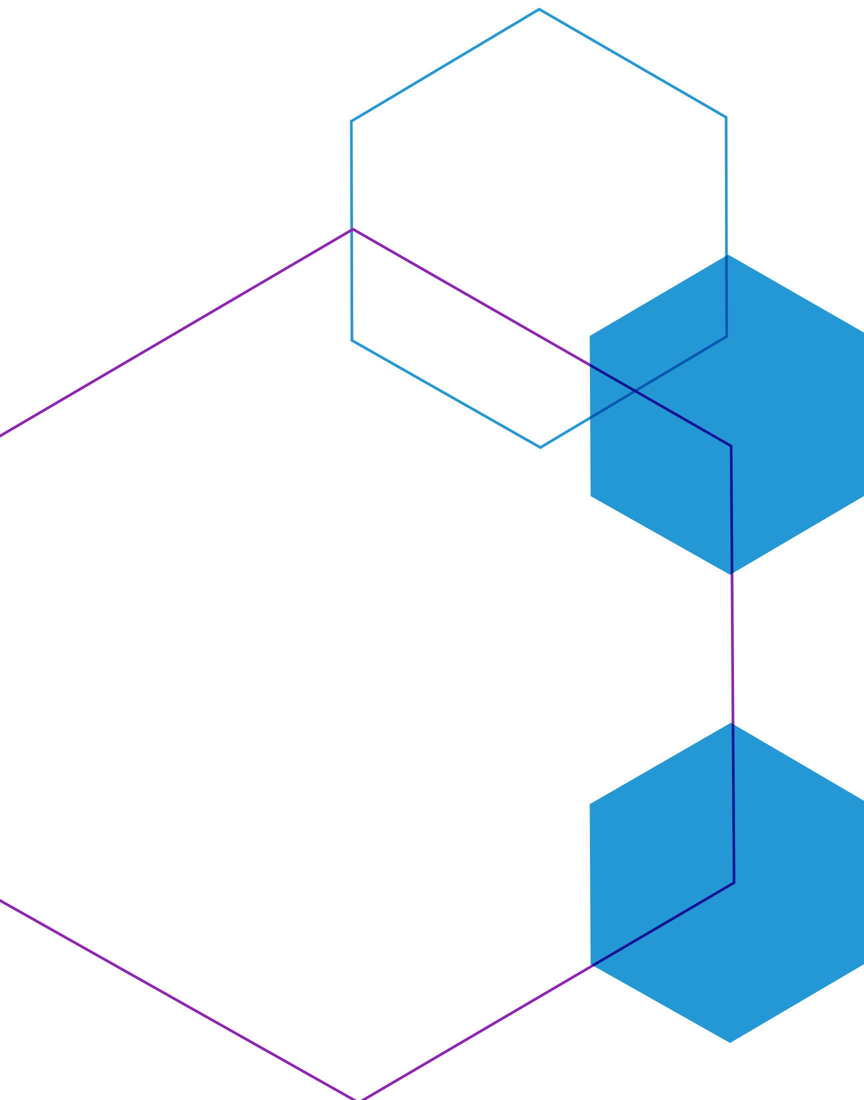

Based on data available on the Intelligize platform
between January 1, 2018 and April 30, 2019

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Background: FASB's New Accounting Standard

For the last 12 years, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) have been hard at work developing a new accounting standard that impacts all entities: public, private and non-profit. Effective for most public companies as of January 1, 2018, the new standard changes Generally Accepted Accounting Principles (GAAP) for FASB Accounting Standards Codification (ASC) Topic 606, *Revenue From Contracts With Customers* (Topic 606). Given the large percentage of businesses with customer contracts, it is difficult to overstate how widespread the impact will be.

In brief, the new standard "does away with the industry-specific, rules-based guidance under which U.S. companies have prepared financial statements in the past and implements a new principles-based standard." This standard uses five steps for determining the creation of a contract:

1. Identify the contract with the customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price.
5. Recognize revenues as performance obligations are satisfied.

One effect of the new standard is to make it easier to compare reporting across industries. That's the good news. The bad news is that it has taken significant work to implement the revenue recognition changes, and the new standard has required companies to make certain judgment calls that were not previously necessary. At least in the short term, this has led to more Securities and Exchange Commission (SEC) review, which may subside once organizations become more familiar with the new standard.

In November 2018, Part I of our white paper series on the new revenue recognition standard, *Examining Early and Standard Adopters*, we looked at the impact of the new accounting standard on the activities of two outlier groups in this process: early adopters and standard adopters. Now in Part II of our series, we use data from the Intelligize platform to check back in on these groups to see how the adoption process has gone. We also analyze the activities of industries, the S&P 500, emerging growth companies (EGCs) and unicorns — companies valued at more than $1 billion — with respect to the adoption of the new accounting standard.

Executive Summary

In November 2018 we took our initial dive into the new revenue recognition standard and its impact on public companies. At that time we analyzed the data available from a comparatively small group of early and standard adopters. Now, in Part II of our white paper series on Topic 606, we look back at the last 15 months to examine the full universe of public companies, how they have handled the adoption of the new standard, and importantly, how the SEC has handled them.

The larger set of companies under SEC review provided a broader insight into what the SEC wanted in companies' Topic 606 disclosures. There appeared to be more emphasis on how companies measured the various steps of their contracts and a willingness to delve deeper into these questions. Determining performance obligations, the timing of recognition, the transfer of control of goods or services, and the establishment of a principal or agent role all seemed to come under additional scrutiny.

For certain companies, the Topic 606 disclosure requirements acted as a microscope into the financial troubles they were suffering. We examine three of them - Kingsway Financial Services, X Financial and Sysorex - in our section on SEC Comment Letters By Industry. In many responses, companies went the extra mile to provide proposed disclosure as appendices based on SEC comments in the hope of minimizing additional inspection. The SEC was also interested in looking at examples of contracts and invoices to better help them understand the interpretations of the company and to facilitate additional exploration by the examiners.

The larger sample also demonstrated the apparent uniformity of the comments when looking at specific industries and, in some cases, the nearly identical questions posed. Though the new standard is meant to measure across all industries, it is difficult to move away from the common factors certain industries present. The intensive concentration on those contracts that include more complicated payment structures such as collaboration and licensing agreements with milestone, royalty or sales-based payments tended to receive multiple comments as the SEC investigated the underlying justifications. We can conclude that this area will be a continued focal point for the SEC but will compete with the adoption of the new lease accounting standard this year.

The relative lack of follow-on comments to the early adopters also suggests the revised disclosure promised in their response letters may have been sufficient for the review process. As additional companies, such as EGCs, begin to come under the adoption requirements, we will be curious to see if the SEC shifts its focus to alternative areas of the requirement, or continues with those areas we have observed.

SEC Comment Letters by Industry

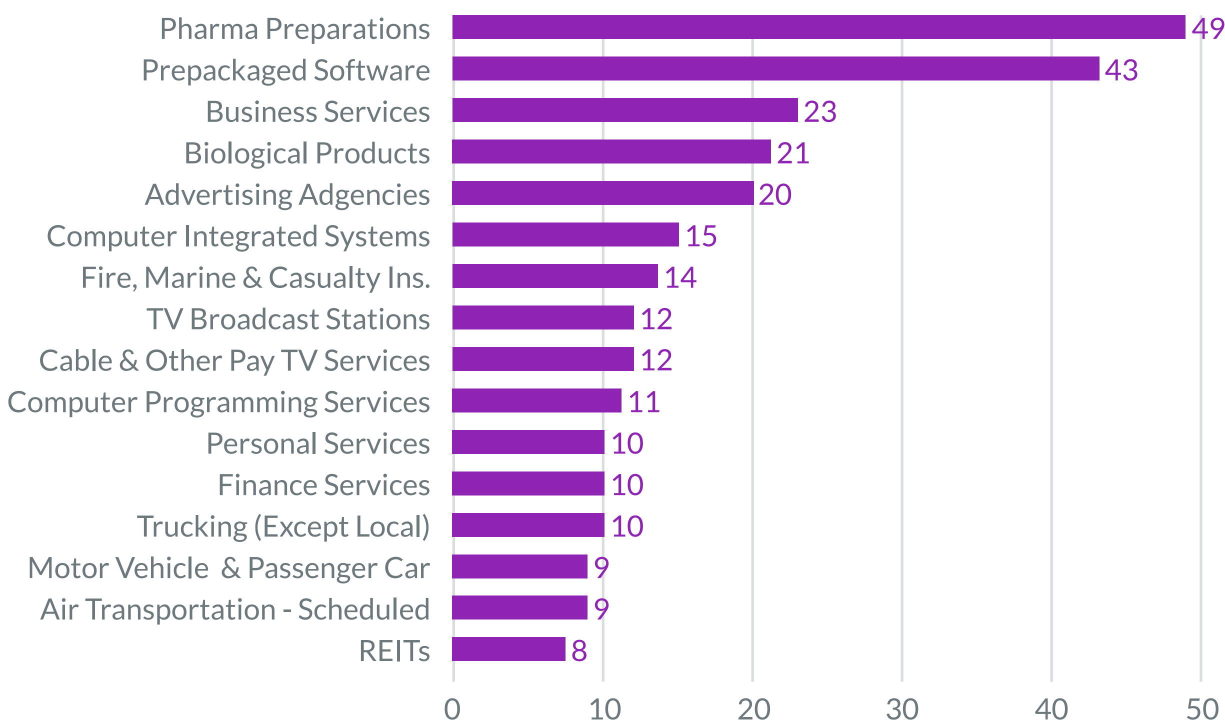
Key Takeaways:

- The Pharmaceutical Preparations and Prepackaged Software Standard Industrial Classification (SIC) codes combined made up nearly 17% of all Topic 606-related SEC comment letters during the timeframe surveyed.
- Our analysis found a correlation between the volume of Topic 606-related SEC comment letters a company received and their perceived revenue streams.
- These industries have the types of contracts most scrutinized by the SEC including license and collaboration agreements with more complicated payment structures such as milestone, royalty or sales-based.

The SEC issued 548 total comment letters on Topic 606 during the 15 months of data we analyzed for this report. One hundred sixteen of those letters, (approximately 20%) were issued to S&P 500 companies, the most prevalent of which are analyzed in the S&P 500 section of this paper.

While the pharmaceutical industry led the way overall with 49 revenue recognition-related comment letters, followed closely by 43 for the prepackaged software SIC Code, the highest number of Topic 606 letters to S&P 500 companies came from the advertising industry (12). In that sector, the Omnicom Group and The Interpublic Group of Companies each received six.

Revenue Recognition-Related SEC Comment Letters by SIC Code



Companies Receiving the Most Revenue-Recognition-Related SEC Comment Letters

Our analysis found a correlation between the volume of Topic 606-related SEC comment letters a company received and their perceived revenue streams. While such a volume of comment letters on these specific topics alone is not a clear indication of a company's financial health (or lack thereof), we will see below that such a relationship does indeed exist.

Kingsway Financial Services

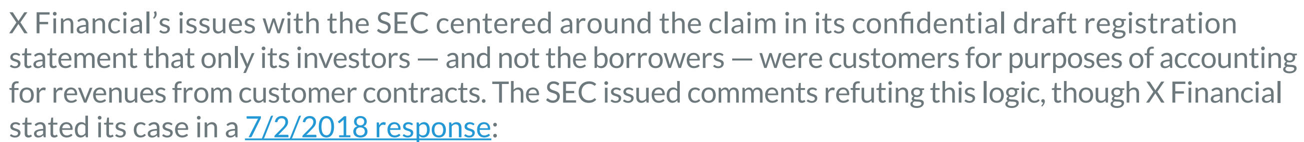
Property and casualty insurance provider Kingsway Financial Services received the most revenue recognition-related comment letters (14). The company's auditors have yet to certify its most recent financial statements, which had to be restated, in part, due to Topic 606 comments. The Topic 606 comment that eventually ended with a restatement was related to warranty subscriptions sold by the company's two wholly-owned subsidiaries, Trinity Warranty Solutions, LLC (Trinity) and PWSC (acquired in October 2017). The SEC review initially began with questions about commissions earned by Trinity but expanded to PWSC and was eventually resolved by restating $990,000 in revenue recognized by PWSC.

