

# STAFF PAPER

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<b>Project</b>	<b>FASB/IASB Joint Transition Resource Group for Revenue Recognition</b>		
<b>Paper topic</b>	October 2014 Meeting – Summary of Issues Discussed and Next Steps		
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## Purpose

1. The second meeting of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) was held on October 31, 2014. The purpose of the meeting was for the TRG members to inform the FASB and the IASB about potential issues with implementing Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, and IFRS 15 *Revenue from Contracts with Customers* (collectively referred to as the “new revenue standard”), to help the Boards determine what, if any, action may be needed to address those issues.
2. The purpose of this paper is to provide a summary of (a) the issues discussed at the October 31, 2014 meeting, (b) views expressed at the meeting by the TRG members and FASB-IASB staff’s views about those issues, and (c) the Boards’ planned next steps, if any, for each of those issues.

## Background

3. The following five topics were discussed at the October 31, 2014 meeting:
  - (a) *Topic 1: Customer options for additional goods and services and nonrefundable upfront fees*

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- (b) *Topic 2*: Presentation of a contract as a contract asset or a contract liability
  - (c) *Topic 3*: Determining the nature of a license of intellectual property
  - (d) *Topic 4*: Distinct in the context of the contract
  - (e) *Topic 5*: Contract enforceability and termination clauses.
4. The staff papers for each of those topics was made public to all stakeholders before the TRG meeting and are available on the [FASB's](#) and the [IASB's](#) websites. A direct link to the staff papers is also included within each topic below.
  5. A replay of the entire meeting is available on the FASB's and the IASB's websites. The websites also contain a log of questions submitted to the TRG.

**Topic 1: Customer options for additional goods and services and nonrefundable upfront fees ([TRG Agenda Ref No. 6](#))**

6. The TRG discussed potential implementation issues with the guidance for determining whether a customer option to acquire additional goods and services gives rise to a material right. The TRG discussed the following issues:
  - (a) Should the evaluation of whether an option provides a material right be performed in the context of only the current transaction with a customer or should the evaluation also consider past and expected future transactions with the customer?
  - (b) Is the evaluation of whether an option provides a material right solely a quantitative evaluation or should the evaluation also consider qualitative factors?
7. Most TRG members agreed that the evaluation of whether an option provides a material right should consider relevant transactions with the customer (that is, current, past, and future transactions) and should consider both quantitative and qualitative factors, including whether the right accumulates (for example, loyalty points).
8. The staff agrees with the view of most TRG members, which is consistent with the standard, that facts and circumstances, including those that exist outside of the

current transaction with the customer, should be considered when evaluating whether a customer option gives rise to a material right, including how a right accumulates over time.

9. The staff also agrees with the view of most TRG members, which is consistent with the standard, that the assessment of whether an option gives rise to a material right includes both quantitative and qualitative factors. This is consistent with the notion that identifying promised goods or services should consider valid expectations of the customer (BC87) and that a customer’s perspective on what constitutes a “material right” might consider qualitative factors (for example, whether the right accumulates).
10. Because the discussion indicated that stakeholders can understand and apply the applicable guidance in the new revenue standard in a manner that the staff believes is consistent with the standard, the staff does not recommend that the Boards take any further action at this time.

**Topic 2: Presentation of a contract as a contract asset or a contract liability**  
**[\(TRG Agenda Ref No. 7\)](#)**

11. The TRG discussed some questions on the application of the guidance in the new revenue standard about the presentation of contract assets and contract liabilities. These questions included:
  - (a) How should an entity determine the presentation of a contract that contains multiple performance obligations?
  - (b) How should an entity determine the presentation of two or more contracts that have been combined and accounted for as a single contract under Step 1 of the revenue model (identify the contract with the customer)?
  - (c) When can an entity offset other assets or liabilities against the contract asset or contract liability?
12. TRG members generally agreed that:
  - (a) A contract is presented as either a contract asset or a contract liability (but not both) depending on the relationship between the entity’s performance

and the customer’s payment. That is, the contract asset or liability is determined at the contract level and not at the performance obligation level.

- (b) When two or more contracts are combined and accounted for as a single contract, the presentation guidance is applied to the combined contract. Accordingly, the combined contract is presented as either a contract asset or a contract liability.
- (c) Entities should refer to other U.S. GAAP or IFRS when determining whether to offset other assets or liabilities against the contract asset or contract liability (for example, IAS 1, *Presentation of Financial Statements*, IAS 32, *Financial Instruments: Presentation*, and *FASB Accounting Standards Codification*<sup>®</sup> Subtopic 210-20, Balance Sheet—Offsetting).

