

STAFF PAPER

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Project	Revenue from Contracts with Customers		
Paper topic	Licensing—feedback on ED <i>Clarifications to IFRS 15</i> and redeliberations		
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This paper has been prepared for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose of the paper

1. This paper provides a summary of the feedback received in response to question 3—Licensing in the IASB [Exposure Draft *Clarifications to IFRS 15*](#) (the ED), which was issued for public comment in July 2015. It also provides the staff's analysis and recommendations on each issue.
2. The staff's conclusions, recommendations and question to the IASB are contained in paragraphs 96–98.

Introduction: Question 3—Licensing

3. Question 3 in the ED asked respondents if they agreed with the IASB's decisions to clarify:
 - (a) the Application Guidance and accompanying Illustrative Examples on determining the nature of the entity's promise in granting a licence of intellectual property; and
 - (b) the Application Guidance on the scope and applicability of the sales-based and usage-based royalties exception (commonly referred to as the 'royalties constraint').

4. The IASB's proposed clarifications regarding the royalties constraint are converged with those proposed by the FASB in its [Proposed Accounting Standard Update](#) (ASU) *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing* (the proposed Update). However, Question 3 of the ED highlights that the FASB has proposed more extensive amendments to the licensing guidance and the Illustrative Examples in other areas, including:
- (a) Replacing some of the existing Application Guidance with an alternative approach for determining the nature of the entity's promise in granting a licence of intellectual property, and amending the related Illustrative Examples;
 - (b) Adding additional Application Guidance and Illustrative Examples addressing the effect of particular contractual restrictions in a licence; and
 - (c) Adding additional Application Guidance addressing when the guidance on determining the nature of the entity's promise in granting a licence applies.
5. In developing the proposals in the ED, the IASB decided that:
- (a) Its proposed clarifications will improve the operability and understandability of the requirements, but do not change the underlying principles contained in IFRS 15; and
 - (b) Clarification is not necessary for the issues outlined in paragraph 4 of this paper, because there is adequate guidance in IFRS 15 with sufficient explanation of the Boards' decisions in the accompanying Basis for Conclusions.
6. In October 2015, the FASB completed redeliberations of its proposals in respect of the licensing topics covered by its proposed Update. The FASB decided to finalise most of its proposals and also made additional decisions within the scope of those topics. The tentative decisions of the FASB can be accessed [here](#). For convenience, we have reproduced those decisions in Appendix B. We also refer to them in the individual sections within this paper when relevant.

Staff recommendations

7. The staff recommend that the IASB affirms its decisions proposed in the ED and, subject to drafting changes and the addition of further explanatory material, to finalise the proposals made in the ED. More specifically, we recommend that the IASB affirms its decisions:
- (a) to clarify the Application Guidance and accompanying Illustrative Examples on determining the nature of the entity's promise in granting a licence of intellectual property;
 - (b) not to replace some of the existing Application Guidance with an alternative approach proposed by the FASB for determining the nature of the entity's promise in granting a licence of intellectual property;
 - (c) not to add additional Application Guidance and Illustrative Examples addressing the effect of particular contractual restrictions in a licence;
 - (d) not to add additional Application Guidance addressing when the guidance on determining the nature of the entity's promise in granting a licence applies;
 - (e) to clarify the Application Guidance on the scope and applicability of the sales-based and usage-based royalties exception (royalties constraint);
and
 - (f) not to change the scope of the royalties constraint.
8. We also recommend that the IASB conclude at this meeting that the issues raised about licence renewals and identifying attributes of a single licence versus identifying additional licences, which were discussed in the November 2015 TRG meeting, are outside the scope of the present project to determine whether or not to finalise the amendments proposed in the ED.

Structure of the paper

9. The summary of the feedback and staff's analysis is structured as follows:
- (a) General comments on the different amendments proposed by the Boards (paragraphs 10–11);
 - (b) Determining the nature of licence (paragraphs 12–35);
 - (c) Sales-based or usage-based royalty (paragraphs 36–63);
 - (d) Topics for which the IASB did not propose any clarifications:
 - (i) Contractual restrictions in a licence (paragraphs 64–71);
 - (ii) When to determine the nature of the entity's promise (paragraphs 72–76).
 - (e) Other matters raised by respondents:
 - (i) Additional Illustrative Examples (paragraphs 77–79).
 - (f) Issues raised after the publication of the ED—matters discussed by the Transition Resource Group (TRG) (paragraphs 80–95):
 - (i) Licence renewals (paragraphs 81–85).
 - (ii) Identifying attributes of a single licence versus identifying additional licences (paragraphs 86–90).
 - (g) Summary of conclusions and recommendations and questions for the IASB (paragraphs 96–98).
 - (h) Appendix A: Summary of the proposals and reasons for them
 - (i) Appendix B: Tentative decisions of the FASB in respect of its proposals on licensing.

General comments on the different amendments regarding the licensing requirements proposed by the Boards

10. Of the 74 comment letters received, 61 commented on question 3. All except one supported the IASB's decision to make some clarifications to the Application Guidance and Illustrative Examples for licensing. The Institute of Public Accountants in Australia disagreed, stating:

The IPA is of the view the changes proposed are not substantive in nature as they do not materially expand upon the principles already espoused in IFRS 15. As such, the proposed changes do not warrant the amendment to IFRS 15.