Kingsway also filed non-timely notices for its annual and quarterly reports (NT-10-K and NT-10-Q). In addition, at the time of this writing, the company's independent auditors hadn't signed off on those reports and they recently switched audit firms and reorganized under Delaware law instead of Canadian. All of these changes presented ample opportunity for financial hiccups, and so perhaps this high volume of SEC inquiries should not have been unexpected. In a 5/30/2019 press release, the company noted:

> The Company originally issued a press release dated March 14, 2019 reporting certain unaudited 2018 fourth quarter and year-end financial results. The Company subsequently issued a press release dated April 16, 2019 announcing that its outside independent auditors required more time to complete their work and stating that certain of its limited liability investments, previously accounted for under the equity method of accounting, will now be accounted for on a consolidated basis. In its April 16, 2019 press release, the Company described, among other things, adjustments expected to increase shareholders' equity by approximately $4 million; improve net loss by approximately $1.2 million; and improve net loss attributable to common shareholders by approximately $0.8 million. The Company's estimates of those adjustments have not changed.

X Financial

X Financial, a company that provides a peer-to-peer platform for lending services in China, received eight SEC comment letters related to the new revenue recognition standard during the 15 months we analyzed. The company had a disappointing debut on the New York Stock Exchange (NYSE) in September 2018, raising $104.5 million. It had originally hoped to raise $250 million.



X Financial's issues with the SEC centered around the claim in its confidential draft registration statement that only its investors — and not the borrowers — were customers for purposes of accounting for revenues from customer contracts. The SEC issued comments refuting this logic, though X Financial stated its case in a 7/2/2018 response:

> The Company respectfully advises the Staff that the lending arrangements facilitated by the Company involve the provision of a loan (i.e., a specified good or service as considered within ASC 606-10-55-36A(a)) from an investor to a borrower. The Company has determined (in consideration of ASC 606-10-55-36) that the nature of the Company's promise within the lending arrangement is to arrange for the loan to be provided from the investor to the borrower. Therefore, based upon guidance within ASC 606-10-55-38, the Company serves as an agent to the investors in the lending arrangements which it facilitates. The investor is the principal in the arrangement (provision of a loan) to its customer, the borrower. [...]
>
> ***View A — Only the investor is the Company's customer***
> This view is supported by the belief that the Company's services (including facilitation, post-origination services and the guarantee services) are performed for the benefit of the investors in the lending arrangements which the Company facilitates. [...]
>
> ***View B — Both the investor and the borrower are the Company's customers***
> This alternative view may be supported by a belief that the Company's services (including facilitation, post-origination services and the guarantee services) are performed for the benefit of both the investor and the borrower in the lending arrangement which the Company facilitates. [...]
>
> ***Conclusion***
> Given the significant judgment involved in determining which party (or parties) is an agent's customer, and in recognition of the potential merits of View B, the Company believes that View A more appropriately depicts the nature of the Company's business model.

The SEC persisted, however, in additional comment letters, and X Financial was ultimately forced to cede its position, stating in its FY 2018 annual report that:

> We determine our customers to be both the investors and borrowers. We consider the loan facilitation service, guarantee service and post-origination service as three separate services, of which, the guarantee service is accounted for in accordance with ASC Topic 460, Guarantees. While the post-origination service is within the scope of ASC Topic 860, the ASC Topic 606 revenue recognition model is applied due to the lack of definitive guidance in ASC Topic 860. The loan facilitation service and post-origination service are two separate performance obligations under ASC 606, as these two deliverables are distinct in that customers can benefit from each service on its own and our promises to deliver the services are separately identifiable from each other in the contract.

Sysorex

Sysorex, an IT and telecommunications solutions company, was spun-off in 2018 from Inpixon, which trades on the Nasdaq. After the spin-off, Sysorex began trading as an OTC security, a peculiarity that might raise red flags among some who are wary of a company debuting in the less heralded, more volatile "pink sheets." An analysis of the company's filings and press releases indicates that Sysorex planned to focus on reducing the trade debt it inherited, and accelerate revenue from maintenance contracts performed by another vendor. The company noted in the press release accompanying its 2018 10-K:

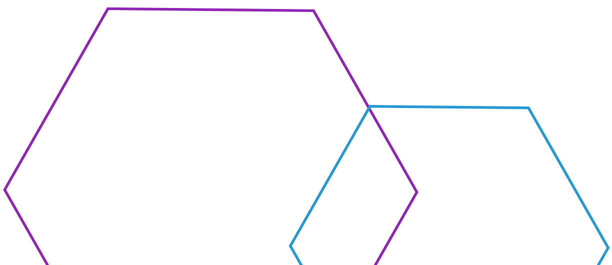
> Our major focus after the separation of our former parent was to focus on reducing the trade debt that we inherited, which we have reduced from $23 million, as of January 1, 2018, to $11.1 million, as of December 31, 2018.

In correspondence with the SEC on August 9, 2018, regarding performance obligations related to revenue from maintenance contracts performed by a third party, the company originally stated:

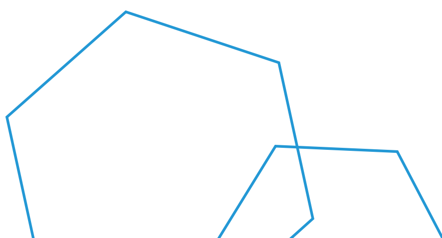
> While a third-party is responsible for actually performing the services for the customer, historically, in accordance with its policies and historical business practices, the Company has assumed responsibility for ensuring that the recommended services that are provided as part of the overall solution meets client expectations and therefore the Company assumes control of the services to be provided before they are performed for the benefit of the customer. In addition, the Company has full discretion in establishing the sale price to the customer which is determined based on the entire customized solution of products and services offered to the customer and bears the credit risk by paying the supplier for purchased services and collecting payment from the customer and therefore recognizes revenue from maintenance services on a gross basis, For these contracts the customer is invoiced one time and pays up front for the full term of the warranty and maintenance contract. Prior to the adoption of ASC 606 as of January 1, 2018, revenue from these contracts was recognized ratably over the contract period with the unearned revenue recorded as deferred revenue and amortized over the contract period. Adoption of Topic 606 has changed the recognition of our license and maintenance revenue as it was previously recognized over time however under the new policy it is recognized at a point in time and therefore the Company's accumulated deferred revenue was accelerated as of January 1, 2018.

After further SEC correspondence, however, Sysorex changed its position, noting in an 8/29/2018 response letter:

> After further consideration of the indicators of "control" resulting from the adoption of ASC 606 as of January 1, 2018, with respect to maintenance services provided by third parties where the Company does not assume any performance obligations to the customer related to providing such services, the Company has determined that it acts as an agent in connection with the sale of the third-party maintenance services. As a result, the Company intends to modify its recognition policy and recognize revenue from the sale of these services on a net basis.



Rank	Company	A/D Office	Industry	SEC Comment Letters
1	Kingsway Financial Services, Inc.	Healthcare & Insurance	Fire, Marine & Casualty Insurance	14
2	X Financial	Financial Services I	Finance Services	8
3	Sysorex, Inc.	Information Technologies & Services	Services - Computer Programming Services	7
4	Diebold Nixdorf, Inc.	Information Technologies & Services	Calculating & Accounting Machines (Except Electronic Computers)	6
	Interpublic Group of Companies, Inc. (S&P 500)	Telecommunications	Services - Advertising Agencies	6
	Obitx, Inc.	Information Technologies & Services	Services - Prepackaged Software	6
	Omnicom Group, Inc. (S&P 500)	Telecommunications	Services - Advertising Agencies	6
	Service Corp. International	Telecommunications	Services - Personal Services	6
	Spark Therapeutics	Healthcare & Insurance	Biological Products, (Except Diagnostic Substances)	6
5	Autodesk, Inc. (S&P 500)	Information Technologies & Services	Services - Prepackaged Software	5
	Bunge Ltd.	Natural Resources	Fats & Oils	5
	IQIYI, Inc.	Transportation & Leisure	Services - Video Tape Rental	5



S&P 500 Disclosure

Key Takeaways:

- Among S&P 500 companies, the SEC looked extensively at the identification of performance obligations, variable consideration and royalties.
- The SEC was consistent in the questions asked to companies within various industries, sometimes using the exact word-for-word comment to companies within the same industry.

Our examination of Topic 606 comments to the S&P 500 looked at a total of 116 letters to 46 different companies in 32 industries. We then focused on four particular industry areas representative of the SEC's focus and the companies' interpretations. These areas were airlines, advertising, broadcast and streaming, and pharmaceuticals. In each case at least one company received multiple rounds of questions.

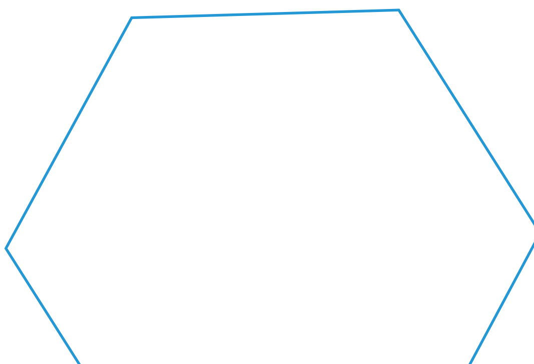
Industry Comments: Airlines

Four airline companies received revenue recognition-related SEC comments during the 2018 period:

Alaska Air Group, Inc.

Filing: 10-Q, 5/4/2018

SEC Comments:
UPLOAD, 7/24/2018: You disclose that passenger ticket breakage is recorded in advance of the flight date using estimates based on the company's historical experience of expired tickets, and other facts such as program changes and modifications. Please explain to us why the recognition of breakage in advance of the flight date rather than on the scheduled flight date is appropriate and represents the expected breakage amount in proportion to the pattern of rights exercised by the customer as prescribed in ASC 606-10-55-48. Additionally, explain to us your ticket validity policy (i.e., the status and value of a ticket after its scheduled departure date but prior to its contractual expiration date and exceptions made to accept invalid/expired tickets) and how it is factored into determining the amount of breakage.



Delta Air Lines, Inc.

Filing: 10-Q, 7/12/2018

SEC Comments:
UPLOAD, 7/16/2018

1. Revise to disclose significant payment terms for sales of mileage credits to credit card companies, hotels, and car rental agencies pursuant to ASC 606-10-50-12(b).

2. You disclose on page 8 that you reduce the air traffic liability for tickets you sell on behalf of other airlines when consideration is remitted to those airlines. Please tell us how recognition of revenue upon remittance of consideration represents when the performance obligation(s) are satisfied and the customer has gained control of the asset pursuant to ASC 606-10-25-23 and 30. In your response, tell us how this compares to the timing of when the transportation is provided.

