Case 1: CBOE Holdings, Inc.

Instructions: Read the following excerpts from CBOE Holding's June 30, 2017 10-Q and the SEC's question regarding CBOE's revenue recognition policy. Then determine the appropriate accounting treatment for CBOE's liquidity payments based on ASC 606.

Excerpts from CBOE's 10-Q (Jun. 30, 2017)

CBOE Holdings, Inc. (CBOE Holdings or the Company) is the owner of the Chicago Board Options Exchange, the Bats Exchanges, CBOE Futures Exchange (CFE) and other subsidiaries. The Company is one of the world's largest exchange holding companies and a leader in providing global investors cutting-edge trading and investment solutions.

The Company offers trading across a diverse range of products in multiple asset classes and geographies, including options, futures, U.S. and European equities, exchange-traded products (ETPs), and multi-asset volatility and global foreign exchange ("FX") products. CBOE Holdings' fourteen trading venues include the largest options exchange by volume in the United States and the largest pan-European stock exchange in Europe by volume. The Company is the second-largest stock exchange operator in the United States by volume and a leading market globally for exchange-traded product (ETP) trading. [10-Q, p. 35]

Transaction fees represent fees charged by the Company for the performance obligation of executing a trade on its markets. These fees can be variable based on trade volume tiered discounts, however as all tiered discounts are calculated monthly, the actual discount is recorded on a monthly basis. Transaction fees, as well as any tiered volume discounts, are calculated and billed monthly in accordance with the Company's published fee schedules. Transaction fees are recognized across all segments. The Company also pays liquidity payments to customers based on its published fee schedules. The Company uses these payments to improve the liquidity on its markets and therefore recognizes those payments as a cost of revenue. [10-Q, p. 35]

Liquidity payments are directly correlated to the volume of securities traded on our markets. As mentioned above, we record the liquidity rebate paid to market participants providing liquidity, in the case of C2, BZX, EDGX and Bats Europe, as cost of revenue. BYX and EDGA offer a pricing model pursuant to which we rebate liquidity takers for executing against an order resting on our book, which is also recorded as a cost of revenue. [10-Q, p. 36]

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. [10-Q, p. 6]

SEC Comment Letter to CBOE dated August 21, 2017 re: 10-Q (June 30, 2017)

Please explain to us how you determined that rebates paid to customers in accordance with published fee schedules should not be accounted for as a reduction of the transaction price. Refer to ASC 606-10-32-25 to 32-27.

ASC 606-10-32-25 to 32-27

32-25 Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 606-10-25-18 through 25-22) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 606-10-32-5 through 32-13.

32-26 If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

32-27 Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognize the reduction of revenue when (or as) the later of either of the following events occurs:

a. The entity recognizes revenue for the transfer of the related goods or services to the customer.
b. The entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

Case 2: Pesky Sales Commissions

Instructions: Read the following case facts and determine the appropriate accounting treatment for Pesky's sales commissions based on ASC 606 and ASC 340. (See questions at the end of this case.)

Pesky employs thousands of door-to-door reps who sell pest control nationwide. Pesky provides year-round pest control services using its own employees and equipment. Customers typically sign up for a new one-year contract for an average price of $480. Customers pay $100 at contract signing, which includes a nonrefundable activation fee of $60 and the first monthly charge of $40. The $60 upfront fee helps offset Pesky's cost of setting up a new customer and paying its sales reps. If a customer chooses to renew for an additional year, the customer pays the currently prevailing monthly rate, which has not increased from $40/month for a number of years. The customer can cancel at any time, but cannot receive a refund for the upfront activation fee.

Sales reps receive a $100 (18.5% = $100 / ($60 + [$40 x 12])) sales commission in the first year a customer signs up with Pesky. Sales reps receive a $40 (8.3% = $40 / [$40 x 12]) sales commission in any year that their original customer renews. Sales reps are encouraged to reach out to existing customers regularly to maintain a good relationship and obtain feedback on ways the company can improve. As a result of these efforts, 70 percent of customers in a given year renew for an additional year. On average, customers stay with Pesky for 3.5 years.