11. Many respondents expressed concern about the two Boards having proposed different amendments to clarify the application of originally converged requirements. However, the majority of respondents that commented on convergence in the context of the licensing proposals preferred the IASB's proposals to those of the FASB. The broader observations and concerns expressed by the respondents about the licensing proposals are as follows:
- (a) Most respondents that commented on the licensing proposals agreed that the IASB's proposals helped to clarify the existing requirements.
 - (b) Many respondents noted that the alternative approach to determining the nature of a licence proposed by the FASB has merits; in particular that it may make the operability of the requirements easier and less costly than the IASB requirements. However, as noted in paragraph 16 of this paper, few respondents supported the FASB approach.
 - (c) Many respondents that expressed concern about the two Boards having proposed different amendments to originally converged requirements noted that it was very helpful that the Basis for Conclusions on the ED acknowledges that different outcomes may arise as a consequence. Some of those respondents recommended that those explanations should be expanded to provide examples of when different outcomes may arise.
 - (d) A few respondents suggested some editorial and other changes to the proposed amendments, and others suggest that additional examples may aid understanding and add further clarity to the proposed amendments.

Determining the nature of the entity's promise in granting a licence of intellectual property

12. The determination of the nature of the licence largely depends on whether the contract requires, or the customer reasonably expects, the entity to undertake activities that significantly affect the intellectual property to which the customer has rights.
13. The IASB decided to clarify the requirements by providing additional guidance on when activities change the intellectual property to which the customer has rights. The FASB has proposed an alternative approach in which intellectual property is classified as either functional intellectual property or symbolic intellectual property. Appendix A provides more details of the Boards' respective proposals.

The general approach

14. Most respondents that commented on the proposals to improve the clarity of the requirements about determining the nature of the licence agreed that the IASB's proposals improved the operability and understandability of the existing requirements.
15. Many respondents commented on the difference between the IASB proposals and those of the FASB. A few commented that retaining converged wording was most important and asked the IASB to work with the FASB to achieve this. However, many respondents emphasised that if converged wording could not be achieved, it is important that the IASB highlight, as it has done in the Basis for Conclusions on the ED, that different outcomes may be possible as a result.
16. Many respondents that commented on both Boards' proposals acknowledged that both approaches have advantages and disadvantages but, on balance, almost all preferred the IASB's approach. The main advantage of the FASB's approach perceived by some respondents is that it reduces, but does not eliminate, the need for judgement. This, the respondents suggest, is likely to make the FASB proposals easier to apply and may reduce costs of application.
17. However, most of the respondents that expressed a view on the FASB proposals noted a concern that the approach is rule-based and varies from the principles in

the Standard. Some suggest that this increases the risk of unintended consequences and may, in some cases, result in an entity recognising revenue in a way that does not reflect the underlying principles of IFRS 15/ Topic 606 or the economic substance of the transaction.

18. In particular, some respondents suggested that, if the IASB was to adopt the FASB approach, it should add an exception to require ‘point in time’ recognition for revenue from a licence of symbolic intellectual property in circumstances in which it is reasonably certain that the entity will not undertake any activities to support or maintain the intellectual property during the licence period. Examples provided of when this might occur include licences to use cartoon characters known for past movies or comics or to use images of (often deceased) stars known for past achievements, such as singers, movie or sports stars.
19. These comments reflect requests from some respondents to the FASB’s proposed Update to provide such an exception. In developing its proposals, the FASB had been made aware of this issue but decided at that time not to enact such an exception. Paragraphs BC51–BC52 of the FASB’s proposed Update noted that:
 - (a) Outreach suggested that the number of licensing agreements for which the outcome would likely to differ between the two approaches is likely to be small; and
 - (b) The approach in the proposed Update would be more operable and reduce the judgement needed compared to that required in determining whether a licence includes an implied promise to support or maintain the intellectual property to which the customer has rights.
20. In its redeliberations in October 2015, the FASB decided not to enact such an exception.

Other issues

21. Respondents generally agreed with the proposals to clarify the requirements about how to determine the nature of an entity’s promise. However, several respondents raised some questions about some of the terminology introduced in proposed new

paragraph B59A, which is intended to clarify when an entity's activities significantly affect the intellectual property. The proposed paragraph states:

B59A An entity's activities significantly affect the intellectual property when either:

- (a) those activities are expected to change the form (for example, the design) or the functionality (for example, the ability to perform a function or task) of the intellectual property to which the customer has rights; or
- (b) the ability of the customer to obtain benefit from the intellectual property to which the customer has rights is substantially derived from, or dependent upon, those activities. For example, the benefit from a brand is often derived from, or dependent upon, the entity's ongoing activities that support or maintain the value of the intellectual property.

Accordingly, if the intellectual property to which the customer has rights has significant stand-alone functionality, a substantial portion of the benefit of that intellectual property is derived from that functionality. Therefore, that intellectual property would not be significantly affected by the entity's activities unless those activities change that functionality.

22. A few respondents asked for one or more further clarifications about aspects of this paragraph, which generally fall into the following categories:
- (a) Meaning of 'stand-alone functionality';
 - (b) Do the activities include past **and/ or** ongoing activities?

Meaning of 'stand-alone functionality'

23. A few respondents expressed concern that the ED proposed that the term 'stand-alone functionality' is to be introduced into the Standard (in proposed new paragraph B59A) without it being defined.

24. However, comments generally suggest that the combination of additional explanatory material proposed in the Illustrative Examples and the Basis for Conclusions on the ED could, with some editorial improvements, be sufficient to help clarify the meaning.
25. Some suggested that the example used in paragraph BC65 of the ED be elevated into the paragraph B59A or into the Illustrative Examples, instead of being included merely in the Basis for Conclusions. Paragraph BC65 states:

‘Intellectual property that often has significant stand-alone functionality includes software, biological compounds or drug formulas, and completed media content (for example, films, television shows and music recordings).’