3. Your disclosure for passenger ticket sales earning mileage credits appears to focus on mileage credits earned and related air transportation. However, it does not appear to address status related benefits. The description of your Medallion loyalty program on your website indicates it includes various benefits such as move to the front of the line, waived fees, and other elite benefits. Please tell us if you consider loyalty status to be a material right that must be accounted for a separate performance obligation or a marketing program pursuant to ASC 606-10-55-42 to 43. If it is a performance obligation, please consider revising to provide the disclosures required by ASC 606-10-50-9 and 12 for your Medallion loyalty status program.

4. Please tell us whether the accounting treatment you apply towards travel vouchers that may be redeemed by customers is in accordance with ASC 606-10-25-10 and 13(a). Additionally, tell us your methodology for allocating the unrecognized consideration received for the original ticket between the remaining performance obligations: (1) the travel voucher issued and (2) the alternate flight provided. To the extent travel vouchers are material to your results of operations, please revise your disclosures accordingly.

Southwest Airlines Co.

Filing: 10-Q, 5/1/2018

SEC Comments:
UPLOAD, 7/26/2018: It appears you have elected the transition provision pursuant to ASC 606-10-65-1(f)(4) in regard to the aggregate effect of historical modifications to the co-branded credit card agreement with Chase Bank USA, N.A. In so doing, ASC 606-10-65-1(g)(2) states that to the extent reasonably possible a qualitative assessment of the estimated effect of applying this expedient is required to be disclosed, but this disclosure is not apparent. Please advise.

United Continental Holdings, Inc.

Filing: [10-Q, 4/18/2018]

SEC Comments:
[UPLOAD, 6/26/2018]

1. Please tell us what consideration you gave to disaggregating revenue by type of customer and timing of revenue recognition. Refer to ASC 606-10-55-91c and f.

2. Please tell us whether advertising under the co-brand agreement is performed over the term of the agreement and whether there is an expected pattern of recognition.

3. You disclose that revenue for the marketing performance obligation under the co-brand agreement is recorded to other operating revenue over the term of the co-brand agreement based on customer's use of the Mileage-Plus credit card. Please tell us why recognition is based on the customer's use of the credit card and how this impacts or is expected to impact the pattern of recognition for the marketing performance obligation over the term of the agreement.

4. Please tell us how you account for breakage, if any, on miles sold under the co-brand agreement.

5. Please tell us who you determined the customer to be for each of the performance obligations under the co-brand agreement.

[UPLOAD, 8/29/2018]

1. We note from your response letter dated July 23, 2018 that you received a one-time payment related to a provision of your co-brand agreement, and that you allocated this type of revenue across your performance obligations. You then describe how you defer this revenue allocated to MileagePlus award miles, but recognize up front revenue allocated to the other three performance obligation categories. Please revise this disclosure to include a policy disclosure related to this type of payment.

2. On page 17 of this Form 10-Q, you indicate that under ASC 606, you identified four separately identifiable performance obligation categories in your co-brand agreement with Chase Bank, and determined revenue recognition patterns based on satisfaction of those performance obligations. We note that travel-related revenue, such as revenue from MileagePlus miles awarded, bag fees, and seat upgrades is deferred and recognized in passenger revenue at the time of travel. In contrast, advertising, lounge pass revenue, and marketing revenue is recorded in other operating revenue based on various factors, such as when the lounge pass is used, or customer use pattern of the credit card over the term of the co-brand agreement. Your response to comment 2 in your letter dated July 23, 2018 indicates the $50 million relates to a cash payment received under a provision of the co-brand agreement and, similar to other consideration received under the co-brand agreement, you allocated the payment across the performance obligations identified in the co-brand agreement based on fixed percentages. The amounts related to MileagePlus miles awarded were deferred, while the $50 million allocated to marketing, advertising, and certain other travel related benefits was recognized on receipt. This recognition pattern appears to be consistent with the policy set forth in your Form 10-K, prior to adoption of ASC 606. Please tell us why you believe your recognition pattern in the first quarter complies with your recognition policy for such revenue under ASC 606.

The SEC focused on breakage or unused services by customers that have previously paid in full. Alaska Air Group was asked why it recognized passenger ticket breakage before the flight date instead of on the flight date. It responded that it estimates ticket breakage in advance at the time of the sale but records the breakage revenue at the departure or flight date and stated it would clarify disclosure of how it recognizes breakage in future filings. United Continental was asked about breakage on miles sold under a co-brand agreement and responded that it recognizes the associated value proportionally as remaining mileage credits are redeemed.

Another area the SEC examined was co-brand agreements. Both Southwest and United Continental were asked about their co-brand agreements with Chase Bank. The SEC asked Southwest about its election of a transition provision for the aggregate effect of historical modifications to the co-branding credit card agreement with Chase Bank and why it did not disclose a qualitative assessment of the estimated effect in applying this expedient. Southwest responded it did not believe it could provide a qualitative assessment of applying the contract modification transition practical expedient without performing a complete quantitative analysis for each modification, which would require an independent third party to assist in the process, which was prohibitive because of the cost and time involved. The airline indicated that it updated the disclosure in its 10-Q filed 8/1/2018 and provided additional updated disclosure addressing the qualitative assessment in its 8/8/2018 response letter.

United Continental received multiple questions on its co-branding agreement with Chase Bank in relation to the MileagePlus credit card. The first question asked if advertising under the co-brand agreement was performed over the term of the agreement and if there is an expected pattern of recognition. United responded in a 6/29/2018 letter that the performance obligations are satisfied over time. The SEC also inquired about why recognition of the revenue for the market performance obligation under the co-brand agreement was being recorded to other operating revenue over the term of the agreement based on the customer's use of the MileagePlus credit card. The company determined its market performance obligation primarily consisted of intellectual property related to its brand and customer list, which is provided to Chase over the term of the agreement with royalties generated each time a MileagePlus member uses their card and the subsequent awarding of miles to the member. The SEC asked who United determined to be the customer for each of the performance obligations under the co-brand agreement. The company cited the AICPA Revenue Recognition Guide, Chapter 10, paragraphs 10.6.45 and 10.6.46, to name "the Company, Chase Bank USA, NA, and the Company's MileagePlus members" as the customers. United determined Chase as its direct customer for the sale of marketing-related elements and the credit card holder the end customer of the airline for earning the miles awarded under the MileagePlus program. The SEC followed up with two additional questions on the co-brand agreement to which United Continental responded on 9/5/2018. The first question related to a one-time payment it received as part of a provision in the co-brand agreement and allocated across the performance obligations but deferred in relation to the MileagePlus award miles and recognized up front in the remaining three performance objectives. United stated they would disclose in future filings that all payments received under the co-brand agreements would be accounted for "by allocating them to the separately identifiable performance obligations."

The SEC also sought further clarification as to why United believed its revenue recognition pattern in the first quarter complied with the revenue recognition policy under Topic 606 in relation to the one-time payment received. The airline answered that the "recognition is the same as the accounting used prior to the adoption of ASC 606."

The last topic the SEC commented on in relation to airlines during this period was disaggregation of revenue. United Continental was asked about the consideration it gave to disaggregating revenue by type of customer and timing of revenue recognition. United Continental responded that they evaluated revenue disaggregation in three categories: Type of Customer; Market Segmentation; and Timing of Transfer of Goods or Services. For the Type of Customer category, United stated that besides geographic region it also considered disaggregating sales to corporate and government customers but determined there were no differing economic factors. Under the Market Segmentation category, the company described the varying fare levels it uses but determined that they were not uniquely impacted differently by economic factors. The company manages flights to earn maximum revenue per flight instead of by fare class and concluded that disaggregation for market segmentation was not appropriate. United also determined not to disaggregate for the third category, Timing of Transfer of Goods or Services, since passenger ticket revenue is recognized at a point in time.

Industry Comments: Advertising

Two advertising companies, Interpublic Group of Companies and Omnicom Group, received comments on their revenue recognition disclosure, with both receiving multiple rounds:

Interpublic Group of Companies

Filing: 10-Q, 4/27/2018

SEC Comments:
UPLOAD, 7/18/2018:

1. We note your disclosure on page 14 regarding your branding arrangements. Please tell us what two specific performance obligations you have identified and how you determined you were the principal for both services. Reference ASC 606-10-25-19 through 22, ASC 606-10-55-36 through 40 and ASC 606-10-50-12.

2. Please provide us with your analysis regarding how you determined you had one performance obligation in your events and public relations arrangements. In addition, tell us how you determined you were acting as the principal in these arrangements. Reference ASC 606-10-25-19 through 22 and ASC 606-10-55-36 through 40.

3. Please provide us with your analysis regarding how you determined you had two performance obligations in both your advertising and media business. In addition, tell us how you determined you were the agent for your production and media buying services. Reference ASC 606-10-25-19 through 22 and ASC 606-10-55-36 through 40.

UPLOAD, 8/24/2018:

1. We note your response to prior comment two. Please revise future filings to more fully discuss how you determined you had one performance obligation in your events and public relations arrangements. Reference ASC 606-10-50-12(c).

2. We note your response to prior comment three. Please address the following items related to your advertising services arrangements:

   - Please further discuss how you determined that your creative services and production services should not be combined into a single performance obligation. In this regard, we note that you have a significant level of oversight associated with the production services and that the production services use the creative services you have provided.

   - Please provide us with a more specific and comprehensive discussion of how you considered the definition of control in your analysis and whether you are directing the use of production services.

   - Tell us when you recognize revenue related to production services. In order for us to better understand your analysis, please provide us with representative contracts and related invoices, if applicable, for these arrangements.

3. We note your response to prior comment three. Please address the following items related to your media services arrangements:

   - Please further discuss how you determined that your media planning and media buying should not be combined into a single performance obligation. In this regard, we note that the media spots purchased are in accordance with a buying guideline that you have developed.

   - Please provide us with a more specific and comprehensive discussion of how you considered the definition of control in your analysis and whether you are directing the media buying services.

   - We note your statement that you neither purchase nor commit to purchase media spots before they are sold to clients. Please help us better understand when media spots are purchased and how purchases might differ by medium. Please specifically address spots purchased through the upfront advertising market for the television broadcast season.

   - Please further describe your consideration of pricing discretion. We note your disclosure on page 9 that you may earn commissions when clients pay you the gross rate billed by media and you pay for media at a lower net rate.

   - Tell us when you recognize revenue related to purchased media spots. In order for us to better understand your analysis, please provide us with representative contracts and related invoices, if applicable, for these arrangements.

UPLOAD, 12/20/2018: Please more fully discuss in future filings how you determined you had two performance obligations in your advertising services and media services arrangements. In addition, please more fully discuss how you determined that you act as an agent for production services and media buying service. Reference ASC 606-10-50-12.

Filing: 10-Q, 4/17/2018

SEC Comments:
UPLOAD, 6/13/2018:

3. We note your disclosure that certain fixed fee projects have a single performance obligation. Please clarify what services you have combined into this single performance obligation and what services you have treated as separate performance obligations. Reference ASC 606-10-25-21 and ASC 606-10-50-12 (c).

4. Please help us better understand the nature of services transferred to your customers in your strategic media planning and buying business. Tell us which services you have combined with others for the purposes of determining your performance obligations and which services you have treated as a separate performance obligation. Please also clarify if and how services provided in this business relate to services provided under your fixed fee projects and retainer contracts. Reference ASC 606-10-25-21 and ASC 606-10-50-12 (c).

5. Please tell us the nature of all third-party-costs you incur on behalf of your clients. Provide us with your analysis of how you determined whether you are acting as a principal or as an agent in these arrangements. Tell us how you considered your role in creating or developing a client's marketing or corporate communications message. Please specifically address amounts paid to both media providers and production companies. Reference ASC 606-10-55-36 through 39 and ASC 606-10-50-12 (c).