In 2017, Pesky conducted a study to understand what makes their sales people successful. Among other things, the responses from sales reps indicated that they spend an average of one hour with a new customer (including initial presentation and two to three follow-up visits) to obtain a new contract. Sales reps also indicated spending an average of only 15 minutes (including emails, phone calls, and on occasion another visit to the home) getting an existing customer to renew their contract for another year. Pesky concluded that its sales commission structure was appropriate given the amount of time sales reps spent with customers. In addition, sales reps seemed to be pleased with the commission structure.

In the last quarter of 2017, Pesky's controller (Bugsy) was finalizing the accounting policy memo related to sales commissions and upfront fees and found herself puzzling at the following guidance in ASC 340-40 *Other Assets and Deferred Costs – Contracts with Customers*:

> **25-1** An entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.
>
> **25-2** The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

25-3 Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

25-4 As a practical expedient, an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less.

35-1 An asset recognized in accordance with paragraph 340-40-25-1 or 340-40-25-5 shall be amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. The asset may relate to goods or services to be transferred under a specific anticipated contract (as described in paragraph 340-40-25-5(a)) [see below].

Costs to Fulfill a Contract

25-5 An entity shall recognize an asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:

a. The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved).

Bugsy felt pretty confident that the sales commissions were incremental costs of obtaining a contract, but she wasn't sure whether to use the practical expedient and expense the commissions immediately or to capitalize and amortize the commissions over a longer period, such as the customer's average life with Pesky (3.5 years).

While considering what to do with the sales commissions, Bugsy also reviewed the guidance on accounting for upfront fees in ASC 606:

55-50 In some contracts, an entity charges a customer a nonrefundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts, and initial fees in some supply contracts.

55-51 To identify performance obligations in such contracts, an entity should assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a nonrefundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfill the contract, that activity does not result in the transfer of a promised good or service to the customer (see paragraph 606-10-25-17). Instead, the upfront fee is an advance payment for future goods or services and, therefore, would be recognized as revenue when those future goods or services are provided. The revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as described in paragraph 606-10-55-42.

> **55-42** If, in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services, and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

Bugsy does not think that Pesky's new customers have a material right to receive future goods or services because customers pay the prevailing monthly rate if they decide to renew. But, Bugsy knows this new standard can be tricky, and Bugsy is just not sure what to do.

Questions: How should Pesky account for the upfront activation fee ($60) paid by new customers and the sales commissions ($100) paid to sales reps for a new customer contract? In particular, over what period (if any) should these amounts be amortized?

Case 3: Ford Motor Company

Instructions: From the perspective of an investor, what categories would you want Ford to use when disaggregating its revenue from contracts with customers? How would your proposed disaggregation be consistent with the following guidance in ASC 606-10?

50-5 An entity shall disaggregate revenue recognized from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. An entity shall apply the guidance in paragraphs 606-10-55-89 through 55-91 when selecting the categories to use to disaggregate revenue.

55-90 When selecting the type of category (or categories) to use to disaggregate revenue, an entity should consider how information about the entity's revenue has been presented for other purposes, including all of the following:

a. Disclosures presented outside the financial statements (for example, in earnings releases, annual reports, or investor presentations)
b. Information regularly reviewed by the chief operating decision maker for evaluating the financial performance of operating segments
c. Other information that is similar to the types of information identified in (a) and (b) and that is used by the entity or users of the entity's financial statements to evaluate the entity's financial performance or make resource allocation decisions.

55-91 Examples of categories that might be appropriate include, but are not limited to, all of the following:

a. Type of good or service (for example, major product lines)
b. Geographical region (for example, country or region)
c. Market or type of customer (for example, government and nongovernment customers)
d. Type of contract (for example, fixed-price and time-and-materials contracts)
e. Contract duration (for example, short-term and long-term contracts)
f. Timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time)
g. Sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).