Staff analysis and recommendation

26. Staff note that proposed paragraph B59A(a) includes an example of what is intended by the term ‘functionality:
- ‘. . . or the functionality (for example, the ability to perform a function or task). . . ’
27. We think that this, together with the related Illustrative Example and explanatory material in the Basis for Conclusions on the ED makes the meaning of ‘stand-alone functionality’ clear.
28. Consequently, we do not recommend adding a definition of ‘stand-alone functionality’ to IFRS 15. However, we recommend that minor editorial changes are made to the existing explanatory material in the Basis for Conclusion and Illustrative Examples to provide further clarity.

*Do the activities include past **and/ or** ongoing activities?*

29. Paragraph BC63 of the ED states:

‘Paragraph B59A proposes to clarify that the assessment of whether the entity’s activities change the intellectual property to which the customer has rights is based on whether those activities affect the intellectual property’s ability to provide benefit to the customer (ie the ‘utility’ of the intellectual property). . . .’

30. This use of the term ‘utility’ is consistent with that in the FASB’s proposed Update (paragraph BC41). However, in paragraph BC46 of FASB’s proposals and in the accompanying proposed Illustrative Examples, it is noted that the utility of symbolic intellectual property is derived from its association with the entity’s **past or** ongoing activities that do not transfer a promised good or service to the customer, including its ongoing business activities (emphasis added).
31. This has led a few respondents to the ED to question whether the activities referred to in paragraphs B59A(a)–(b) should be the entity’s past or ongoing activities or ongoing activities only.
32. In addition, a few respondents, expressed concern over a perceived lack of clarity in the wording of paragraph BC63 in the ED. They highlighted some possible confusion between the way that various terms are used in different parts of the explanatory material, including ‘utility’ ‘the ability to provide benefit’ and ‘activities that significantly affect’.

Staff analysis and recommendation

33. Paragraph B58 sets out the criteria that must be met to determine that an entity’s promise in granting a licence is a promise to provide a right of access. Revenue from a licence that grants a right of access is recognised over time, instead of at a point in time. The criteria are:
- (a) the contract requires, or the customer reasonably expects, that the entity **will undertake** activities that significantly affect the intellectual property to which the customer has rights (see paragraphs B59–B59A) [emphasis added];
 - (b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity’s activities identified in paragraph B58(a); and
 - (c) those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 25).
34. The criterion in B58(a) refers to activities that the entity **will undertake**, which in our view, clearly indicates that these are ongoing activities, not past activities.

Paragraph B59A supports the application of the criteria in paragraph B58.

Consequently, staff consider that the wording of paragraph B59A, together with the accompanying material in paragraphs B58–B59, Illustrative Examples and explanatory material in the Basis for Conclusions on the ED should be sufficiently clear that the activities relate to ongoing activities, not past activities.

35. However, we note that the FASB’s proposals use the phrase ‘past or ongoing activities’ in the context of its proposals to classify intellectual property as either functional or symbolic. We understand that this use of similar words in a different context could contribute to some confusion. Consequently, we recommend that the Basis for Conclusions highlights the differences between IFRS 15 and Topic 606 and confirms the IASB’s intention that only ongoing activities are relevant to the application of the requirements in IFRS 15.

Sales-based and usage-based royalties exception

36. In response to stakeholder concerns about when the royalties constraint applies and whether a single royalty should be split into a portion to which the royalties constraint would apply and a portion to which it would not, the Boards decided to propose to clarify the application of the royalties constraint as follows:

- (a) the royalties constraint should apply whenever the predominant item to which the royalty relates is a licence of intellectual property; and
- (b) an entity should not split a single royalty into a portion subject to the royalties constraint and a portion that is not (and, therefore, would be subject to the requirements applicable to variable consideration, including the constraint on variable consideration).

37. The ED proposed to make the clarifications by adding new paragraphs B63A–B63B and amending Illustrative Examples 60–61. Proposed paragraphs B63A–B63B state:

B63A The requirement on sales-based or usage-based royalties in paragraph B63 applies when the royalty relates only to a licence of intellectual property or when a licence of

intellectual property is the predominant item to which the royalty relates.

B63B Revenue from a sales-based or usage-based royalty should be recognised entirely in accordance with either the requirement in paragraph B63 (if paragraph B63 applies) or the requirements on variable consideration in paragraphs 50–59 (if paragraph B63 does not apply).

38. The FASB proposed converged additions to Topic 606 and Illustrative Example 60, except the FASB added additional wording to illustrate the meaning of ‘predominant’. Consequently, proposed paragraph 606-10-55-65A of Topic 606 (equivalent to proposed paragraph B63A of IFRS 15) reads:

‘... is the predominant item to which the royalty relates (for example, when the customer would ascribe significantly more value to the license than to the other goods or services to which the royalty relates).

39. In addition, the FASB proposed more extensive changes to Example 61 in order to illustrate additional points about identifying the nature of the licence and the measure of progress but the conclusion reached about the royalties constraint is consistent with the IASB’s Illustrative Example 61.

Feedback from respondents

Meaning of ‘predominant’

40. Many respondents did not comment specifically on the royalties constraint proposals. Almost all of those that did agreed with the proposed changes. Quite a few (mainly accountancy firms, accounting bodies and Standard-setters) asked the IASB to provide more clarity around the meaning of ‘predominant’ but views were mixed about whether this should be done in the Standard, Illustrative Examples or the Basis for Conclusions. In most cases, the respondents did not specify what type of detail they were looking for in the clarification. However, a few of the respondents asked whether predominant is intended as ‘over half’ or ‘substantially all’ and whether the measure is based on value (as suggested by the

wording in paragraph 606-10-55-65A of the FASB's proposed Update) or some other factor.