6. We note your disclosure that for certain retainer contracts you recognize revenue on a straight-line basis. Please tell us how you determined that your efforts are expended evenly throughout the performance period. Please specifically address what consideration you gave to seasonal patterns. Reference ASC 606-10-25-31 and ASC 606-10-50-18(b).

UPLOAD, 7/23/2018:

1. We have reviewed your response to comment three. We note you have combined managing third-party service providers on behalf of clients to produce content or deliver media or production services with other services into a single performance obligation. Please provide us with a specific and comprehensive discussion of the nature of the activities involved in these management services. In addition, please clarify if you earn any commissions specific to these services. If so, please tell us when the associated revenue is recognized. Finally, please tell us how you considered the guidance related to variable consideration for a series. Reference ASC 606-10-32-40.

2. We have reviewed your response to comment four. We note in your commission arrangements you consider the airing of media a constraint and only record revenue when the media has been run. Please further explain why an estimate of variable consideration cannot be made in an earlier period. In addition, please reconcile your response to your disclosure on page 7 hereunder in which you state that commission revenue is recognized when it is probable that the media will be run. Reference ASC 606-10-32-5 through 14.

3. We note your response to comment five. Please address the following items:

- Quantify the significance of media purchases where you act as an agent and those where you act as a principal.
- We note your assessment of indicators. Please provide us with a more specific and comprehensive discussion of how you considered the definition of control in your analysis and whether you are directing the use of the purchased media and studio production services.
- Please discuss how you considered the use of your Annalect, Omni and Accuen platforms.
- In order for us to better understand your analysis, please provide us with representative contracts and related invoices, if applicable, for your purchased media and studio production services.

In addition to the comments received by Omnicom, the company also held telephone conferences with the Staff on 9/11/2018, 10/16/2018 and 12/21/2018. For both Omnicom and Interpublic, the SEC focused on the determination of performance obligations in the various businesses they operate and what services made up these performance obligations, as well as establishing their role as principal vs. agent in these services.

Interpublic initially received three questions. The first asked about its branding arrangements with customers, the two performance obligations identified, and how they identified themselves as principal for both of these services. Interpublic, in its 8/1/2018 response, listed concept creation and implementation as the two performance obligations. The role as principal was concluded based on Interpublic's control of the inputs and "the direction of their use in combined output in their specified good or service."

The second question related to Interpublic's events and public relations arrangements and how one performance obligation was established, along with their determination they were acting as principal in these arrangements. Interpublic identified that its "event creation and event execution services cannot be treated as distinct services" and were not "separately identifiable from each other." The company reached a similar conclusion for its public relations services. The role of principal was determined for both events and public relations because the company obtains control of the inputs from third parties and directs their use for the combined output.

The final question inquired about the advertising and media business and how two performance obligations were found in each business as well as how they determined they were agents in the production and media buying services. The two services identified by Interpublic were creative and production services within the advertising business and media planning and media buying services. These were determined to be distinct since the customer receives a stand-alone benefit from each separate service in both cases. Interpublic established itself as agent in the advertising and the media businesses based on the involvement of third-party vendors in each business and the company's limited ability to control inventory, pricing and the services being fulfilled. The SEC requested further discussion as to why the creative services and production services should not

be combined into a single performance obligation; how the definition of control was considered and whether the company directed the use of production services; and when revenue related to production services was recognized. The SEC also requested representative contracts and related invoices. Interpublic responded on 10/1/2018 that the creative and production services could be considered distinct services with stand-alone benefits being potentially derived by the client. Interpublic stated that it did not direct the use of nor obtain substantially all of the benefits of the production services prior to transfer to the client. The company recognized revenue for production services over time beginning with the pre-production phase and ending with delivery of the completed advertisement.

Omnicom received four questions from the SEC. Similar to Interpublic, Omnicom was also asked about its performance obligation conclusions in the first two questions. The initial question regarded how a single performance obligation was determined for certain fixed-fee projects. The company responded that the services are “highly interrelated” and the “integration of the various components of a marketing message is essential to our services” and thus the services should be considered as a single performance objective. Omnicom went on to state that in certain cases their long-term fixed fee contracts have more than one service or performance obligation but they do not use Topic 606 guidance in these instances but instead “allocate a portion of the fee to each performance obligation based on its stand-alone selling price.” The SEC requested additional information on this question, asking for “specific and comprehensive discussion of the nature of the activities involved in” managing third-party services including discussion of any commissions earned from the services, when the associated revenue was recognized, and any guidance considered for variable consideration for the services. In an 8/16/2018 response, Omnicom provided detailed information on the administrative efforts it provides coordinating third-party services including eleven different tasks associated with content production services, nine requirements for production services, and six activities for the media buying process. They went on to say they generally do not earn additional or separate commissions for their role coordinating the third-party production or media services. Any variable consideration is estimated as part of the estimated fee at the beginning of the contract and updated over the time of the contract. On 10/19/2018 the company provided supplemental information relating to services provided in the creative advertising and strategic media planning and buying services requested in teleconferences on 9/11/2018 and 10/16/2018. The materials included additional details on client contracts and identification of performance obligations; revenue recognition procedure related to certain commission-based client arrangements; and consideration of whether the company acted as agent or principal.

The second question in relation to performance obligations referred to the company’s media planning and buying business including the “nature of services transferred to your customers.” The SEC also requested the company describe the services provided related to services under the fixed fee projects and retainer contracts. The company replied that it had five types of arrangements with their clients: fixed-fee arrangements; media commission arrangements; multi-discipline arrangements; multi-discipline commission arrangements; and hybrid arrangements. Omnicom continued that it used the same conclusion as the previous comment in determining a single performance objective existed because the planning and buying services were not viewed as distinct and separate. It also stated the services provided in the strategic media planning and buying were done in the same way as their other agencies. Additional information was requested from the SEC specific to their commission arrangements and “why an estimate of variable consideration cannot be made in an earlier period.” In the same 8/16/2018 response, the company clarified its original response stating the timing of the revenue

recognition when the "performance obligations are satisfied at the point-in-time when it is probable that the media will be run" and took into account it could no longer be canceled by the client. The company also noted that it was unable to estimate variable consideration earlier because of guidance under Topic 606 which restricted this as long as there was a possible "significant reversal of cumulative revenue." In this case that was the client's cancellation rights prior to the media run date which "represents a significant constraint" on the potential revenue they could receive.

The third question involved third-party costs incurred on behalf of the company's clients and how they determined if they were a principal or agent. They were also asked about their role in "creating or developing a client's marketing or corporate communication's message" as well as "amounts paid to both media providers and production companies." Omnicom responded that third-party costs consisted of direct costs and incidental costs. The incidental costs were reimbursed by clients and included as revenue since the company controlled the specified services prior to transfer to the client. Direct costs depend on whether Omnicom is acting as agent or principal on behalf of the client. Like Interpublic, they determined this by considering the fulfillment risk, inventory risk and pricing risk assumed by the company in comparison to the client. Omnicom stated that they acted as agent in certain cases and principal in others and the key difference in their media planning and buying business was whether the actual price of the media was or was not disclosed to the client. Since their typical arrangement was a fixed-fee model and the cost of media is incorporated into the overall cost the company acted as a principal in the fixed-fee arrangements.

The SEC requested expanded information on media purchases and where the company acted as an agent or a principal; the definition of control in relation to directing the use of purchased media and studio production services; the use of the Annalect, Omni and Accuen platforms; copies of customer contracts and related invoices for the purchased media and production services. Omnicom replied on 8/16/2018 with a breakdown of media purchases by percentage as both agent and principal. The actual percentages were redacted pursuant to a confidential treatment request. The company also further explained the circumstances in which they acted as agent when they are purchasing media and production services on behalf of clients and the cost is known to the client. These are also referred to as "pass-through costs" and that the company does not control the goods or services prior to delivery to the client. The instances in which the company acts as principal the cost is not disclosed to the client and instead is incorporated into the overall contract, or "bundled." The company determined they control the goods and services throughout the contract as described in their earlier response letter. Omnicom went on to describe Annalect, Omni, and Accuen as "in-house technology tools that our agencies use to provide targeted marketing services." They also stated that they would be providing the requested contracts and invoices under separate cover as supplemental information and requested confidential treatment.

The last question Omnicom received related to its retainer contracts and the recognition of revenue on a straight-line basis. The company responded that its retainer contracts are structured on a monthly basis but also included a "stand-ready obligation" for services to be performed on an ongoing basis generally up to a year. Omnicom believed "the pattern of benefit to the client" and "the effort to fulfill the contract are generally the same throughout the period" leading to a "straight-line fee billing arrangement."

Industry Comments: Broadcast and Streaming

Five broadcast or streaming companies received SEC comments related to the new recognition standard:

CBS Corp.

Filing: 10-Q, 8/2/2018

SEC Comments:
UPLOAD, 8/22/2018:

5. We note certain advertising contracts have guarantees of audience member views. Please clarify if these guarantees are treated as variable consideration in determining your transaction price. Refer to ASC 606-10-32-5 and 606-10-50-20.

6. Please identify the specific products and/or services transferred to your customers within your affiliate agreements. Tell us which products and/or services you have combined with others for the purposes of determining your performance obligations and which you have treated as a separate performance obligation. Tell us if you believe these arrangements contain a functional license of intellectual property and if this is the predominant item to which royalties relate. Please also describe the judgments used in determining both the timing of satisfaction and amounts allocated to each performance obligation. To the extent applicable, tell us how you considered any minimum guarantees. Refer to ASC 606-10-50-12 and 606-10-50-17.

7. Please tell us your basis for recognizing revenue on a relative fair value basis for affiliate arrangements with fixed fees.

8. Please tell us if you consider your retransmission arrangements to be functional licenses of intellectual property and if you are applying the guidance for sales-based or usage-based royalties. Please refer to ASC 606-10-50-12.

9. We note your disclosure on page 43 that you have contracts for library programming. Please clarify if existing content and new content represent separate performance obligations. In addition, please explain the judgments used in determining both amounts allocated to and the timing of satisfaction of the related performance obligations. Refer to ASC 606-10-50-12 and ASC 606-10-50-17.

Comcast Corp.

Filing: 10-Q, 7/26/2018

SEC Comments:
UPLOAD, 9/24/2018:

1. Please identify the specific products and/or services transferred to your customers within your distribution and affiliate agreements. Tell us if you have combined any products and/or services for purposes of determining your performance obligations. Specifically address if these arrangements contain a video-on-demand library. Tell us if you believe these arrangements contain a functional license of intellectual property and if this is the

predominant item to which royalties relate. Please also describe the judgements used in determining both the timing of satisfaction and amounts allocated to each performance obligation. Refer to ASC 606-10-50-12 and 606-10-50-17. Content Licensing, page 11.

2. Please tell us if content licensing agreements include promises to provide content libraries. If these arrangements are material, please tell us how you considered if existing content and new content represent separate performance obligations and explain how you considered judgments in determining both amounts allocated to and the timing of satisfaction of each performance obligation. Refer to ASC 606-10-50-12 and 606-10-50- 17.

3. For content licensing agreements that include variable pricing, you disclose that you recognize revenue as variable amounts become known. Please further clarify your statement and tell us how you consider amounts earned when there is a lag in reporting. Please refer to ASC 606-10-32-5 and 606-10-50-20.

UPLOAD, 11/6/2018: We note your response to prior comment 1. Please revise your disclosures in future filings to clarify that you consider your distribution agreements to be functional licenses of intellectual property. Please refer to ASC 606-10-50-12.

Discovery, Inc.

