

# Understanding ASC 606: Why Agencies Still Struggle With Revenue Recognition (2025 Update)



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## If you are an Agency Principal, Account Manager or Project Manager...STOP!

This article still isn't for you. Really. If you've got time between client deadlines and curiosity gets the better of you, read on — but do so at your own risk. You may experience mild boredom and an urge to over analyze your SOWs.

## But, Agency CFOs and Controllers?

You'll definitely want to read this.

Even though **ASC 606, Revenue from Contracts with Customers**, has been in effect for several years now, it continues to be one of the most misunderstood and inconsistently applied accounting standards in the agency world. The rules haven't changed much — but how agencies operate has. With hybrid work models, AI-assisted production, evolving scopes of work, and retainer-based relationships, revenue recognition has only grown more complex.



## Why Revisit ASC 606 Now?

When ASC 606 was first adopted, many agencies viewed it as a compliance exercise — something to “get through” in time for audit season. Fast-forward to 2025, and it’s become clear that true mastery of the standard is what separates agencies with clean, predictable revenue from those constantly reconciling after-the-fact.

We’re also seeing renewed attention from auditors and investors around the *practical* application of ASC 606 — particularly how agencies define performance obligations, manage change orders, and evaluate “over-time” versus “point-in-time” revenue recognition.

So, even if your agency implemented ASC 606 years ago, now is the time to double-check your assumptions, systems, and contracts.

## A Quick Refresher

Before ASC 606, US GAAP revenue recognition guidance was fragmented and inconsistent across industries. The FASB and IASB joined forces in 2002 to create a unified standard, culminating twelve years later in **ASC 606** (FASB) and **IFRS 15** (IASB): both titled *Revenue from Contracts with Customers*.

With only minor differences between them, the two standards established a single, principle-based model for recognizing revenue across all industries — including marketing and advertising agencies.

Although most private companies adopted ASC 606 in 2019, the lessons and pitfalls continue to surface. If you haven’t revisited your policies recently — or if your client contracts look suspiciously like they did pre-606 — this is your sign.

**So, fasten your seatbelt — let’s revisit ASC 606 with fresh eyes and practical takeaways for today’s agency finance world.**

<sup>1</sup> The FASB ASC (Accounting Standards Codification) is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. This ASC has been updated and amended through several ASU’s (Accounting Standards Update), which are not in themselves authoritative. ASU’s are documents that communicate how the ASC is being amended. Please consult with your CPA or external auditors for the latest updates.



ASC 606 supersedes all previous revenue recognition guidance and applies to all entities, regardless of industry. It's based on a simple (but deceptively detailed) five-step framework:

**1 — Identify the Contract with a Customer** p 3

**2 — Identify the Performance Obligations** p 6

**3 — Determine the Transaction Price** p 7

**4 — Allocate the Transaction Price** p 7

**5 — Recognize Revenue** p 9

In this updated guide, we'll interpret each step specifically for **marketing and creative agencies** — replacing “entity” with “Agency” and “customer” with “Client,” so it feels a little less abstract and a little more real.

## 1 IDENTIFY THE CONTRACT WITH A CUSTOMER

Definition of a contract: An agreement between two or more parties that creates enforceable rights and obligations (ASC 606-10-20)

All of the following criteria must be met before an Agency accounts for a contract with a customer under the revenue standard (ASC 606-10-25-1):

- The parties to the contract have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their respective obligations.
  - Simply put, a contract must be approved by the Agency and its Client, e.g. the Client signs and the Agency counter-signs a contract/SOW. Termination clauses are recommended, stating that either party can cancel at any time, etc.
- The entity (Agency) can identify each party's rights regarding the goods or services to be transferred.
  - The contract should clearly and specifically state what work will be performed or what service will be delivered, as well as the amount that the Client will pay.
- The entity (Agency) can identify the payment terms for the goods or services to be transferred.
  - Make sure your contracts contain a payment schedule or clear payment terms.
- The contract has commercial substance; that is, the risk, timing, or amount of the entity's (Agency's) future cash flows is expected to change as a result of the contract.
  - It's important to note here that a change in future cash flows does not necessarily mean that noncash payments have no commercial substance. Noncash payments might mean reduced cash outflows in the future, as in barter or trade contracts. However, pro bono work would not have commercial substance (similar to volunteer work).
- It is probable that the entity (Agency) will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.
  - An Agency must determine that its Client has the ability and intent to pay (obviously!); probability, according to US GAAP, can be interpreted as 75-80% likelihood. Work done for a pro bono client would not fall under ASC 606 because it is known that the Agency will not collect any payment.