Pattern of timing of recognition

41. The existing requirements and guidance address when to recognise revenue when the royalties constraint applies. A few respondents asked for more examples to demonstrate the pattern of timing of recognition of revenue required when using the royalties constraint, in particular with regard to licences that provide access to an entity's intellectual property over time. A couple of respondents provided an example with two alternative views as follows:

Example 1

An entity licenses the use of its logo for one year to a customer. The customer will pay a royalty of 5 percent of the sales price for any merchandise sold using the entity's logo. In the first month, the customer sells CU1 million of merchandise using the entity's logo and owes the entity CU50,000 in sales-based royalties. The entity determines that using a time-based measure of progress appropriately depicts its performance under the contract.

View A—The entity recognises royalty revenue of CU4,167 (CU50,000 in royalties x (1 month/12 months)). It will recognise the remaining royalty revenue of CU45,833 over the remaining eleven months of the licence term.

View B—The entity recognises the entire royalty revenue of CU50,000 at the end of the first month, when the underlying sale or usage has occurred.

42. Other respondents asked for additional examples to cover other, more complex fact patterns.
43. A small number of stakeholders have asked whether the royalties constraint could or should apply to sales or licences that may be viewed to be 'in-substance' sales of intellectual property, as well as to licences of intellectual property.

Staff analysis and recommendations

Meaning of 'predominant'

44. In paragraph BC75 of the ED, the IASB noted that the FASB had proposed an example of when a licence is the predominant item to which a royalty relates in

paragraph 606-10-55-65A (proposed paragraph B63A of IFRS 15). However, at that time, the IASB decided that no further guidance on the term ‘predominant’ is necessary because stakeholder feedback suggests that the term can be applied in practice and that judgement is required to determine when a licence is the predominant item to which a sales-based or usage-based royalty relates.

45. The staff acknowledge that judgement is required in determining the basis on which ‘predominant’ should be measured. Although we consider that value is a logical factor to consider in an assessment of whether a licence is the predominant item, it may not always be the only determinative factor. We think that the appropriate measure will be determined by facts and circumstances and would caution against prescribing a determinative factor at this time. The determinative factor may depend on such assessments as why the promised goods or services were bundled into a combined performance obligation with a licence of intellectual property.
46. We think that the question about the quantum of ‘predominant’, that is, just over half or substantially all, is a difficult question to address. In this case, we think that it is inappropriate to provide more guidance because we think that this is a matter of judgement which, as noted in Paragraph BC75 of the ED, is generally accepted by the majority of stakeholders.
47. As a result, we do not think that it is necessary to make amendments to the wording of the Standard to better articulate the intended interpretation of ‘predominant’. However, we can see that there could be some benefit in adding a similar explanatory example to that used in the FASB’s proposed paragraph 606-10-55-65A (see paragraph 38 of this paper), which would provide more fully converged wording between IFRS 15 and Topic 606. If the IASB agree with this suggestion, we think that adding further explanatory material in the Basis for Conclusions about the need to consider a variety of factors in determining whether the licence is the predominant item will help.
48. In addition, we agree with respondents that Illustrative Example 60 could be improved by explaining why the movie in that example is determined to be the predominant item.

Pattern of timing

49. The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. IFRS 15 uses a five-step approach for recognising revenue in accordance with that core principle.
50. Step 3 of the approach is to determine the transaction price. Paragraph BC203 of IFRS 15 explains that, in developing the revenue Standard, the Boards decided that an entity should constrain the estimate of variable consideration to be included in the transaction price when the outcome of the estimate is too uncertain.
51. Step 5 of the approach is to recognise revenue when (or as) the entity satisfies a performance obligation. The amount of revenue recognised is the amount of the transaction price allocated to the satisfied performance obligation. Paragraph BC219 of IFRS 15 notes that the application of the royalties constraint is an exception to the requirements that apply to the general variable consideration constraint. In effect, the royalties constraint constrains the amount of revenue that can be recognised when or as a performance obligation is satisfied, rather than constraining the total amount of the transaction price to be allocated.
52. As a result, the royalties constraint prevents an entity from recognising any revenue for uncertain amounts until the uncertainty is resolved (ie when the entity's subsequent sales or use usage occurs).
53. Since publication of the ED, the TRG has discussed the timing of recognition of revenue using both the general variable consideration constraint and the sales-based or usage-based royalties constraint.¹ The relevant section of the TRG meeting summary concludes:

‘Because the discussion indicated that stakeholders can understand and apply the applicable guidance in the new revenue standard in a manner that the staff believe is

¹ TRG Agenda Paper 39 Application of the Series Provision and Allocation of Variable Consideration, July 2015

consistent with the standard, the staff recommend that the Boards take no further action.’

54. The staff have reached a similar conclusion in its analysis of the responses to the ED. Consequently, we do not think that is necessary to change the wording of paragraph B63 of IFRS 15 or to provide additional Illustrative Examples. Providing such additional examples risks raising further questions about other scenarios that may have slightly different fact patterns, such that the volume of illustrative material could expand significantly.
55. The staff consider that the wording in Illustrative Example 61, which states ‘. . . the entity recognises revenue as and when sales of items using the team name or logo occur’ are sufficiently clear that the royalties should be recognised as the sales occur (ie view B in the example in paragraph 41 of this paper).
56. However, we think that additional clarity could be provided with some minor drafting changes to the explanatory material contained in the ED.

Sales and ‘in substance sales’ of intellectual property

57. In developing IFRS 15, the Boards decided to restrict the scope of the royalties constraint to licences of intellectual property.² The reasons for the Boards’ previous decision are explained in paragraphs BC415–BC421 of the Basis for Conclusions on IFRS 15. In particular, BC416 states:

‘In redeliberating the 2011 Exposure Draft, the boards observed that because the restriction for a sales-based or usage-based royalty on a licence of intellectual property was structured to apply to only a particular type of transaction, other economically similar types of transactions might be accounted for differently. . . .’