Filing: 10-Q, 8/8/2018

SEC Comments:
UPLOAD, 9/12/2018:

1. Please help us understand why your video on demand ("VOD") offerings match the programs that are airing on your linear network. Tell us if there are circumstances in which existing content is delivered at the outset of the distribution arrangements.

2. We note your disclosure on page 41 that most of your distribution contracts are licenses of functional intellectual property. Please help us understand your basis for recognizing revenue for fixed price contracts over the contract term.

3. We note that certain distribution contracts have minimum guarantees. Please explain the types of guarantees provided and clarify your pattern of revenue recognition. Refer to ASC 606-10-50-19.

4. We note certain advertising contracts have audience level guarantees and revenues are deferred until the guaranteed audience level is delivered or the rights associated with the guarantee lapse. Please help us understand the terms of the guarantee. It is unclear if the guarantee relates to individual episodes or a program season. In addition, please clarify if these guarantees are treated as variable consideration in determining your transaction price. Refer to ASC 606-10-32-5 and 606-10-50-20.

5. Please tell us if your arrangements include promises to provide content libraries. If so, please tell us how you considered if existing content and new content represent separate performance obligations and explain how you considered judgments in determining both amounts allocated to and the timing of satisfaction of each performance obligation. Refer to ASC 606-10-50-12 and ASC 606-10-50-17.

Fox Corp.

Filing: DRS, 10/9/2018

SEC Comments:
UPLOAD, 11/6/2018:

9. We note your disclosure that advertising revenue is recognized net of agency commissions. Please revise to clarify, if true, that agents are your customers and the amount recognized as revenue is your transaction price. Reference ASC 606-10-50-17.

10. Please identify the specific products and/or services transferred to your customers within your affiliate agreements. Tell us which products and/or services you have combined with others for the purposes of determining your performance obligations and which you have treated as a separate performance obligation. Specifically address if these arrangements contain a video-on-demand library. Tell us, and revise to clarify, whether you believe these arrangements contain a functional license of intellectual property and if this is the predominant item to which royalties relate. Please also describe the judgements used in determining both the timing of satisfaction and amounts allocated to each performance obligation. Refer to ASC 606-10-50-12 and 606-10-50-17.

Netflix, Inc.

Filing: 10-Q, 4/18/2018

SEC Comments:
UPLOAD, 6/8/2018: Please provide us with your analysis regarding payments made to partners. Describe in detail the nature of these payments and further clarify when payments are classified as marketing expenses and when payments are recognized as a reduction in revenue. Refer to ASC 606-10-32-25 and 26.

The SEC requested information on affiliate agreements from CBS, Comcast and Fox, asking almost the identical question of the products and services transferred to customers under these agreements: what performance obligations were determined; if the arrangements contained a video-on-demand library; did the arrangements contain a functional license of intellectual property; if this was the predominant item to which royalties relate; and the judgments used to determine the timing of satisfaction and amounts allocated to each performance obligation. CBS identified two performance obligations, a license to the continuous delivery of live or "linear feeds" of the programming and a license to the programming through video-on-demand viewing. Comcast determined there was a single performance objective since the enhanced services (video on demand) and the linear programming were "significantly integrated." Fox appeared to follow the CBS interpretation of splitting up the continuous linear feed and the video-on-demand content. All three agreed that a functional license of intellectual property was included in the arrangements

Like the affiliate agreements, the SEC asked very similar questions regarding advertising contracts from CBS and Discovery, inquiring if these agreements have audience-level guarantees and if the guarantees were considered variable consideration. Both CBS and Discovery determined there was no variable consideration component since the contracts were for a fixed price and if the company failed to deliver the guaranteed amount the customer would be provided with additional advertising spots until that number was met.

The next area of focus related to content licensing agreements and if these included promises to provide content libraries. CBS, Comcast, and Discovery all were asked if the existing and new content were considered separate performance obligations. All three companies appeared to view these the same, recognizing the delivery of individual episodes or titles as a separate performance obligation.

Netflix received a single question in relation to its payments to partners and when the payments were considered marketing expenses instead of reductions in revenue. Netflix responded in a 6/13/18 letter that marketing expenses and costs of revenue are recognized when the service is offered by partners at a standalone monthly retail price established by the company. In circumstances where the Netflix service is bundled with other services from the partner and the partner establishes the price the company can only recognize the amounts it receives from partners.

Industry Comments: Pharmaceutical

Three pharma companies received revenue recognition-related SEC comments during the 2018 period:

Biogen, Inc.

Filing: 10-Q, 4/24/2018

SEC Comments:
UPLOAD, 6/18/2018:

1. In your Product Revenue disclosure on page 11, you indicate that you estimate variable consideration using the most likely method. Please tell us why it is appropriate to apply this method rather than the expected value method. See ASC 606-10-32-8. In addition, tell us where you have made the disclosure specified in ASC 606-10-50-12b or your consideration for providing this disclosure.

2. In your Revenues from Anti-CD20 Therapeutic Programs disclosure on page 11, you indicate that you do not have any future performance obligations under your license or collaboration agreement. Please reconcile this statement with the following disclosures that imply that you may be obligated to perform some tasks:

   - On page 12 you indicate that you are reimbursed for your selling and development expenses in the U.S. for RITUXAN;

   - In the last paragraph on page F-11 of the 2017 Form10-K you indicate that your co-promotion profits on RITUXAN and GAZYVA include reimbursement for joint development expenses incurred; and

- In the second paragraph on page F-57 of the 2017 Form 10-K you indicate that you recognize your share of the development and commercialization expenses of GAZYVA as a reduction of your pre-tax profits.

3. Please clarify for us whether you are applying the ASC 606 royalty recognition constraint to your co-promotion profits and royalties associated with your Genentech collaboration. If so, clarify for us the consideration you gave in reaching your conclusion to apply the constraint to the following:

   - You assigned, rather than licensed your Canadian collaboration rights. See page F-57 of your 2017 Form 10-K, ASC 606-10-55-65A and paragraph BC 78b of ASU 2016-10.

   - Your obligation to provide development services and/or other goods or services.

4. Please tell us where you have made the disclosure of your accounting policy for classifying payments between participants to a collaborative arrangement or your consideration for providing this disclosure. In your response, tell us how you handle both net profits and expense reimbursements (either paid or received) and how you distinguish between the two. Help us understand how your policies are the same as or differ from the example beginning at ASC 808-10-55-3 and the extent to which they are consistent with your ongoing major or central operations. In this regard, we note from disclosure:

   - In the last paragraph on page F-58 of your 2017 Form 10-K that you include your share of development expenses as a reduction to revenue after an anti-CD20 product is approved;

   - At the top of page 12 of your March 31, 2018 Form 10-Q that the reimbursement of development expenses in the U.S. for RITUXAN is included in revenues; and

   - In the second paragraph on page F-59 of your 2017 Form 10-K that reimbursement of research and development expenses from AbbVie are netted against research and development expense in your consolidated statements of income.

Bristol-Myers Squibb Co.

Filing: 10-Q, 4/26/2018

SEC Comments:
UPLOAD, 7/3/2018:

1. Your arrangements may include fixed up-front amounts as well as variable consideration such as contingent development and regulatory milestones, sales-based milestones and royalties. Please tell us, and propose accounting policy disclosure for future filings that clarifies, the following:

   - what method you are using to estimate your variable consideration under ASC 606-10-32-8, and why it is appropriate to apply that method; and

   - how you allocate and recognize variable consideration.

2. You disclose on page 9 that your alliance and other arrangements may include the transfer of certain rights to develop or commercialize investigational compounds or products and joint obligations to provide development, distribution, promotion, sales and marketing services and clinical or commercial product supply. Please tell us, and propose accounting policy disclosure for future filings that clarifies, the facts and circumstances that result in your use of the accounting in ASC 606-10-55-65 for sales-based milestones and sales-based royalties for your performance obligations, including when a single performance obligation includes a license (or licenses) of intellectual property and one or more of the other goods or services noted above. Please identify for us any alliances to which you apply the accounting in ASC 606-10-55-65 that involve a license and development activities before regulatory marketing approval. In addition, provide an analysis supporting that the license of intellectual property is the predominant item to which the sales-based milestones and sales-based royalties relate.

UPLOAD, 8/24/2018:

1. Please revise your proposed disclosure to describe how you recognize constrained variable consideration and at what amount when the uncertainty associated with the variable consideration is subsequently resolved.

2. You state that "the license is a distinct performance obligation in [y]our current arrangements and have concluded that the variable consideration relates entirely to the license." Please provide supporting analysis for this conclusion referencing ASC 606-10-32-39 to -41 for the collaboration arrangements under which there are multiple performance obligations, including development services.

3. Please clarify for us the nature of your obligations to deliver clinical "supplies" and commercial product "supplies." In this regard, tell us whether your obligation is limited to delivering ingredients or includes commercial product. Furthermore, explain how you determined that the supplies were distinct from the license and other performance obligations in your arrangements.

Nektar Therapeutics

Filing: 10-Q, 11/8/2018

SEC Comments:
UPLOAD, 11/19/2018: On February 13, 2018 you entered into the BMS collaboration agreement to jointly develop and commercialize NKTR-214. You state that you identified two performance obligations, consisting of the delivery of the licenses and your participation on joint steering and other collaboration committees. Your accounting policy on page 9 states that for collaboration arrangements with multiple performance obligations, such as granting a license and performing research and development activities, you allocate the upfront and milestone payments under a relative standalone selling price method. It is not clear why amounts for research and development in the BMS agreement are not considered a performance obligation nor why, as you state on page 15, that you record cost reimbursement payments to you from BMS as a reduction of research and development expense rather than as revenue. It appears to us that your separation, measurement, allocation and classification of amounts related to the BMS agreement is inconsistent with your accounting policy on page 9 and with your accounting for your agreement with Lilly. Please provide us an analysis with reference to authoritative literature supporting your accounting for the BMS agreement. Also, provide us proposed revised accounting policy disclosure to be included in future filings addressing this inconsistency or tell us why revised disclosure is not necessary.

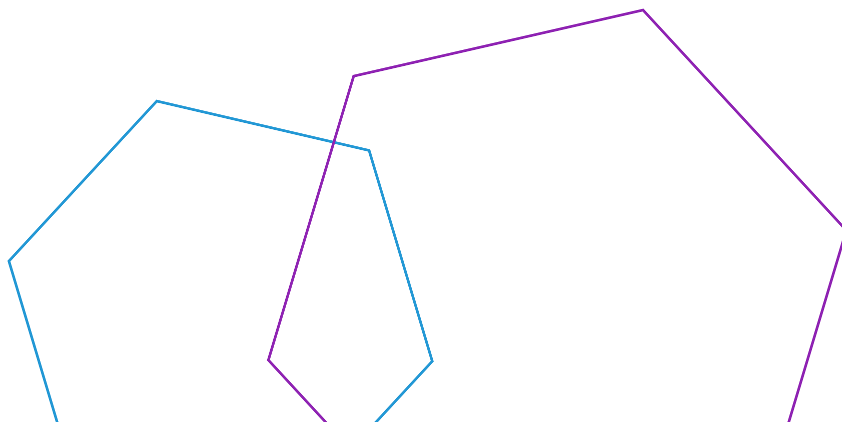
The areas of interest to the SEC in its review of the pharmaceutical industry included estimates of variable consideration and performance obligations under collaboration or license agreements.

