

# STAFF PAPER

July 13, 2015

<b>Project</b>	<b>FASB/IASB Joint Transition Resource Group for Revenue Recognition</b>		
<b>Paper topic</b>	March 2015 Meeting – Summary of Issues Discussed and Next Steps		
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This paper has been prepared by the staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB | IASB Joint Transition Resource Group for Revenue Recognition. It does not purport to represent the views of any individual members of either board or staff. Comments on the application of U.S. GAAP or IFRS do not purport to set out acceptable or unacceptable application of U.S. GAAP or IFRS.

## Purpose

1. The fourth meeting of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) was held on March 30, 2015. 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 March 30, 2015 meeting, (b) the views expressed at the meeting by the TRG members and FASB-IASB staff views about those issues, and (c) the Boards’ planned next steps, if any, for each of those issues.

## Background

3. The following topics were discussed at the March 30, 2015 meeting:

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit [www.ifrs.org](http://www.ifrs.org)

The Financial Accounting Standards Board (FASB) is an independent standard-setting body of the Financial Accounting Foundation, a not-for-profit corporation. The FASB is responsible for establishing Generally Accepted Accounting Principles (GAAP), standards of financial accounting that govern the preparation of financial reports by public and private companies and not-for-profit organizations in the United States and other jurisdictions. For more information visit [www.fasb.org](http://www.fasb.org)

- (a) *Topic 1:* Allocation of the transaction price for discounts and variable consideration
  - (b) *Topic 2:* Accounting for a customer's exercise of a material right
  - (c) *Topic 3:* Consideration payable to a customer
  - (d) *Topic 4:* Partial satisfaction of performance obligations prior to identifying the contract
  - (e) *Topic 5:* Warranties
  - (f) *Topic 6:* Significant financing components
  - (g) *Topic 7:* Whether contributions are included or excluded from the scope
  - (h) *Topic 8:* Series of distinct goods or services.
4. The staff papers for each of those topics were 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. This summary should be read in conjunction with those staff papers which contain a more detailed description of the issues, views, and staff analysis.
5. A replay of the entire meeting is available on the FASB's and the IASB's websites. Due to some technical difficulties, most portions of the TRG meeting were conducted separately by the FASB and the IASB. The websites also contain a [log](#) of questions submitted to the TRG.

**Topic 1: Allocation of the transaction price for discounts and variable consideration ([TRG Agenda Ref No. 31](#))**

6. Step 4 of the model in the new revenue standard requires an entity to allocate the transaction price to the performance obligations in the contract. The TRG discussed the interaction between the guidance on allocating discounts and allocating variable consideration because the guidance on allocating discounts to only one or some, but not all, performance obligations in a contract is different from the guidance on allocating variable consideration to only one or some, but not all, performance

obligations (or distinct goods or services that comprise a single performance obligation in accordance with paragraph 606-10-25-14(b) [22(b)]<sup>1</sup>).

7. TRG members agreed with the staff view that paragraph 606-10-32-41 [86] establishes a hierarchy for allocating variable consideration such that when a contract includes variable consideration, an entity should first apply the guidance on allocating variable consideration before considering the guidance on allocating discounts. TRG members also pointed out that not all discounts are variable and that if a discount is fixed, it does not result in variable consideration. In those cases, an entity would apply the guidance on allocating discounts and would not consider the guidance on allocating variable consideration.
8. 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 consistent with the standard, the staff recommend that the Boards take no further action.

**Topic 2: Accounting for a customer’s exercise of a material right ([TRG Agenda Ref No. 32](#))**

9. At its October 31, 2014 meeting, the TRG discussed the types of factors that should be considered when evaluating whether a customer option to acquire additional goods or services provides a material right ([TRG Agenda ref 6](#)). At that meeting, most TRG members agreed with the staff that the evaluation 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). Because that discussion indicated that stakeholders can understand and apply the applicable guidance in the new revenue standard in a manner that the staff believe is consistent with the standard, the staff did not recommend that the Boards take any further action.

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<sup>1</sup> IFRS 15 references are included in “[XX]” throughout this paper.

