

Case 20-3c

Hi-Tech Commerce Co.

Hi-Tech Commerce Co. (HTC) sells and provides service of efficient end-to-end communications and IT systems and solutions. One of the company's key products and services includes Telecom and IT hardware (hardware and equipment). HTC maintains premium resale relationships and certifications with a variety of branded technology manufacturers, which allows HTC to provide a wide array of telecommunications and IT infrastructure equipment to meet the needs of its customers.

In addition, HTC (1) resells manufacturer maintenance contracts on hardware and equipment and (2) provides hardware installation services. Manufacturer maintenance contracts cover a term of one or three years and are billed in advance. The manufacturer provides the maintenance, and the customer deals directly with the manufacturer for all issues. The manufacturer also provides the primary warranty for its products. HTC recognizes revenue for the manufacturer maintenance contracts on a net basis. The customer may also engage HTC to provide hardware installation services. The purchase of the hardware and the services to install the hardware are considered separate performance obligations because each meets the requirements to be distinct under ASC 606-10-25-19 — they are distinct because (1) customers can purchase the hardware and install it themselves, or they can engage a certified reseller for that vendor to do the installation, and (2) HTC does not need to be involved after the hardware purchase is complete. The installation services are also distinct within the context of the contract since there is no significant modification or customization of the goods as part of a bundled package that is highly integrated. The customer can direct the installation, removal, or both, of any or all of the hardware at any time. As a result, HTC accounts for the hardware and the installation as separate performance obligations.

For the sale of hardware and equipment, HTC engages with customers to determine the best solution for a customer's hardware needs. After HTC finalizes the combination of products that will fulfill a customer's requirements and determines the price, the customer submits a purchase order to HTC and the company places the order with the manufacturer.

Customer needs vary, from ordering additional handsets to replacing or upgrading their existing network technology infrastructure to meet increasing demands for voice, data, and other services.

All of the sales orders for hardware and equipment are “drop-shipped,” which means they are shipped directly from the manufacturer to the customer. HTC does not order goods for inventory and has no fixed purchase commitments with its manufacturers.

HTC's cost from the manufacturer is determined based on a discount on the manufacturer list price. HTC sets the price to the customer after understanding the cost from the manufacturer and developing the related bill of materials.

Because HTC's systems link customer orders to the related manufacturer purchase, delivery of hardware by the manufacturer and receipt by the customer triggers HTC to bill the customer and recognize revenue.

Customer Engagement

For simple orders (e.g., additional handsets or equipment), or when a customer has its own technical team to determine the necessary equipment, HTC's sales team verifies that the goods are consistent or compatible with the customer's previous purchases and HTC's knowledge of the customer's environment before placing the order.

For more complex orders (e.g., updating a network technology infrastructure), HTC's sales team and technical engineers may meet with the customer to understand the customer's business and telecommunication needs. To help the customer select an appropriate solution, the sales and technical engineers may consult with the customer to (1) gain an understanding of the current environment, (2) determine the functionality the customer is requesting, and (3) determine how the equipment will be integrated into the customer's current environment.

For certain large or complex customer situations, HTC involves the manufacturer's representatives directly to ensure the products selected will meet the customer's needs.

Once the sales and technical teams understand the customer's requirements and identify equipment from the various manufacturers, a solution is developed. This process consists of combining one or more standard products from existing manufacturer catalogs to meet the customer needs; there is no customization performed by either HTC or the manufacturer as a part of the process.

Once the customer's equipment needs are identified, HTC prepares a bill of materials and a quote for the customer. While the company may develop various solutions that meet the customer's requirements, the ultimate selection of the hardware and the manufacturer that will provide the hardware is at the sole discretion of the customer. The solution selected by the customer determines which manufacturer HTC will use.

HTC can order the goods directly from the manufacturer or any of the manufacturers' approved distributors. However, the company may not select a different hardware manufacturer after the customer has placed an order.

Pricing

Discounts that manufacturers provide to HTC vary based on the level of certifications, volume of business, and manufacturer's promotions. HTC then takes cost, manufacturer list price, competition, complexity of the product, and volume of business the customer provides into consideration when setting a price for the customer.

Shipping, Title, and Risk of Loss

The manufacturer is responsible for (1) shipping the goods, including the determination of when the goods ship; (2) the method in which the goods are shipped; and (3) the shipping carrier.

HTC purchases hardware from the manufacturer with “free-on-board” (FOB) shipping-point terms, and the hardware sold to the customer is shipped FOB destination. As a result, title passes from the manufacturer to HTC during shipping and from HTC to the customer upon delivery.

HTC has legal title to the hardware while it is in transit even though the manufacturer makes the shipping arrangements; however, the company never takes physical possession of the hardware.

Ability to Redirect Goods While in Transit

Because customer orders and manufacturer purchases are linked in HTC’s systems, HTC would need to cancel an original order and create a new order if it wants that order shipped to another customer. That is, HTC has the ability to cancel an order before it is shipped but would not control the hardware before it is shipped to the customer. Rather, the manufacturer would retain control of the hardware before shipment.

Returns

HTC’s return policy states that the company will only accept returns if it has return rights with the manufacturer. HTC’s sales representatives assist customers with (1) determining the manufacturer’s return policy and (2) communicating with the manufacturer regarding return requests.

HTC does not physically receive the equipment subject to return. The customer will send returned equipment directly to the manufacturer.

Required:

1. For HTC’s hardware product revenue stream, what is the distinguishing factor that should be considered when determining whether HTC is acting as a principal or as an agent?
2. What indicators should be considered when determining whether HTC controls the specified good or service before it is transferred to the customer?
3. Which facts support the view that HTC is the principal in the hardware product sales arrangement?
4. Which facts support the view that HTC is an agent in the hardware product sales arrangement?
5. Should HTC record revenue for the sale of its hardware products on a gross or a net basis under ASC 606?