13. The staff agrees with the view of most TRG members and considers those views to be consistent with the guidance provided in the standard. Paragraph 606-10-45-1[105]<sup>1</sup>, together with the explanation in paragraph BC317, states that contract asset or contract liability positions are determined for each contract on a net basis. In other words, an entity nets each contract to either a contract asset or a contract liability and does not recognize separately a contract asset and a contract liability for a single contract. In respect of contracts that are combined in accordance with paragraph 606-10-25-9[17], paragraph BC72 indicates that the objective of combining contracts is to “identify[ing] the contract that is to be accounted for as the unit of account.” In other words, the rights and obligations in the individual contracts are interdependent across the combined contracts and this is best reflected by combining and presenting the individual contracts as if they were a single contract.
14. The staff agrees with the view of most TRG members that guidance outside of the revenue standard sometimes might need to be referenced when answering implementation questions.
15. Because the discussion indicated that stakeholders can understand and apply the applicable guidance in the new revenue standard in a manner that the staff believes

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<sup>1</sup> Paragraph references in “[XX]” throughout this paper refer to IFRS 15.

is consistent with the standard, the staff does not recommend that the Boards take any further action at this time.

**Topic 3: Determining the nature of a license of intellectual property ([TRG Agenda Ref No. 8](#))**

16. The TRG discussed potential implementation issues related to determining the nature of a license of intellectual property (IP). The TRG discussed the following issues:

- (a) For a license of IP that is not a separate performance obligation, does an entity need to determine the nature of the license as a right to access the entity's IP or a right to use the entity's IP (that is, determine whether the license is satisfied over time or at a point in time)? (*Issue 1*)
- (b) For the nature of a license to be a right to access the entity's intellectual property as it exists throughout the license period, do the contractual or expected activities of the licensor have to change the form and/or functionality of the underlying IP or do significant changes in the value of the IP alone constitute a change to the IP? (*Issue 2*)
- (c) If a customer is not required to use the most recent version of the underlying IP, do the licensor's activities directly expose the customer to positive or negative effects of the IP to which the customer has rights? (*Issue 2(a)*)
- (d) Are activities that transfer a good or service that is not separable from the license of the IP considered in determining the nature of the license? (*Issue 2(b)*)
- (e) Can restrictions in a contract for a license of IP affect the determination of whether that contract contains one or multiple licenses when applying Step 2 (identify performance obligations) of the new revenue standard? (*Issue 3*)

17. On Issue 1, TRG members and the staff generally agreed that a view consistent with the standard is that in some cases an entity will need to determine the nature of a license even if the license is not a separate performance obligation. That is, when the license is not distinct and, thus, combined with other goods or services, the basis

for conclusions (BC407) suggests that the guidance on licenses should be applied if the license (or licenses) is the primary or dominant component in a single performance obligation. They also generally agreed that the licenses guidance would not apply when the license is an insignificant component in the single performance obligation. However, some TRG members expressed a view that the new revenue standard was unclear about whether the licenses guidance would apply when the license is neither an insignificant nor a dominant component.

18. On Issue 2, TRG members had mixed views on when licenses are considered a right to access IP versus a right to use IP, in particular when contractually-required or otherwise expected activities of the licensor “significantly affect the intellectual property to which the customer has rights.” TRG members discussed three views of the guidance.
  - (a) *View A:* For activities to significantly affect the IP to which the customer has rights, those activities must be expected to change the form and/or functionality of that IP. Changes that solely affect the value of the IP do not significantly affect the IP to which the customer has rights.
  - (b) *View B:* For activities to significantly affect the IP to which the customer has rights, those activities only need to significantly affect (that is, change) the value of the IP to the customer. Those activities also could significantly affect the form and/or functionality of the IP, but changes to form and/or functionality are not required to meet the criterion.
  - (c) *View C:* This view is the same as view B, except that the notion of “significantly affects the intellectual property” is a high threshold.
19. Different group members noted several pieces of guidance in the standard that they think support both Views A and B. Several group members stated that View C is what they thought the Boards intended with their decisions about licenses, but they thought the language in the standard may not support that view.
20. On Issues 2(a) and 2(b), TRG members generally agreed that stakeholders can understand and apply the applicable guidance in the new revenue standard and did not object to the following characterizations provided by the staff for the two issues:

- (a) *Issue 2(a)*: A customer will generally *not* be directly exposed to positive or negative effects of a change in the IP if it has the contractual and practical ability to continue to use prior versions of the IP. There are likely to be few instances in which a customer will have the ability to continue to use a prior version of IP that is deemed to have changed as a result of a change in value. This is because even if the IP is unchanged in its form or functionality, a customer generally cannot choose to be associated with a prior value of that IP.
- (b) *Issue 2(b)*: The third criterion in paragraph 606-10-55-60 (IFRS 15, paragraph B58) states that expected activities of the licensor are considered in determining the nature of a license only if those activities do not result in the transfer of a good or service to the customer. The criterion does not state that those activities are excluded only if they result in the transfer of a good or service that is a separate performance obligation.