## Contract Modifications

As we know, there are many instances where an Agency determines that the scope of a particular project has either expanded or changed, i.e. a Change Order, most likely resulting in an increase in the original contract price. Per ASC 606, this would be defined as a contract modification and is accounted for as either a separate contract or as an adjustment to the existing contract, depending on the nature of the modification.

Modifications accounted for as a separate contract must meet both of these conditions:

1. The scope of the contract increases because of the addition of distinct promised goods or services.
  - A. An Agency must be able to identify a distinct additional good to be delivered or additional service to be performed; it cannot simply be an increase due to additional hours expended to complete a service already in the existing contract.
2. The price of the contract increases by an amount of consideration that reflects the entity's (Agency's) standalone selling price of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract.
  - A. The additional price reflects its standalone selling price, e.g. the Client wants a new logo, which was not part of the existing contract and the Agency attaches a standalone selling price for the creation and delivery of the logo.

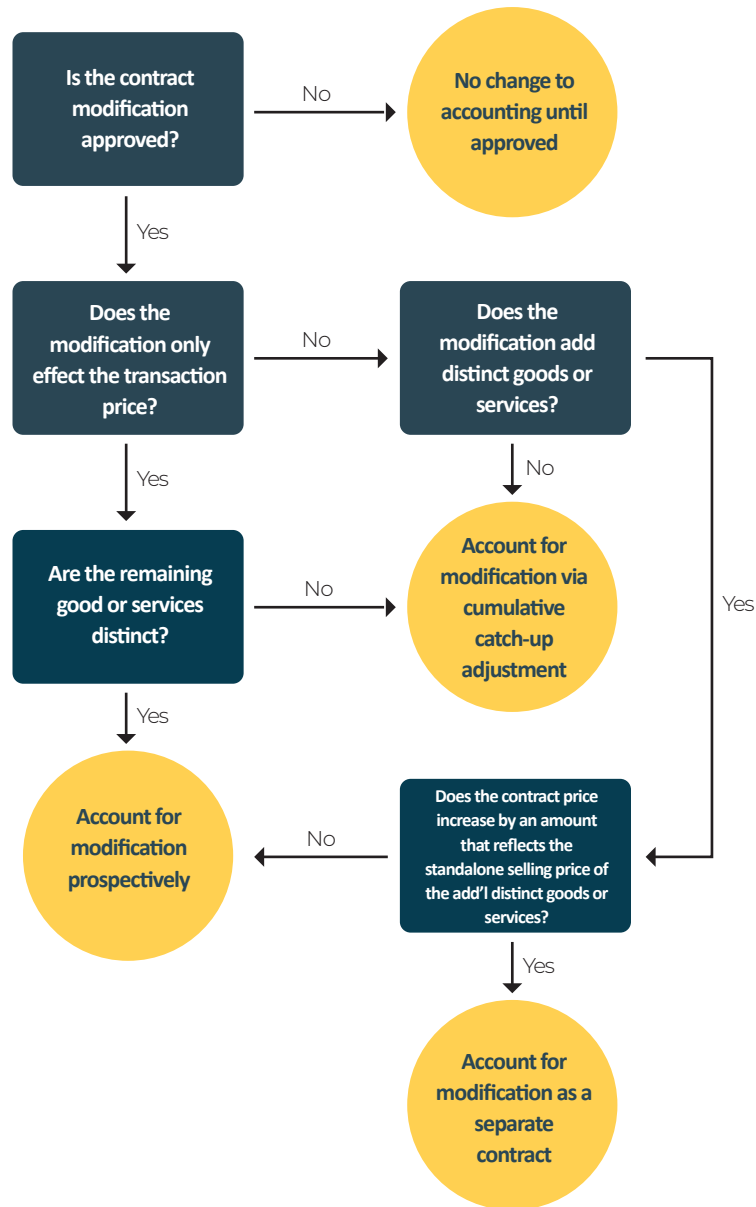
Modifications which do not meet the above criteria, e.g. additional rounds of revisions to an existing deliverable, should be accounted for as an adjustment to the existing contract, applied in one of the following two ways:

- Cumulative catch-up
- Prospectively

What is meant by **cumulative catch-up**? The modification is added to the existing contract as if it was always there, and revenue associated with the modification would be trued up at the next reporting period (typically the next reporting month).

What is meant by **prospectively**? The modification is added to the existing contract as if it were a separate contract, and revenue associated with the modification is recognized as of the modification date and going forward.