58. In addition, paragraph BC421 concludes by stating:

‘. . . The boards also noted that because this is a specific requirement intended for only limited circumstances, entities should not apply it by analogy to other types of

² Discussed in October 2013 joint meeting of the IASB and FASB, Agenda Paper 7A/FASB Memo 175A Constraint on Estimates of Variable Consideration.

promised goods or services or other types of variable consideration.’

59. The staff consider that the existing explanatory material is sufficiently clear that the use of the royalties constraint is restricted to licences of intellectual property and should not be used by analogy in other transactions, including sales of intellectual property.
60. As noted in the summary of feedback to the ED (Agenda Paper 7A), the IASB decided to apply a high hurdle when considering whether to amend the Standard and, thus, to minimise changes to the extent possible. On this basis, the IASB is proposing amendments to the Standard only when:
- (a) it considers those proposed amendments to be essential to clarifying the Boards’ intentions when developing the requirements in IFRS 15; or
 - (b) it views the benefits of retaining converged requirements as greater than any potential costs of amending the requirements (for example, in respect of the principal versus agent considerations).
61. In October 2015, the FASB also considered a similar request in its redeliberations of its proposed ASU. The FASB decided:
- (a) Not to expand the scope of the royalties exception to include sales of intellectual property.
 - (b) An entity should not attempt to discern whether a licence to intellectual property is an “in-substance sale” of that intellectual property in deciding whether or not the royalties exception applies.
62. The staff consider that the issues around sales and determining which licences may be ‘in-substance sales’ are outside the scope of the current project because it would change the existing requirements, instead of merely clarifying the underlying principle.
63. The staff think that developing guidance for determining what type of licences might be defined as ‘in-substance sales’ would be difficult and could raise new questions and create unintended consequences. Changing the scope of the royalties constraint would also create new differences between IFRS 15 and

Topic 606. Consequently, the staff recommend that no changes be made to the Standard in this area.

Contractual restrictions in a licence

64. Paragraph B62 of IFRS 15 states that restrictions of time, geographical region or use define the attributes of the promised licence, rather than define whether the entity satisfies its performance obligation at a point in time or over time. Stakeholders acknowledged that that paragraph B62 is clear that restrictions of time, geography or use do not affect the licensor's determination about whether the licence is satisfied over time or at a point in time.
65. However, prior to the publication of the ED, some stakeholders suggested that it was unclear whether particular types of contractual restrictions would affect the identification of the promised goods or services in the contract. For example, an arrangement might grant a customer a licence of a well-known television programme or movie for a period of time (for example, three years), but the customer might be restricted to showing that licensed content only once per year during each of those three years. The stakeholders suggested that it is unclear whether the airing restrictions affect whether the entity has granted one licence or three licences.
66. Paragraph BC411 of IFRS 15 includes an example of a term licence that permits the customer to show a movie six times over a two year period. BC411 confirms that 'the restrictions in that example determine the nature of the asset that the entity has obtained (ie six showings of a movie), rather than the nature of the underlying intellectual property (ie the underlying movie)'.
67. Paragraph BC81 of the ED notes that, in developing the proposed clarifications to IFRS 15, the IASB decided that a clarification about the effect of contractual restrictions in licensing arrangements on the identification of the promised goods or services in the contract was not necessary. This is because, in its view, there is adequate guidance in IFRS 15 and the accompanying Basis for Conclusions. Paragraph BC81 of the ED again confirmed that the IASB did not intend for a

licence to show a movie only on a particular date in each year over a three-year period to be accounted for as three licences.

68. Quite a few respondents, mainly accounting firms and standard-setters, commented on this issue and all agreed with the principle about restrictions. The majority of those that did comment suggested that the existing explanatory material was adequate in the context of recognising a licence over time or at a point in time.
69. However, many of them noted that the material referred to in BC81 of the ED does not explicitly address the number of promises in the licence, which is addressed elsewhere in IFRS 15 (ie Step 2 of the revenue recognition model). They suggest that the Basis for Conclusions could be redrafted to make it clearer that entities should consider all of the terms in the contract in order to first identify the promises in the contract, before looking to the licences application guidance to identify when to recognise the revenue.
70. Consequently, the staff recommend that the IASB affirms its original decision not to amend IFRS 15 or the Illustrative Examples for this issue. However, we recommend that the drafting of the Basis for Conclusions on the ED is clarified to reflect the respondents' comments.
71. We note that the FASB's proposed Update included a couple of additional Illustrative Examples, which the IASB decided not to include in its ED. The examples tried to demonstrate issues around distinguishing between identifying attributes of a single licence versus identifying additional licences. A few respondents suggested that these should be added to the Illustrative Examples accompanying IFRS 15 and some raised questions about the conclusions reached. We also note that these issues are related to a discussion about contractual restrictions in the November 2015 TRG meeting. These are considered in the section headed 'Issues raised after the publication of the ED—matters discussed by the TRG', beginning at paragraph 80 of this paper.

