# An Easy Formula for Direct Costs Classification under ASC 606 & IFRS 15



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A lot has been said about the new ASC 606 guidance on contract revenue recognition: What the changes are, who is affected, when it takes effect, how to get ready, and more. But not much has been said about the Direct Costs the changes have on the way direct costs are to be accounted for.

**Should the costs associated with fulfilling a contract be expensed or capitalized under ASC 606?**

The best way to make this determination is by following an easy formula proposed by PwC in their guide Revenue from Contracts with Customers.

First of all, you need to find out if the cost is in the scope of another FASB standard. Some costs such as treatment of inventory, intangibles, property and plant and equipment are in the scope of other standards and ASC 606 does not apply.

Then, for each cost incurred to fulfill a contract that is not in the scope of other standards follow the below formula:

**Does the cost relate directly to a contract?** If the answer is NO then expensed the cost. If the answer is YES then proceed with question two.

**Does the cost generate or enhance resources that will be used to satisfy performance obligations?** If the answer is NO then expensed the cost, otherwise proceed to question three.

**Is the cost likely to be recovered?** If the answer is YES, then you can recognize this cost as an asset and it can be capitalized. If you don't expect to recover the cost, then you must expense it as it is incurred.

Some costs such as employee wages and supplies used as part of the contract are easy to classify. Other costs such as learning curve costs, setup and mobilization costs and abnormal costs will require more analysis and the application of judgment.

Intacct, the best-in-class ERP, handles all the requirements to comply with ASC 606 and IFRS 15. For instance, it's important to document your decisions at each stage of the process so auditors have a trail to follow. With Intacct Collaborate, relevant documents that belong to the way a specific cost was classified can be uploaded directly into the corresponding conversation.

Contact us to learn more about how ASC 606 will affect your company and how Intacct can help you to get ready, or attend one of the webinars on the topic.