



CAPITALIZED COSTS TO OBTAIN A CONTRACT

ASC 340-40-25-1 states that the cost of obtaining a contract should be recognized as an asset if the costs are incremental and are expected to be recovered. The key word is “incremental.” Certain items are not considered incremental costs and may not be considered as capitalized expenses. For example, the cost of engineering and design work that is incurred prior to obtaining the contract may qualify as precontract costs but not as incremental costs. That is because the cost would be incurred whether or not the contract was obtained.

HOW THIS RULE WORKS

- ▶ Certain contract fulfillment costs that are not governed by other standards (e.g., inventory) may be capitalized on the balance sheet.
- ▶ Incremental costs incurred in obtaining a contract may be capitalized on the balance sheet and amortized on a basis consistent with the transfer of goods or services to which they relate. Unamortized costs should be evaluated for impairment.

CAPITALIZED COSTS MUST

- Directly relate to a contract or an anticipated contract
- Be specifically identifiable
- Generate or enhance resources that will be used in satisfying (or continuing to satisfy) future performance obligations
- Be recoverable

- ▶ Any costs that are capitalized must be amortized over the period during which control was transferred to the customer.

FINANCIAL STATEMENTS MUST REFLECT CAPITALIZED COSTS

- Such costs may be reported as “deferred contract costs,” “capitalized contract costs”
- Unamortized costs are reported as “unamortized costs to obtain contracts”
- Classification of contracts assets as current or noncurrent depends on the timing of the expected recovery
- Impairment losses are presented separately

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DISCLOSURE REQUIREMENTS

- Judgements made in determining the amount of costs incurred to obtain or fulfill the contract
- The amortization method used
- Amount of amortization
- Impairment losses
- Use of practical expedient

This determination requires the contractor to use a significant amount of judgment. To avoid making an error, be sure to review your determination with a professional with expertise in ASC 606.

HAVE QUESTIONS?

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