In order to properly categorize contract modifications and determine how to account for them, consider the following flowchart. We recommend walking through this chart to determine how to treat change orders anytime your project scope increases or is changed.



Adapted from PwC's "Revenue from contracts with customers 2014"

Pretty charts aside, let's summarize and break down this crazy accounting jargon. Determine first if the modification will result in a separate contract or a modified contract. A modification that adds a distinct good or service (i.e. separately identifiable and can stand alone) and where the additional amount attached to this good or service reflects a standalone selling price would result in the creation of a **separate contract**. If the modification does not meet these two conditions, it should be treated as an **adjustment to the existing contract**.

If you've determined that you need to modify the existing contract, you must next decide if you should account for the modification cumulatively or prospectively; to figure that out, answer the following questions:

1. Does the modification affect the transaction price only, without adding a distinct good or service?
  - A. Then you should account for the modification as a cumulative catch-up.
  
2. Does the modification add a distinct good or service, but the additional amount attached to this good or service does NOT represent a standalone selling price?
  - A. Then you should account for the modification prospectively.

## 2 IDENTIFY THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

A performance obligation is a promise to transfer a distinct good or service; goods and services that are not distinct are bundled with other goods or services in the contract until a bundle of goods or services that is distinct is created. The bundle, in this case, is a single performance obligation.

Promised goods or services include, but are not limited to:

- Transferring produced goods or reselling purchased goods
- Arranging for another party to transfer goods or services
- Standing ready to provide goods or services in the future
- Building, designing, manufacturing or creating an asset on behalf of a customer
- Granting a right to use or access to intangible assets, such as intellectual property
- Granting an option to purchase additional goods or services that provides a material right to the customer
- Performing contractually agreed-upon tasks

### 3 DETERMINE THE TRANSACTION PRICE

ASC 606-10-32-2 states that:

*“An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.”*

This is all fancy language to say that an Agency must determine and state the price it is going to charge its Client for the goods and services included in the contract – so don't deliver a contract to your Client with no price!

### 4 ALLOCATE THE TRANSACTION PRICE

The transaction price should be allocated to each performance obligation based on the relative standalone selling prices of the goods or services being provided to the customer.

ASC 606-10-32-31 states that:

*“To allocate the transaction price to each performance obligation on a relative standalone selling price basis, an entity shall determine the standalone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those standalone selling prices.”*

The best evidence of standalone selling price is the price an Agency charges for that good or service when the Agency sells it separately in similar circumstances to similar customers. However, since goods or services are not always sold separately, the standalone selling price needs to be estimated or derived by other means.

The revenue standard does not prescribe or prohibit any particular method for estimating the standalone selling price, as long as the method results in an estimate that faithfully represents the price an Agency would charge for the goods or services if they were sold separately.



Suitable methods include, but are not limited to:

- Adjusted market assessment approach – this considers the market in which the good or service is sold and estimates the price that a customer in that market would be willing to pay (i.e. value-based pricing)
- Expected cost plus a margin approach – costs included in the estimate should be consistent with those an entity (Agency) would normally consider in setting standalone prices (i.e. labor inputs, or rate-based costing)
- Residual approach – estimate based on the total transaction price less the sum of the observable standalone selling prices of other goods and services promised in the contract (Circumstances where this can be used are limited; see ASC 606-10-32-34 + 35)

Many Agencies incur pass-through expenses, such as travel, or marked up expenses which they turn around and bill their clients, and oftentimes prices are not allocated to them in a contract (e.g. “TBD”). Note that ASC 606 is pretty clear that prices must be allocated to each performance obligation, and pass-through or marked up expenses are no exception. You might determine that the expense is not a separate performance obligation, but rather should be bundled with other performance obligations. Either way, it is understood that pricing for these hard costs aren’t always fully known at contract inception, and ASC 606-10-32-5 “Variable Consideration” addresses this:

*“If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.”*

So, as long as it is clear that prices associated with these costs are estimates (and therefore subject to change in accordance with actual costs), most Clients would not be put out if the billed amounts differed from the estimate in the contract.

## Allocating Discounts

If an Agency is giving its Client a discount, it may be appropriate in some instances to allocate the discount to only one or more of the performance obligations in the contract, rather than all performance obligations.

This could occur when an Agency has observable evidence that the discount relates to one or more, but not all, of the performance obligations in the contract. ASC 606-10-32-37 contains criteria by which an entity (Agency) may allocate a discount to one or more (but not all) performance obligations.