When the guidance on determining the nature of the entity's promise in granting a licence applies

72. Paragraph B55 requires that an entity apply the general revenue recognition model (paragraphs 31–38 of IFRS 15) to determine whether a performance obligation that contains a licence that is not distinct (in accordance with paragraph 27 of IFRS 15) is satisfied at a point in time or over time. Since the issuance of IFRS 15, some stakeholders have questioned when the licensing guidance on determining the nature of an entity's promise applies to a performance obligation that contains a licence and other goods or services (ie a 'combined performance obligation').
73. The FASB proposed amendments that explicitly state that an entity should consider the nature of its promise in granting a licence when applying the general revenue recognition model to a combined performance obligation that includes a licence and other goods or services (ie when applying the requirements in Topic 606 equivalent to those set out in paragraphs 31–45 of IFRS 15). In its October 2015 meeting, the FASB affirmed its decision to clarify that, in some cases, an entity would need to determine the nature of its promise in granting a licence that is not a separate performance obligation in order to appropriately apply the general guidance on whether a performance obligation is satisfied over time or at a point in time and/or to determine the appropriate measure of progress for a combined performance obligation that includes a licence.
74. Having considered the wider implications of amending IFRS 15, the IASB decided not to propose a clarification in this respect in the ED. The IASB noted that Paragraph BC407 of IFRS 15 highlights that an entity would consider the nature of its promise in granting the licence if the licence is the primary or dominant component of a combined performance obligation. The IASB also acknowledged that an entity will need to apply judgement to determine the nature of the performance obligation, and to select a method of measuring progress that is consistent with the objective of depicting the entity's performance.
75. A few respondents (mainly standard-setters and accounting bodies) commented specifically on this issue. Almost all of those that did comment noted that they agreed with the IASB's decision not to make any amendments to the wording in

the Standard. They agreed that the explanatory material in paragraph BC407 is adequate, although some suggested improvements could be made to make the point clearer.

76. Consequently, the staff recommend that the IASB affirms its decision not to amend IFRS 15 for this issue. In addition, we recommend providing added clarity to the Basis for Conclusions in the ED.

Additional Illustrative examples

77. A few respondents asked the IASB to consider adding new Illustrative Examples to those that accompany IFRS 15. In particular, some of these respondents asked that the same, or similar, additional examples to those proposed by the FASB to be included.

78. However, the staff think that trying to deal with more fact patterns may encourage stakeholders to ask for more and more examples to be included in order to deal with their specific facts and circumstances. This, in our view, risks increasing the volume of explanatory materials significantly. As noted by one respondent

‘IFRS 15 is a principle-based Standard . . . It should not include rules for how to account for every possible type of contractual clause’.

79. Consequently, staff caution the IASB against introducing new fact patterns and examples to the Illustrative examples because we think that the risk of creating new questions is greater than the benefit of clarifying the existing requirements.

Issues raised after the publication of the ED—matters discussed by the TRG

80. During the November 2015 meeting, members of the TRG discussed issues including:³

- (a) Accounting for renewals of time-based licences that provide the customer with a right to use the entity’s intellectual property (that is,

³ TRG Agenda Paper 45 Licenses—Specific Application Issues About restrictions and Renewals, November 2015.

licences that are satisfied at a point in time that are separate performance obligations); and

- (b) Identifying attributes of a single licence versus identifying additional licences.

Licence renewals

81. No respondents to the ED raised any concerns about the treatment of renewals of licences. The issue raised through the TRG relates to the application of paragraph B61 of IFRS 15, which states:

‘... revenue cannot be recognised for a licence that provides a right to use the entity’s intellectual property before the beginning of the period during which the customer is able to use and benefit from the licence. For example, if a software licence period begins before an entity provides (or otherwise makes available) to the customer a code that enables the customer to immediately use the software, the entity would not recognise revenue before that code has been provided (or otherwise made available).’

82. The wording used in paragraph B61 of IFRS 15 that constrain the earliest time at which an entity can recognise revenue has been carried forward from the ED published in 2011 and has been subject to the normal due process and analysis in the finalisation of IFRS 15. During that due process and analysis, no significant concerns were raised about the clarity of the requirements or how it would be applied when a licence period is renewed or extended. Similarly, respondents to this ED did not suggest that the IASB’s proposed clarifications raised any new questions in this area.
83. The discussion at the TRG meeting indicated that this is an area in which diversity may arise under IFRS 15. A specific example was discussed in which a three-year term licence, for which revenue was recognised at a point in time, was renewed during the third year, such that the overall licence period was extended from three years to six years. Views were mixed about whether the renewal fee should be

recognised when the renewal contract was signed or should be recognised at the start of the renewal period.

84. Staff acknowledge that the mixed views could result in some diversity in practice. However, we note that IAS 18 *Revenue*, the predecessor to IFRS 15, did not contain guidance in this area and so diversity is already likely to exist in this area. However, without undertaking further outreach, we are unable to quantify the existing diversity.
85. We understand that the FASB are currently conducting outreach around this issue and are likely to deliberate the issue in a public meeting after that outreach is complete. However, the deliberations are unlikely to take place before January 2016.

Identifying attributes of a single licence versus identifying additional licences

86. This issue is related to the points raised in the section headed ‘Contractual restrictions in a licence’ beginning at paragraph 66 of this paper. The TRG discussion tried to analyse different fact patterns in which the licence contained ‘staggered’ rights, that is, the customer’s rights accrue over time. For example, an entity grants a customer the right to use its patent to manufacture a product for sale for seven years. In the first two years, the customer may only sell the product produced using the patent in Europe and may additionally sell the product in Japan during years three to seven inclusive. The TRG discussion considered whether the contract clauses that staggered the rights were merely restrictions of time, geographical region or use contained within a single licence; or did the contract clauses create separate promises within the contract.
87. Again there were mixed views expressed on this issue (and the staff’s rationale for its views on this issue). In particular the difference between the treatment of a time attribute in the renewal example in paragraph 83 of this paper and other attributes, such as geography in this staggered rights example.
88. It seems clear that entities will need to apply judgement to apply step 2 of the general revenue model in such cases, that is, to identify the number of promises granted in the contract. We acknowledge that the level of judgement required

may be greater when considering some licensing arrangements as compared to some other types of arrangements, for example, the sale of tangible products. This is because a licence is, by nature, a bundle of rights associated with the underlying intellectual property, rather than the transfer of the underlying intellectual property.