Biogen and Bristol-Myers Squibb were asked about the methods used to estimate variable consideration and why they chose the methods. Both companies disclosed their use of the most likely method. The SEC asked Biogen why they did not use the expected value method, to which Biogen responded in a 6/28/2018 letter "upon further analysis . . . [we] now believe our estimation process conforms to the expected value method" and would revise future disclosures moving forward and included their proposed revised disclosure. Biogen based this on a review of industry practices and disclosures. Bristol-Myers Squibb, in its 7/26/2018 response, noted it used the most likely amount method "to estimate contingent development, regulatory and sales-based milestones" and used the expected value method to estimate royalties except for specific instances. The company stated it believed this was appropriate "because a broad range of potential outcomes exist." The SEC followed up, asking Bristol-Myers Squibb to revise its proposed disclosure to "describe how you recognize constrained variable consideration" and "when the uncertainty associated with the variable consideration is subsequently resolved." Bristol-Myers Squibb promised to revise future disclosure in a 9/24/2018 response letter.

All three companies were asked about the performance obligations under their collaboration or license agreements. Biogen was asked about its disclosure of no future performance obligations under its license and collaboration agreement with Genentech and confirmed that it did not have future performance obligations but that it would clarify future disclosure in relation to its "share of collaboration expenses." The company was also asked if it was applying Topic 606 royalty recognition constraint to the co-promotion profits and royalties associated with the Genentech collaboration. Biogen stated that it accounts for the Genentech relationship under Topic 808 and follows guidance under Topic 808 that refers to Topic 606 guidance where applicable, and that it will modify its disclosure in future filings.

Bristol-Myers Squibb was asked about the accounting for sales-based milestones and sales-based royalties for performance obligations. The company replied that it accounted for sales-based milestones and royalties for certain out-license arrangements and identified three types: straight-license arrangements; arrangements that include a license and an additional performance obligation to supply product upon the request of the third-party; and collaboration arrangements. It went on to state that most of the out-license arrangements had a single performance objective.

Nektar Therapeutics was asked about its collaboration agreement with Bristol-Myers Squibb, its identification of two performance obligations and why it was inconsistent with the accounting used in an agreement with Eli Lilly. The company responded in a 12/7/2018 letter that it considered Eli Lilly to be a customer under that agreement and was accounted for under Topic 606 while the Bristol-Myers Squibb agreement was accounted for under Topic 808 because of the difference in development activities.



Checking in on Previous Early Adopters

Key Takeaways:

- While our 2018 report found that nearly one-third of Topic 606 early adopters received at least one SEC comment letter on the new revenue recognition standard, a look at their activities since indicates that all have satisfied the SEC's initial questions.
- The only new Topic 606-related comment letter to an early adopter since our first white paper was to R1 RCM Inc. Consistent with the majority of early adopter cases, this SEC letter focused on the company's measurement of performance obligations.
- In total, 11 early adopters replied to the SEC's initial revenue recognition-related comments by promising to revise their language in future filings to address the SEC's concerns.

In our first white paper on the new revenue recognition standard, we identified 32 early adopters — companies that elected to adopt Topic 606 during the 2017 calendar year. We found that nearly one-third of early adopter companies had received comment letters from the SEC related to revenue recognition.

For our new paper, we checked back with these early adopters and found that the companies that received comment letters from the SEC appeared to take them to heart: None of them has received a subsequent comment letter from the SEC focused on the new revenue recognition standard.

One New Early Adopter Comment Letter

The SEC has, however, issued one new revenue-recognition-related comment letter to an early adopter since we published our last white paper. R1 RCM Inc. received a comment related to Topic 606 in a 5/3/2018 letter, which was not made publicly available until 12/17/2018. R1 RCM is a provider of technology-enabled revenue cycle management services across hospitals, health systems, and physician groups.

In keeping with the majority of its previously-issued comments, the SEC targeted the company's measurement of performance obligations, noting that R1 RCM constrained estimates of variable consideration and asking R1 RCM to explain the judgments it used in making its assessment. The SEC also requested that R1 RCM describe the factors that resulted in the constraint of variable consideration and how it will resolve the constraint. The SEC further requested that the company explain "how [it] considered ASC 606-10-50-17 and 50-20 related to disclosures of significant judgments used in determining the transaction price."

R1 RCM responded to the SEC in a 6/1/2018 letter, explaining that it considered the application of the constraint to individual contracts within each of its revenue streams and determined that it needed to constrain estimates of variable consideration only for revenues generated from incentive fees. Emphasizing the longer-term nature of most of its customer contracts, the company went on to explain

that "significant judgments associated with estimating transaction price are limited as the Company's customer contracts satisfy the allocation requirements in ASC 606-10-32-40. As a result, our estimates of transaction price are typically for shorter time durations, and the uncertainty associated with the fees is typically resolved within the service period limiting the need to apply constraint for such fees."

Apparently dissatisfied with R1 RCM's response, the SEC followed up with a letter on 6/20/2018, questioning the adequacy of the company's overall disclosure of its performance obligation. In its letter, the SEC stated, "We note from your response ... that your contracts satisfy the allocation requirements in ASC 606-10-32-40. In future filings, please expand your disclosure of the nature of your performance obligation to clarify that your performance obligation is a series and how you allocate variable consideration to each distinct service in the series." The company agreed to do so in a response letter dated 6/28/2018, stating that it would expand the disclosure regarding the nature of its performance obligation in future filings starting with its next 10-Q for the period ending on 6/30/2018. On 7/5/2018, the SEC notified R1 RCM that it had completed its review of the company's filing. The company did so on its 10-Q for Q2 2018.

For comparison, in the next section we include a redline of the changes R1 RCM made to its 10-Q between its Q1 and Q2 2018 filings.

What Have Early Adopters Done Since the SEC's Initial Topic 606 Comments?

In addition to R1 RCM, ten early adopter companies received SEC comments related to Topic 606 in 2017 and, in response, promised to revise their language in future filings to address the SEC's concerns. The below table includes the type of SEC comment and, where available, the language that it revised in a subsequent filing. In some instances (shaded in purple in the table), the company merely stated that it would address the comments in future filings without providing proposed language.

Importantly, the revisions that each of these companies made in their subsequent filings were successful in addressing the SEC's concerns, as none of them received a second round of comment letters.

Topic 606 Early Adopter	2017 Topic 606 SEC Comments	Filings Examined	Filings Redline Comparison
Alphabet (Google)	Performance Obligation Measurements: Principal vs. Agent Considerations; Timing of Satisfaction of Performance Obligations; Determining Transaction Price Disaggregation of Revenue	10-Q (Q2 2017) 7/25/2017 vs. 10-Q (Q3 2017) 10/27/2017	For ads placed on Google Network Members' properties, we evaluate whether we are the principal (i.e., report revenues on a gross basis) or agent (i.e., report revenues on a net basis). Generally, we report advertising revenues for ads placed on Google Network Members' properties on a gross basis, that is, the amounts billed to our customers are recorded as revenues, and amounts paid to ~~publishers~~ Google Network Members are recorded as cost of revenues. Where wWe are the principal, ~~because~~ we control the advertising inventory before it is transferred to our customers. Our control is evidenced by our sole ability to monetize the advertising inventory before it is transferred to our customers,and is further supported by us being primarily responsible to our customers~~,~~ and having a level of discretion in establishing pricing~~, or a combination of these~~.

continued

Topic 606 Early Adopter	2017 Topic 606 SEC Comments	Filings Examined	Filings Redline Comparison
CBOE Global Markets, Inc.	Consideration Payable to a Customer Performance Obligation Measurements: Tx Price Allocated to Remaining Performance Obligations	10-Q (Q2 2017) 8/4/2017 vs. 10-Q (Q3 2017) 11/7/2017	In 2017, the Company changed the presentation of liquidity payments, or rebates paid to customers in accordance with published fee schedules, to be a cost of revenues, which historically had been netted against transaction fees. The Company also changed the presentation of royalty fees to be a cost of revenues. The presentation of routing fees and costs were also changed. Routing fees were presented in transaction fees in total revenues and routing and clearing costs in total cost of revenues. These fees were previously presented as a net operating expense. These changes were made to conform to current presentation and the changes have been reflected in all periods presented.
Commvault Systems, Inc.	Performance Obligation Measurements: Standalone Selling Price Residual Approach; Obligations Satisfied at a Point in Time	10-Q (Q1 2018) 7/26/2017 vs. 10-Q (Q2 2018) 10/27/2017	The Company's software licenses typically provide for a perpetual right to use the Company's software. The Company also sells term-based software licenses that expire, which are referred to as subscription arrangements. The Company does not customize its software for customers and installation services are not required. The software is delivered before related services are provided and is functional without professional services, updates and technical support. The Company has concluded that its software license is functional intellectual property that is distinct as the customer can benefit from the software on its own. Software revenue is typically recognized when the software is delivered and/or made available for download as this is the point the user of the software can direct the use of, and obtain substantially all of the remaining benefits from the functional intellectual property. The Company does not 's customer. In addition, the Company has licensing arrangements with customers that are accounted for as usage-based royalties. Revenue from these arrangements is recognize software revenue related to as the renewal of subscription software licenses earlier than the beginning of the subscription period sage occurs.

continued

Topic 606 Early Adopter	2017 Topic 606 SEC Comments	Filings Examined	Filings Redline Comparison
First Solar, Inc.	Performance Obligation Measurements: Timing of Satisfaction of Performance Obligations; Variable Consideration; Non-Cash Consideration; Principal vs. Agent Considerations	10-Q (Q2 2017) 7/28/2017 vs. 10-Q (Q3 2017) 10/27/2017	In applying cost based input methods of revenue recognition, we use the actual costs incurred relative to the total estimated costs (including solar module costs) to determine our progress towards contract completion and to calculate the corresponding amount of revenue and gross profit to recognize. Cost based input methods of revenue recognition are considered a faithful depiction of our efforts to satisfy long-term construction contracts and therefore reflect the transfer of goods to a customer under such contracts. Costs incurred that do not contribute to satisfying our performance obligations ("inefficient costs") are excluded from our input methods of revenue recognition as the amounts are not reflective of our transferring control of the system to the customer. Costs incurred towards contract completion may include costs associated with solar modules, direct materials, labor, subcontractors, and other indirect costs related to contract performance. We recognize solar module and direct material costs as incurred when such items have been installed in a system. Cost based input methods of revenue recognition require us to make estimates of net contract revenues and costs to complete our projects. In making such estimates, significant judgment is required to evaluate assumptions related to the amount of net contract revenues, including the impact of any performance incentives, liquidated damages, and ~~other forms of variable consideration as well as any~~ payments to customers~~, such as indemnifications accounted for pursuant to Accounting Standards Codification ("ASC") 460, Guarantees.~~ Significant judgment is also required to evaluate assumptions related to the costs to complete our projects, including materials, labor, contingencies, and other system costs.