- 21. On Issue 3, while TRG members acknowledged that the guidance in the new revenue standard is clear that contractual restrictions do not affect the nature of a license of IP, TRG members had different views about whether and how contractual restrictions can affect the identification of the goods or services promised in a contract.
- 22. The discussion helped to inform the Boards about the challenges that are expected to arise in applying the new revenue standard with respect to licenses of IP. Board members instructed the staff to perform additional research and outreach on the topic. The focus of the additional research and outreach is to understand whether there are specific improvements the Boards could make that would reduce the potential diversity in how entities could apply the license implementation guidance. The research also will include issues related to the scope of the constraint on sales-based and usage-based royalties for IP, which was discussed at the July 18, 2014 TRG meeting. Research updates will be provided to all stakeholders.

**Topic 4: Distinct in the context of the contract ([TRG Agenda Ref No. 9](#))**

23. TRG members discussed the guidance related to identifying performance obligations (Step 2 in the new revenue model). The discussion primarily was about the criterion that a good or service that is promised to a customer is distinct if the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (that is, the good or service is distinct in the context of the contract) in paragraphs 606-10-25-19(b) and 25-21 [27(b) and 29].
  
24. TRG members generally agreed that multiple factors in a transaction will often influence the analysis such that one factor will often not be determinative. That is, an entity should consider all of the facts and circumstances in assessing whether promised goods or services are distinct in the context of the contract. For example, a learning curve, the customer's motivation, or contractual restrictions may have differing effects on the distinct analyses for different contracts or types of transactions. Some group members expressed the view that it was unclear to what extent all of the factors in paragraph 606-10-25-21[29] must be evaluated for each promise in the contract. That is, whether an entity needs to evaluate all three factors in the guidance or if they could solely look to those that are most applicable based on the nature of their transaction.
  
25. Two areas in which TRG members had some inconsistent views was whether the analysis should be made from the entity's perspective, the customer's perspective, or solely based on the contract and how to apply the factor in paragraph 606-10-25-21(c)[29(c)] about when goods or services are highly dependent on or highly interrelated with other goods and services promised in the contract. The factors in 606-10-25-21[29] are applicable only in the context of the criterion in paragraph 606-10-25-19(b)[27(b)]. However, the discussion indicated that some of the inconsistent views arise because some entities are analyzing those factors outside of that criterion.
  
26. The discussion helped to inform the Boards about the challenges that are expected to arise in determining whether a promised good or service is distinct in the context of the contract. Board members instructed the staff to perform additional research



and outreach on the topic. The focus of the additional research and outreach is to understand whether there are specific improvements the Boards could make that would reduce the potential diversity in how entities identify performance obligations. Research updates will be provided to all stakeholders.

**Topic 5: Contract enforceability and termination clauses ([TRG Agenda Ref No. 10](#))**

27. TRG members discussed how termination clauses should be evaluated in determining the duration of a contract (that is, the contractual period). TRG members discussed a number of examples that were included in the staff paper. Most TRG members agreed that the conclusions reached in the paper were consistent with the standard (see link to paper above) and agreed with the respective views for each of those examples regarding the determination of contract duration. Some TRG members highlighted the need to consider additional factors in the assessment, such as whether the termination payment is substantive.
28. Because the discussion indicated that stakeholders can understand and apply the applicable guidance in the new revenue standard in a manner that the staff believes is consistent with the standard, the staff does not recommend that the Boards take any further action at this time.

**Other Topics**

29. The FASB Vice-Chairman reported to the TRG that the FASB has received a number of requests for deferral of the effective date of the new revenue standard. The FASB also has received feedback that some entities do not think a deferral is necessary.
30. The FASB staff and Board members will perform outreach, including some site visits, with preparers across a broad spectrum of industries, including those industries most affected by the new revenue standard. The objective of the outreach is to have a detailed discussion about each entity's transition method, implementation plan and status, perspective about whether a deferral is necessary, and the effect of a deferral on implementation costs.

31. The FASB plans to complete the outreach in early 2015 so the Board has the information necessary to decide on the effective date as soon as possible.
32. The IASB Vice-Chairman observed that presently the IASB has not received the same level of feedback about the effective date as the FASB. However, he explained that the IASB would work together with the FASB on next steps.
33. The Boards expect to have a joint Board meeting to discuss the feedback on the effective date early in the second quarter of 2015.