However, it is more common to allocate the discount over all performance obligations in the contract. It is important to note that allocation of an entire discount to a single item (in a contract containing multiple items) is expected to be a rare occurrence.

Agencies who identify discounts as Principal Investment will need to allocate this discount across all performance obligations in a contract or use ASC 606-10-32-37 as a guide to determine the specific performance allocation(s).

## 5 RECOGNIZE REVENUE WHEN OR AS THE ENTITY SATISFIES A PERFORMANCE OBLIGATION

ASC 606-10-65-1 states:

*“An entity shall determine at contract inception whether it satisfies the performance obligation over time or satisfies the performance obligation at a point in time. It is one or the other; if an entity determines that it does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.”*

In other words, you should determine, at the time you set the contract with your Client, if your performance obligations will be met on an ongoing basis (e.g. monthly as you go through the scope of work) or at a specific time (e.g. upon delivery of a specific good or service to your Client).

The guidance also states that an entity (Agency) can recognize revenue over time if one of the following criteria is met (ASC 606-10-25-27):

1. The customer simultaneously receives and consumes the benefits provided by the entity’s (Agency’s) performance as the entity performs; or
2. The entity’s (Agency’s) performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced; or
3. The entity’s (Agency’s) performance does not create an asset with an alternative use to the entity (Agency), and the entity (Agency) has an enforceable right to payment for performance completed to date.

The first two criteria do not seem to apply to marketing agencies, but the third criterion makes a valid case for an Agency to recognize revenue as direct labor is incurred (and billable)<sup>2</sup>. The first part of the sentence, “... does not create an asset with an alternative use to the entity” can be viewed as the service an Agency provides which is unique to its Client and therefore would not have an ‘alternative use’ to the Agency.

<sup>2</sup> For our purposes in this section, we will discuss revenue recognition as it relates to direct labor only, since expenses are typically treated as pass-through expenses (i.e. Revenue + COS net to zero).



ASC 606-10-55-161 through 55-164 provides a very relevant example [Example 14] of an entity entering into a contract with a customer to provide a consulting service that results in the entity providing a professional opinion to the customer. In their example, the contract requires the customer to compensate the entity (in our case, the Agency) for costs incurred plus a 15% margin. The 15% margin approximates the profit margin that the entity (Agency) earns from similar contracts. This may not be necessary for most Agencies, since they already build a margin in their marked up rates.

Paragraph 606-10-55-163 explains that an entity (Agency) can solidly claim to have met the criteria of determining that the performance obligation is satisfied over time due to the following factors:

- A. In accordance with paragraphs 606-10-25-28 and 606-10-55-8 through 55-10, the development of professional opinion does not create an asset with alternative use to the entity (Agency) because the professional opinion relates to facts and circumstances that are specific to the customer. Therefore, there is a practical limitation on the entity's (Agency's) ability to readily direct the asset to another customer.
- B. In accordance with paragraphs 606-10-25-29 and 606-10-55-11 through 55-15, the entity (Agency) has an enforceable right to payment for its performance completed to date for its costs<sup>2</sup> plus a reasonable margin, which approximates the profit margin in other contracts.

## Recognizing Revenue Over Time

According to paragraph 606-10-55-16, there are two methods you may use in measuring progress toward complete satisfaction of a performance obligation satisfied over time: Output Methods and Input Methods.

Output Methods recognize revenue on the basis of the entity's (Agency's) deliverables or specific performance obligations, such as:

- Surveys of performance completed to date
- Appraisals of results achieved
- Milestones reached
- Time elapsed
- Units produced
- Units delivered

ASC 606 states that an entity (Agency) should consider whether the output selected would faithfully depict the entity's (Agency's) performance toward complete satisfaction of the performance obligation. It further states that if an entity (Agency) has a right to consideration in an amount that corresponds directly with the value of the entity's (Agency's) performance to date, the entity (Agency) may recognize revenue to which they have a right to invoice.



Agencies using Output Methods would need to construct SOWs/contracts to specifically identify milestones or performance obligations with amounts directly attached. Disadvantages of Agencies using Output Methods are that the outputs used to measure progress may not be directly observable, and the information required to apply them may not be available without undue cost. Additionally, revenue related to the Output Method may not match labor costs in a given period, which may make financial statements more difficult to analyze.

Input Methods recognize revenue on the basis of the entity's (Agency's) efforts or inputs to the satisfaction of a performance obligation, such as:

- Resources consumed
- Labor hours expended
- Costs incurred
- Time elapsed
- Machine hours used

Agencies whose employees accurately track time on a daily basis will find Input Methods to be the most practical and expedient.