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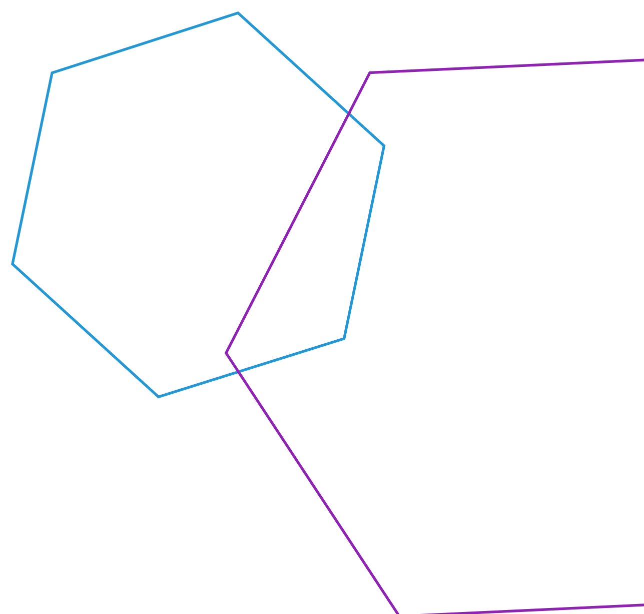

Topic 606 Early Adopter	2017 Topic 606 SEC Comments	Filings Examined	Filings Redline Comparison
Ford Motor Co.	Performance Obligation Measurements: Obligations Satisfied at a Point in Time; Significant Payment Terms Disaggregation of Revenue Reclassification of Debt	10-Q (Q2 2017) 7/26/2017 vs. 10-Q (Q3 2017) 10/26/2017 and 10-K (FY 2017) 2/8/2018	10-Q (Q3 2017) Revenue is recognized when obligations under the terms of a contract with our customer are satisfied; generally this occurs with the transfer of control of our vehicles, parts, accessories, or services. Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods or providing services. Sales, value add, and other taxes we collect concurrent with revenue-producing activities are excluded from revenue. Incidental items that are immaterial in the context of the contract are recognized as expense. The expected costs associated with our base warranties and field service actions continue to be recognized as expense when the products are sold (see Note 16). We recognize revenue for vehicle service contracts that extend mechanical and maintenance coverages beyond our base warranties over the life of the contract. We do not have any material significant payment terms as payment is received at or shortly after the point of sale. 10-K (FY 2017) **U.S. Sales by Type** The following table shows 2017 U.S. retail sales volume and U.S. wholesales segregated by truck, SUV, and car sales. U.S. retail sales volume reflects transactions with (i) retail and fleet customers (as reported by dealers), (ii) government, and (iii) Ford management. U.S. wholesales reflect sales to dealers. | | U.S. Retail Sales | U.S. Wholesales | Trucks: 1,123,416 / 1,114,304 SUVs: 867,909 / 869,725 Cars: 595,390 / 581,754 Total Vehicles: 2,586,715 / 2,565,783

	U.S. Retail Sales	U.S. Wholesales
Trucks	1,123,416	1,114,304
SUVs	867,909	869,725
Cars	595,390	581,754
Total Vehicles	2,586,715	2,565,783

continued

Topic 606 Early Adopter	2017 Topic 606 SEC Comments	Filings Examined	Filings Redline Comparison
General Dynamics Corp.	Combination of Contracts Costs of Contract Performance Obligation Measurements: Warranties; Significant Financing Component; Timing of Satisfaction of Performance Obligations; Obligations Satisfied at a Point in Time; Distinct Goods or Services	10-Q (Q3 2017) 7/26/2017 vs. 10-Q (Q3 2017) 10/25/2017	A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASC Topic 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The majority of our contracts have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and, therefore, not distinct. S~~F~~ome of our contracts ~~wit~~ have multiple performance obligations, most commonly due to the contract covering multiple phases of the product lifecycle (development, production, maintenance and support). For contracts with multiple performance obligations, we allocate the contract's transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. The primary method used to estimate standalone selling price is the expected cost plus a margin approach, under which we forecast our expected costs of satisfying a performance obligation and then add an appropriate margin for that distinct good or service.
Microsoft Corp.	Performance Obligation Measurements: Distinct Goods or Services	10-Q (Q1 2018) 10/26/2017 vs. 10-Q (Q2 2018) 1/31/2018	Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. Wh~~C~~en ~~rt~~a~~in~~ cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software licence is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, ~~and~~ interdependency, and interrelation between the desktop applications and cloud services, an~~. Ju~~d~~gment is required to determine whether the softw~~are ~~license is considered distinct and~~ accounted for ~~separately, or not distinct and accounted for~~ together as on ~~with th~~e performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided. Judgment is required to determine the SSP for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount that needs to be allocated based on the relative SSP of the various products and services.

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Topic 606 Early Adopter	2017 Topic 606 SEC Comments	Filings Examined	Filings Redline Comparison
R1 RCM, Inc.	Performance Obligation Measurements: Timing of Satisfaction of Performance Obligations	10-K (FY 2017) 3/9/2018 vs. 10-Q (Q2 2018) 8/9/2018	RCM services fees are primarily variable and performance related, and are generally viewed as the consideration earned in satisfaction of a single performance obligation which is considered a series. Variable consideration for end-to-end RCM services are allocated to and recognized over the related time period as the amounts reflect the consideration the Company is entitled to and relate specifically to the Company's efforts to satisfy its performance obligation. Fees for physician group and EMS provider RCM services are variable consideration contingent on customer collections and inputs to the Company's revenue estimates typically include historical service fees and historical customer collection amounts. RCM services fees consist of net operating fees, incentive fees, and other fees. [...] The Company does not disclose information about remaining performance obligations with an original expected duration of one year or less. The Company has elected certain of the optional exemptions from the disclosure requirement for remaining performance obligations for specific situations in which an entity need not estimate variable consideration to recognize revenue. Accordingly, the Company applies ~~the~~ a practical expedient ~~in paragraph 606-10-55-18~~ to its stand-alone PAS contracts and modular RCM services and does not disclose information about variable consideration from remaining performance obligations ~~for which~~ when the Company ~~recognizes revenue~~ has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date. PAS performance obligations are typically short in duration (often less than 1 day) with any uncertainty related to the associated variable consideration resolved as each increment of service (completion of a level of care review or an appeal) is completed which reflects the value the Customer receives from the Company's fulfillment of the performance obligation. Modular RCM services performance obligations for variable consideration are of short duration with fees corresponding to the value the customer has realized, for example, patient accounts collected on behalf of the Customer or medical record lines transcribed. ~~The Company also applies the guidance in paragraph 606-10-50-14A(b) to variable consideration within its~~ For end-to-end RCM contracts ~~and~~, the Company does not disclose information about remaining, wholly unsatisfied performance obligations for variable consideration that the Company is able to allocate to one or more, but not- all, of the performance obligations in its contracts ~~in accordance with paragraph 606-10-32-40. The~~ Company's end-to-end RCM services performance obligations are satisfied over time and are substantially the same from period to period under either a co-managed or operating partner model. Fees are variable and consist of net operating fees and incentive fees with the uncertainty related to net operating fees and certain incentive fees being resolved quarterly with the uncertainty of other incentive fees being resolved annually. The information presented in the table above includes estimates for incentive fees where the uncertainty related to the final fee is resolved on longer than a quarterly basis and to the extent the Company does not believe the associated consideration is constrained.

continued

Topic 606 Early Adopter	2017 Topic 606 SEC Comments	Filings Examined	Filings Redline Comparison
Radius Health, Inc.	Performance Obligation Measurements: Significant Payment Terms	10-Q (Q3 2017) 11/2/2017 vs. 10-Q (Q1 2018) 5/10/2018	We recognize ~~the Company's products.~~ ~~The Company recognizes~~ revenue on product sales when the Customer obtains control of our ~~the Company's~~ product, which occurs at a point in time (upon delivery). Product revenues are recorded net of applicable reserves for variable consideration, including discounts and allowances. Payment from Customers is typically due within 31 calendar days of the invoice date. If taxes should be collected from Customers relating to product sales and remitted to governmental authorities, they will be excluded from revenue. We expense ~~The Company expenses~~ incremental costs of obtaining a contract when incurred, if the expected amortization period of the asset that we ~~the Company~~ would have recognized is one year or less. However, no such costs were incurred during the three months ended March 31, 2018. ~~and nine months ended September 30, 2017.~~ Reserves for Variable Consideration-Revenues ~~Consideration-Revenues~~ from product sales are recorded at the net sales price (transaction price), which includes estimates of variable consideration for which reserves are established. Components of variable consideration include trade discounts and allowances, product returns, provider chargebacks and discounts, government rebates, payor rebates, and other incentives, such as voluntary patient assistance, and other allowances that are offered within contracts between us and our ~~the Company and its~~ Customers, payors, and other indirect customers relating to the sale of our ~~Company's sale of its~~ products. These reserves, as detailed below, are based on the amounts earned, or to be claimed on the related sales, and are classified as reductions of accounts receivable (if the amount is payable to the Customer) or a current liability (if the amount is payable to a party other than a Customer). These estimates take into consideration a range of possible outcomes which are probability-weighted in accordance with the expected value method in Topic 606 for relevant factors such as current contractual and statutory requirements, specific known market events and trends, industry data, and forecasted customer buying and payment patterns. Overall, these reserves reflect our ~~the Company's~~ best estimates of the amount of consideration to which it is entitled based on the terms of the respective underlying contracts.

continued

Topic 606 Early Adopter	2017 Topic 606 SEC Comments	Filings Examined	Filings Redline Comparison
Sanchez Energy Corp.	Derecognition of Deferred Gains	10-Q (Q3 2017) 11/6/2017 vs. 10-K (FY 2017) 3/1/2018	~~In~~ May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." In March, April, and May of 2016, the FASB issued rules clarifying several aspects of the new revenue recognition standard. The new guidance is effective for fiscal years and interim periods beginning after December 15, 2017. This guidance outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods and services. The new standard also requires more detailed disclosures related to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company will ~~not early adopt the standard although early adoption is permitted. The Company's expectation is to~~ apply the modified retrospective approach. As part of the assessment, the Company ~~has~~ formed an implementation work team, completed trainings on the new revenue recognition model and ~~gathered a representative sample of~~ our material revenue contracts covering current revenue streams for which we ~~are currently evaluating the impact under the new standard. The Company is currently collecting all remaining contracts and evaluating~~ evaluated the impacts to ~~its~~ the consolidated financial statements under the revised standards. In addition, the Company is evaluating the impacts of significant historical transactions under the new standard. As of ~~September 30~~December 31, 2017, the Company determined that the deferred gains recorded under the Carnero Gathering Disposition and Carnero Processing Disposition (defined below in Note ~~11~~10, "Related Party Transactions") ~~could~~ will be de-recognized under the new standard and a derivative asset could be recorded for the value of the earnout provision owed to us by SNMP. Under the modified retrospective approach, ~~we would adjust~~ the balance of accumulated deficit will be adjusted on January 1, 2018.
Workday, Inc.	Costs of Contract	10-Q (Q1 2018) 6/2/2017 vs. 10-Q (Q2 2018) 8/31/2017	Sales commissions earned by our sales force are considered incremental and recoverable costs of obtaining a contract with a customer. ~~These costs~~ Sales commissions for initial contracts are deferred and then amortized on a straight-line basis over a period of benefit that we have determined to be five years. We determined the period of benefit by taking into consideration our customer contracts, our technology and other factors. Sales commissions for renewal contracts are deferred and then amortized on a straight-line basis over the related contractual renewal period. Amortization expense is included in Sales and marketing expenses in the accompanying condensed consolidated statements of operations.

Early Adopter Emerging Growth Companies

Key Takeaways:

- EGCs electing not to take advantage of the deferred accounting compliance found themselves under the same scrutiny as regular adopters, with the SEC issuing multiple rounds of comments if it was not satisfied with the initial responses.
- The questions posed to EGCs mirrored those asked of regular adopters, signalling a consistent approach in the review of disclosure

In 2012, the JOBS Act created a new category of securities issuer, the EGC, that included those with revenues under $1 billion which either had not gone public or just had its initial public offering (IPO). The classification as an "emerging growth company" is an important one, as EGCs are permitted to adopt new or revised accounting standards on the same, less ambitious schedule as private companies.

As stated in the Division of Corporation Finance's Financial Reporting Manual:

> All other entities, including EGCs that have appropriately elected to defer compliance with new or revised financial accounting standards until a company that is not an issuer (as defined under section 2(a) of the Sarbanes-Oxley Act of 2002) is required to apply such standards, must apply ASU No. 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019.