89. Consequently, the licensor can grant different customers different bundles of rights over the same underlying intellectual property. An entity would, therefore, need to carefully analyse the specific facts and circumstances around the nature of the rights granted in order to reach decisions about whether the contract clauses are merely attributes related to time, geographical region or use or, instead, create separate promises within the licensing contract.
90. As with the renewals issue, staff acknowledge that the mixed views could result in some diversity in practice. However, we again note that IAS 18 *Revenue*, the predecessor to IFRS 15, did not contain guidance in this area and so diversity is already likely to exist in this area.

Possible approaches to address the issues that emerged from the TRG's discussions

91. Staff consider that the IASB has a choice of approach in this area:
- (a) address the issues further, in the light of the TRG discussions, the FASB's outreach and redeliberations; or
 - (b) conclude at this meeting that the issues are outside the scope of the present project to determine whether or not to finalise the amendments proposed in the ED.
92. The staff recommend option (b).
93. As noted previously, in developing the proposals, the IASB decided to apply a high hurdle to making clarifying amendments to IFRS 15 at this time. In reaching its decisions, the IASB observed that amendments to a recently issued standard create a risk of unintended consequences and may place an unwarranted burden on some stakeholders, such as the need in some jurisdictions to translate the amendments and incorporate them into a Standard that may be partly through its

endorsement process. Amendments could also be disruptive to the implementation process that is already underway and potentially generate undue costs if entities have to revisit the implementation work that they have already performed.

94. We acknowledge that judgement will be required to be applied in these areas and that some diversity may arise as a result of a decision by the IASB not to provide additional clarity through amendments to IFRS 15 at this time.
95. However, we think that further exploration of the issues might lead to considering further amendments to principles in the Standard, including changes to paragraph B61. Any such changes may require further consultation. This would further delay the timely finalisation of amendments to IFRS 15 and would further disrupt the implementation work that entities are currently performing. We do not think that this is justified by the nature of this issue, which ultimately requires judgement to be applied to each set of specific facts and circumstances. Consequently, on balance, we recommend that IFRS 15 is not amended for this issue. In the meantime, the issues can be monitored as stakeholders review their implementation processes and practice develops.

Conclusions, staff recommendation and question(s) to the IASB

96. Overall, the majority of the respondents agreed that the IASB's proposed clarifications will improve the operability and understandability of the requirements and agreed with the IASB's decisions that clarification in IFRS 15 is not necessary for the issues outlined in paragraph 4 of this paper.
97. Consequently, the staff recommend that the IASB affirms its decisions proposed in the ED and, subject to drafting changes and the possible addition of further explanatory material, to finalise the proposals made in the ED. More specifically, we recommend that the IASB affirms its decisions:
- (a) to clarify the Application Guidance and accompanying Illustrative Examples on determining the nature of the entity's promise in granting a licence of intellectual property;

- (b) not to replace some of the existing Application Guidance with an alternative approach proposed by the FASB for determining the nature of the entity's promise in granting a licence of intellectual property;
- (c) not to add additional Application Guidance and Illustrative Examples addressing the effect of particular contractual restrictions in a licence;
- (d) not to add additional Application Guidance addressing when the guidance on determining the nature of the entity's promise in granting a licence applies;
- (e) to clarify the Application Guidance on the scope and applicability of the sales-based and usage-based royalties exception (royalties constraint);
and
- (f) not to change the scope of the royalties constraint.

98. We also recommend that the IASB conclude at this meeting that the issues raised about licence renewals and identifying attributes of a single licence versus identifying additional licences, which were discussed in the November 2015 TRG meeting, are outside the scope of the present project to determine whether or not to finalise the amendments proposed in the ED.

Question for the IASB

Do you agree with each of the staff recommendations in paragraphs 97–98? If not, why not and what alternative(s) do you recommend?

Appendix A: Determining the nature of the entity's promise in granting a licence of intellectual property—Summary of proposals and reasons for them

99. IFRS 15 specifies criteria in paragraph B58 for determining whether the nature of the entity's promise in granting a licence is to provide a customer with:
- (a) a right to access the entity's intellectual property as it exists throughout the licence period (the licence transfers over time), or
 - (b) a right to use the entity's intellectual property as it exists at a point in time when the licence is granted (licence transfers at a point in time).
100. In developing IFRS 15, the Boards noted that the criteria in B58 were necessary because it is difficult to assess when the customer obtains control of assets in a licence without first identifying the nature of the entity's performance obligation. The determination of the nature of the licence largely depends on whether the contract requires, or the customer reasonably expects, the entity to undertake activities that significantly affect the intellectual property to which the customer has rights.
101. In developing the clarifying proposals, the IASB has acknowledged stakeholder concerns that it is unclear whether changes in the value of the intellectual property, without a change in form or function, are sufficient to meet the criteria in B58.
102. The IASB decided to clarify the requirements by providing additional guidance on when activities change the intellectual property to which the customer has rights. The IASB noted that the reference to form or functionality in paragraph B61 (and some of the Illustrative Examples and Basis for Conclusions) was not intended to suggest that the nature of a licence is a right to access intellectual property only if the entity's activities significantly affect the form or functionality of the intellectual property to which the customer has rights. Determining the nature of a licence is defined by the criteria in paragraph B58, which do not refer to form or functionality.
103. A new paragraph B59A proposes to clarify that the assessment of whether the entity's activities change the intellectual property to which the customer has rights is based on whether those activities affect the form or function of the intellectual

property **or** affect the intellectual property's ability to provide benefit to the customer (ie the 'utility' of the intellectual property). Paragraph BC63 of the ED is clear that, in the latter case, it is not necessary for those activities to change the form or functionality of the intellectual property to significantly affect the utility of the intellectual property. This is because, in some circumstances (eg licences of brands), the benefit of the intellectual property is derived from its value **and** the entity's activities to support or maintain that value.