ASC 606-10-55-21 notes that Input Methods may not directly correspond with the entity's (Agency's) progress in satisfying the performance obligation. Per the guidance:

*"An entity would not recognize revenue on the basis of costs incurred that are attributable to significant inefficiencies in performance that is not reflected in the price of the contract (e.g. unexpected amounts of wasted materials, labor, etc.) that were incurred to satisfy a performance obligation."*

This means that an Agency needs to determine, on a project-by-project basis, whether the labor inputs align with progression towards the deliverable (i.e. the idea of "percent complete" as described in superseded GAAP guidance). If labor inputs exceed the progress of a project (e.g. if you are 50% of the way through the budgeted hours but only 25% of the way through the work), excess hours should be written off and not recognized as revenue.

With respect to Retainers, depending on how the contract is worded, retainer contracts could use either Output or Input Methods; you need to determine which method applies to each of your retainer contracts and follow the above guidelines. In either case, if an Agency does not meet its performance obligations, it will need to evaluate whether it can recognize the full month of revenue.



## Enforceable Right to Payment

In order to recognize revenue over time (as opposed to upon completion of a project), Agencies must meet BOTH of the following criteria (ASC 606-10-25-27):

1. It [The Agency] does not create an asset with an alternative use to itself; and
2. It [The Agency] has an enforceable right to payment for performance completed to date.

This “enforceable right to payment for performance completed to date” can be explained further by ASC 606-10-25-29:

*“An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with paragraph 606-10-25-27.”*

Agencies should include a cancellation clause in all SOWs/contracts so that payment for performance completed (and expenses incurred) to date may be enforceable.

### EXAMPLE CANCELLATION POLICY

If Client decides to cancel services set forth herein (for reasons other than nonperformance), Client agrees to compensate Agency for work completed, including outside expenses incurred, through date of cancellation.

# ASC 606 in a Nutshell

Phew, you made it through! Congratulations! So, now that you're clear on the new ASC 606 rules, what do you do next? In order to prepare for the new year, when many annual contracts are renewed, here's a list of items we recommend your Finance and Operations teams tackle together:

## 1 Review your clients' contracts to ensure:

1. Contracts contain the necessary criteria, i.e.
  - Proper approvals
  - Identification of each party's rights regarding goods/services to be transferred
  - Identification of payment terms
  - Has commercial substance
  - Collection of payment is probable (75%-80% likelihood)
2. Distinct performance obligations are identified
3. Contract price is documented
4. Contract price is allocated to performance obligations

## 2 Review the requirements to recognize revenue over time to be certain you're meeting them; ensure the following:

1. Your agency's performance does not create an asset with an alternative use to the agency, i.e. the work is custom to each client.
2. Your agency has an enforceable right to payment for performance completed to date.
  - A cancellation policy must be written into SOWs and other contracts.
  - Agency has a detailed time-tracking system with daily time tracking compliance so that labor hours may be quantified in order to be paid for performance completed to date.

**IMPORTANT:** if your agency does not meet BOTH criteria listed in #2, revenue must be recognized at a specific point in time, as each performance obligation is completed and delivered to your client. **You will NOT be able to recognize revenue over time!**

I know that was a LOT of information! Once again, this article is not intended to be an all-inclusive prescription from an audit perspective. We strongly advise you to consult with your CPA or external auditors for specific recommendations and directives for your agency <sup>3</sup> – but hopefully this has helped clarify the new ASC 606 standard so that you can make changes as necessary to ensure compliance once these go into effect in 2019!

<sup>3</sup> Specific recommendations and/or directives would include transition methods (e.g. Retrospective or Cumulative Effect) for financial statement presentation and reporting, which are not covered in this article.

# About The Author



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Rene Blevins is an Accounting black belt and CPA, focused on driving accounting and financial Best Practices for our clients. She has a diverse background that includes forensic auditing, SEC reporting, custom reporting & analysis, budgeting, forecasting, financial reporting and project management. Her clients have been known to nickname her “grace under fire” and “voice of reason.”

A proud Hawaiian native, Rene has lent her expertise to us “mainlanders” to help multi-entity and multi-national organizations solve complex accounting problems, improve processes and “help people not like me” willingly adopt accounting best practices.

Rene graduated with honors from the University of Hawaii with a degree in Accounting. When not training for her next marathon, Rene is an avid doughnut connoisseur and professional online shopper.

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