EGCs are also not subject to the same SEC reporting requirements as other public companies. Specifically, Title I provides scaled disclosure provisions for EGCs, including two years of audited financial statements in the Securities Act registration statement for an IPO of common equity securities, the smaller reporting company version of Item 402 of Regulation S-K, and no requirement for Sarbanes-Oxley Act Section 404(b) auditor attestations of internal control over financial reporting. In addition, EGCs need only disclose the compensation of their three top executives (as opposed to four for other public companies) and are not required to disclose pay ratio for their principal named executive officer.

Several EGC companies decided not to take advantage of the deferred compliance. These included biopharmaceutical company Alector, connected planning company Anaplan, search company Elastic, survey software maker SVMK and cyber exposure technology firm Tenable Holdings. Two of these companies, Alector and Tenable, received multiple rounds of SEC comments.

As we saw earlier in the paper with pharmaceutical firms, the SEC focused on Alector's collaboration agreement with Abbvie, how it accounted for the agreement, the duration of Phase 2 clinical trials and a description of milestone payments in an 11/7/2018 comment letter. Alector responded that the initial phase was accounted for under Topic 808 Collaborative Arrangements but that the Phase 2 clinical trials represented "a customer/vendor relationship" since the company was required to perform research and development services for a fixed fee and identified two performance obligations under Topic 606 in its 11/16/2018 response letter.

Tenable Holdings received an initial comment letter on 5/24/2018 and was asked about when it began recognizing revenue and how it determined control had been transferred. It was also asked about its perpetual license arrangements including if a material right had been identified as a separate performance obligation and if the material right had been combined with the perpetual license and maintenance, the timing over which revenue is recognized for the combined performance obligation, and the period of time revenue is recognized for the material right. Tenable responded on 6/6/2018 that it determined for accounting purposes its direct customers were the distributor and the indirect customer was the end user. It went on to explain that it considered transfer of control when the end user received the electronic key for the software. Tenable said it was unable to separately identify the promise to transfer the software license and ongoing maintenance and considered them inputs into a combined item and thus a single performance objective.

Unicorns

Key Takeaways:

- More than half of unicorns were early adopters of the new revenue recognition standard, despite the fact that most of these companies — as EGCs — were eligible to adopt on the delayed schedule afforded non-public entities.
- Topic 606-related SEC comments on the handling of revenues from subscription-based services were evident in several of the unicorns we examined. These are issues that we anticipate will continue to arise with greater frequency moving forward, which it will become increasingly important for the SEC to address.
- The size of unicorns ($1 billion-plus) makes them likely to have mature financial processes in place and, therefore, to use the full retrospective method when transitioning to the new revenue recognition standard, just as the majority of more established public companies did in 2018.

Earlier this year we released a report looking at the IPOs of unicorn companies. Unicorns are classified as companies:

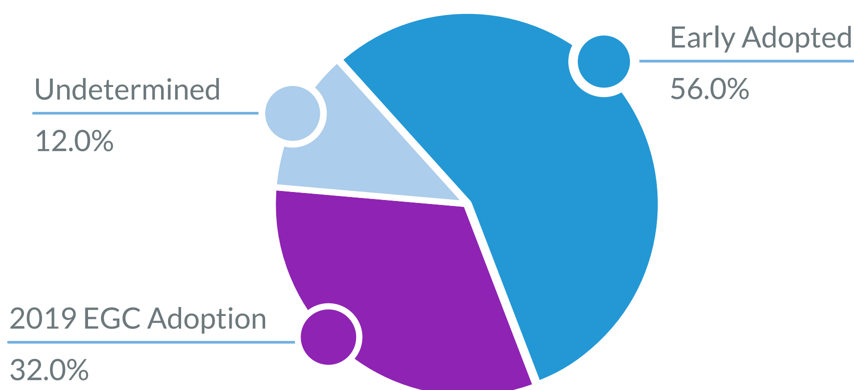
- Valued at $1 billion or greater at the time of IPO;
- that are venture-capital backed;
- listing common stock or a class of common stock (not ADRs); and
- listing on the NYSE or Nasdaq, with more than 50% of outstanding voting securities held by U.S. residents.

For this report on revenue recognition, we examined unicorns with registration effective from January 1, 2018, through April 30, 2018. During this period, 25 unicorns debuted on the public markets, 22 of which are classified as EGCs — only Lyft, Sonos and Dropbox are not.

Unicorn Early Adopters

In our Unicorn IPO report, we noted that 55% of 2018 unicorn IPOs elected to early adopt the new revenue recognition standards. That percentage remained consistent in our research for this report, which includes 2018 and the first four months of 2019. During that time, 14 unicorns (56%) were early adopters of the new revenue recognition standard while 32% opted to adopt based on the schedule allowed for 2019 EGCs.

Early Adoption of ASC 606 by Unicorns



Unicorn SEC Comment Letters on New Revenue Recognition Standards

As technology continues to move the U.S. and global economies in the direction of service-based businesses, we anticipate that we will continue to see an influx of IPOs from companies that derive significant portions of their revenues from the sale of ongoing subscriptions — either as standalone services (like ride-sharing service Lyft) or associated with an accompanying hardware-based offering (like technology-enabled exercise company, Peloton, which confidentially filed for an IPO in June 2019). Of the 25 unicorns that went public during the time period reviewed, seven (28%) received SEC comment letters related to the new revenue recognition standard, including:

- Lyft
- Alector
- Anaplan
- Elastic
- SVMK
- Sonos
- Tenable Holdings

In reviewing the comment letters to these companies, we noted a predominance of SEC comments focused on trying to understand how several of them treat revenue from subscription-based services. This was evident in its comments to Lyft; SVMK, the parent of Survey Monkey; and Dutch search company, Elastic — the likes of which were generally absent in last year's report that examined early and standard adopters. The SEC's Topic 606 comments to Lyft, SVMK and Elastic (highlighted in the table below), however, are a clear indication of the types of issues the Staff will continue to grapple with and must be sorted out as the volume of public companies with subscription-based revenues continues to increase.

Lyft

Subscription-Focused Revenue Recognition Comments:
UPLOAD, 2/4/2019: We note your disclosure on page 120 that you offer subscription plans and ride passes. Please explain your revenue recognition policy for each offering including how you have considered any expected breakage amounts and, if material, revise your disclosure as appropriate. Refer to ASC 606-10-50-12 and 606-10-50-17.

SVMK

Subscription-Focused Revenue Recognition Comments:
UPLOAD, 7/13/2018: We note that you generate revenue from a wide range of purpose-built solutions. Please tell us the nature of the purpose-built subscription services and the timeframe over which they are provided. Clarify whether these subscriptions are considered separate performance obligations from the subscriptions to the survey platform. If accounted for separately, tell us when revenue is recognized. Refer to ASC 606-10-25-19 and 25-23 and ASC 606-10-50-12.

Subscription-Focused Revenue Recognition Comments:
UPLOAD, 7/11/2018: We note that Elastic Cloud customers may purchase subscriptions either on a month-to-month basis or on a committed contract of at least one year in duration. Please tell us and clarify in your disclosures whether or not you include month-to-month subscriptions in your calculation of ACV or customers. Additionally, to the extent that month-to-month subscriptions are material, disclose the proportion of subscriptions which are on a month-to-month basis.

You disclose that your ACV prior period value "effectively represents recurring dollars that [you] expect in the subsequent 12-month period from that group of customers." Please tell us if prior period ACV includes contracts with remaining subscription terms of less than 12 months as of the prior period measurement date and revise your disclosure accordingly.

Full vs. Modified Retrospective

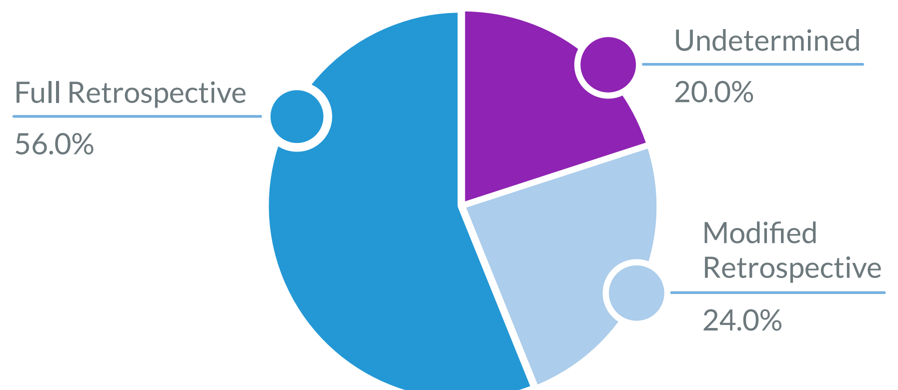
All Topic 606 adopters must decide whether to use the full or modified retrospective transition method. When it comes to unicorns, their sheer size makes them most likely to have mature financial processes in place. While they are newly public, they are by no means bootstrapped start-ups at this point. So, it stands to reason that these companies would use the same transition method as more established public companies.

The full retrospective method is more thorough and has the significant benefit of enabling an "apples-to-apples" comparison of financials both before and after adoption. As a result, however, it is far more resource intensive and challenging to implement – the equivalent of a company having to restate three years' worth of earnings. Using the full retrospective approach, a company must determine the cumulative effect of applying the new standard as of the beginning of the first historical period presented, and then recast revenue and expenses for all prior periods presented in the year of adoption of the new standard.

The modified retrospective, on the other hand, includes accommodations for a quicker and easier transition but poses higher risks to a company during the first year of adoption. Under the modified retrospective approach, a company applies the new accounting standards to all new contracts initiated on or after the effective date, and, for contracts that have remaining obligations as of the effective date, a company must make an adjustment to the opening balance of its retained earnings account. Under this method, companies do not restate comparative periods in their financial statements.

In analyzing the transition methods of unicorns, we found that of the 25 unicorns that adopted the new revenue recognition standard between January 1, 2018, and April 30, 2019, more than twice as many (14) used the full retrospective method as used the modified retrospective method (6). The full retrospective method is somewhat easier to implement for newly public companies. Further, the "apples-to-apples" comparison it provides allows unicorns planning IPOs to better address potential investor demands when selling the IPO to the market.

Revenue Recognition Transition Method for Unicorn IPOs



Methodology

This study was researched in its entirety using the Intelligize platform, which collects, analyzes and connects related documents, including SEC filings and associated exhibits; comment letters and responses; earnings call transcripts; deal summaries and underlying agreements; FASB accounting rule changes; and market standard language for accounting disclosures.

The data and insights presented are based on information available on the Intelligize platform between January 1, 2018, and April 30, 2019.

The Intelligize platform includes:

- SEC Filings
- Section Analysis & Trends
- Agreements & Other Exhibits
- Comment Letters
- No-Action Letters
- Regulatory Materials
- Securities Drafting & Compliance
- Accounting Standards & Guidance
- Registered Offerings
- Mergers & Acquisitions
- Exempt Offerings
- Corporate Governance
- Firm Memos
- Earnings Call Transcripts

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Intelligize is the leading provider of best-in-class content, exclusive news collections, regulatory insights, and powerful analytical tools for compliance and transactional professionals.

Intelligize offers a web-based research platform that ensures law firms, accounting firms, corporations and other organizations stay compliant with government regulations, build stronger deals and agreements, and deliver value to their shareholders and clients.

Headquartered in the Washington, DC metro area, Intelligize serves Fortune 500 companies, including Starbucks, IBM, Microsoft, Verizon and Walmart, as well as many of the top global law and accounting firms.

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