104. In developing the proposals, the IASB considered the wider implications of amending IFRS 15 and decided to clarify the approach to determining the nature of an entity's promise in providing a licence, rather than change that approach. The IASB is of the view that changing the requirements at this stage creates the risk of unintended consequences and of disrupting the process of implementing the Standard.

Alternative approach proposed by the FASB

105. The FASB has proposed an alternative approach to determine whether a licence constitutes a right to access or a right to use based on the nature of the intellectual property. The FASB explained that the basis for this approach is whether an entity's promise to a customer includes supporting or maintaining the intellectual property to which the customer has rights, which in turn largely depends on whether the intellectual property has significant stand-alone functionality.
106. Consequently, using the FASB approach, intellectual property is classified as either:
- (a) **functional** intellectual property, which is intellectual property that has significant stand-alone functionality and derives a substantial portion of its utility from its significant stand-alone functionality; or
 - (b) **symbolic** intellectual property, which is intellectual property that does not have significant stand-alone functionality. Substantially all of the utility of symbolic intellectual property is derived from its association with the entity's past or ongoing activities, including its ordinary business activities.
107. Using the FASB approach:

- (a) a licence to symbolic intellectual property is treated as a grant of a **right of access** to the symbolic intellectual property, which is satisfied over time; and
- (b) a licence to functional intellectual property is treated as a grant of a **right to use** the functional intellectual property as it exists at a point in time, unless both the following criteria are met:
 - (i) the functionality of the intellectual property to which the customer has rights is expected to substantively change during the licence period as a result of activities of the licensor entity that do not transfer a good or service to the customer; and
 - (ii) the customer is contractually or practically required to use the updated intellectual property resulting from criterion (i).

Appendix B

Tentative decisions of the FASB in respect of its proposals on licensing

The Board met and redeliberated its May 2015 proposed Accounting Standards Update, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*.

The Board affirmed most of the amendments in the proposed Update. The Board also made additional decisions within the scope of the following topics:

1. Identifying performance obligations
2. Licensing.

Licensing

The Board reached decisions about (1) determining the nature of the entity's promise in granting a license, (2) when an entity should determine the nature of its promise in granting a license, (3) sales-based and usage-based royalties, and (4) contractual restrictions in licensing arrangements.

Determining the Nature of the Entity's Promise in Granting a License

The Board affirmed that an entity's promise to transfer a license to functional intellectual property (that is, intellectual property that has significant standalone functionality—for example, the ability to process a transaction, perform a function or task, or be played or aired) that is a separate performance obligation is satisfied at the point in time the license is granted unless both of the following criteria are met:

1. The functionality of the intellectual property to which the customer has rights is expected to substantively change during the license period as a result of activities of the entity that do not transfer a promised good or service to the customer.
2. The customer is contractually or practically required to use the updated intellectual property resulting from criterion (1).

The Board also affirmed that an entity's promise to transfer a license to symbolic intellectual property (that is, all intellectual property that does not have significant standalone functionality) is satisfied over time because the entity's promise to the customer includes continuing to support or maintain the intellectual property to which the customer has rights.

The Board decided not to enact a provision that would recognize licenses of symbolic intellectual property at the point in time the license is granted if it is reasonably certain the entity will not undertake any activities to support or maintain the intellectual property during the license period.

When an Entity Should Determine the Nature of Its Promise in Granting a License

The Board affirmed its decision to clarify that, in some cases, an entity would need to determine the nature of its promise in granting a license that is not a separate performance obligation in order to appropriately apply the general guidance on whether a performance obligation is satisfied over time or at a point in time and/or to determine the appropriate measure of progress for a combined performance obligation that includes a license.

Sales-Based and Usage-Based Royalties

The Board affirmed its decision to clarify the scope and applicability of the implementation guidance on sales-based or usage-based royalties promised in exchange for a license of intellectual property as follows:

1. An entity should not split a single royalty into a portion subject to the sales-based and usage-based royalties recognition exception and a portion that is not subject to the exception (and, therefore, would be subject to the general guidance on variable consideration, including the constraint on variable consideration).
2. The sales-based and usage-based royalties exception should apply whenever the predominant item to which the royalty relates is a license of intellectual property.

In addition, the Board decided all of the following:

1. To clarify application of the sales-based and usage-based royalties exception to performance obligations satisfied over time through revisions to the relevant examples and the basis for conclusions of the final Accounting Standards Update
2. Not to expand the scope of the royalties exception to include sales of intellectual property
3. An entity should not attempt to discern whether a license to intellectual property is an “in-substance sale” of that intellectual property in deciding whether or not the royalties exception applies.

Contractual Restrictions in Licensing Arrangements

The Board decided to affirm its decision to clarify in Topic 606 that contractual restrictions of the nature described in paragraph 606-10-55-64 are attributes of a license and, consequently, do not define whether the entity satisfies its performance obligation at a point in time or over time or change the number of promises in the contract. The Board also affirmed its view that differentiating attributes of a promised license from other promises to the customer in the contract often will require judgment.

Next Steps

The Board directed the staff to draft a final Accounting Standards Update for vote by written ballot.