10. Subsequent to the October 2014 TRG meeting, some stakeholders raised other questions about the accounting for a customer option that provides a material right. The questions are as follows.
- (i) How should an entity account for a customer's exercise of a material right?  
*(Issue 1)*
  - (j) How should an entity evaluate whether a customer option that provides a material right includes a significant financing component? *(Issue 2)*
  - (k) Over what period should an entity recognize a nonrefundable upfront fee?  
*(Issue 3)*
11. On Issue 1, most TRG members agreed with the staff view that View C (the exercise of a material right should be accounted for as variable consideration) is not supported by the guidance in the new revenue standard. TRG members agreed with the staff view that the guidance in the standard could be interpreted to support the following views.
- (a) View A: At the time a customer exercises a material right, an entity should update the transaction price of the contract to include any consideration to which the entity expects to be entitled as a result of the exercise. The additional consideration should be allocated to the performance obligation underlying the material right and should be recognized when or as the performance obligation underlying the material right is satisfied.
  - (b) View B: The exercise of a material right should be accounted for as a contract modification. That is, the additional consideration received and/or the additional goods or services provided when a customer exercises a material right represent a change in the scope and/or price of a contract. An entity should apply the modification guidance in paragraphs 606-10-25-10 through 25-13 [18–21].
12. Although most TRG members thought both Views A and B were supportable by the new revenue standard, most TRG members leaned toward View A. Other TRG members thought that View B could be acceptable based on the definition of a contract modification in the standard. The staff agrees with TRG members that both

View A and View B could be in accordance with the guidance in the new revenue standard, depending on the facts and circumstances. TRG members observed that in most, but not all, cases the financial reporting outcome of applying View A or View B would be similar. Only in cases in which the optional goods or services are determined to be not distinct from the original promised goods or services, would the results appear to differ. The staff thinks that an entity typically would conclude that an optional good or service is distinct. The method used to account for the exercise of a material right will depend on the facts and circumstances of the arrangement. TRG members agreed with the staff view that the method used should be applied consistently by an entity to similar types of material rights with similar facts and circumstances.

13. On Issue 2, TRG members agreed with the staff view that an entity should consider the effects of the time value of money when determining the transaction price. This evaluation would include consideration of whether a significant financing component exists in the contract as a result of a material right. The TRG agenda paper noted that the standard includes factors to evaluate in determining whether a significant financing component does or does not exist. The factor in paragraph 606-10-32-17(a) [62(a)] is whether the timing of transfer of goods (that were paid for in advance) is at the discretion of the customer. This factor may apply to some customer options.
14. On Issue 3, TRG members agreed with the staff view that the period over which a nonrefundable fee, such as an activation fee, will be recognized depends on whether the nonrefundable fee provides the customer with a material right. If an entity concludes that the activation fee provides the customer with a material right, the fee would be recognized over the service period during which the customer is expected to benefit from not having to pay an activation fee upon renewal of service. Conversely, if an entity concludes that the activation fee does not provide the customer with a material right, the activation fee is, in effect, an advance payment for the promised goods or services in the contract.
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 believe is consistent with the standard, the staff recommend that the Boards take no further action.

**Topic 3: Consideration payable to a customer ([TRG Agenda Ref No. 28](#))**

16. TRG members discussed three questions related to consideration payable to a customer as follows.
- (a) Which payments to a customer are in the scope of the guidance on consideration payable to a customer? (*Issue 1*)
  - (b) Does the guidance on consideration payable to a customer relate to customers in the distribution chain, or more broadly to a customer of an entity's customer? (*Issue 2*)
  - (c) Timing of recognition of consideration payable to a customer (*Issue 3*)
17. On Issue 1, TRG members discussed the following three views.
- (a) View A: Entities should assess all consideration payable to a customer
  - (b) View B: Entities should assess consideration payable to a customer only within the context of that contract with a customer (or combined contracts)
  - (c) View C: Entities should assess consideration payable to a customer only within a contract with a customer (or combined contracts) and to a customer in the distribution chain of that contract with a customer.
18. TRG members had mixed views between Views A and B. No TRG member agreed with View C. Many U.S. TRG members considered that, while they thought the scope of the transactions subject to the consideration payable to a customer guidance in the new revenue standard was similar to the scope of transactions subject to the guidance in existing U.S. GAAP, they did not think the standard would require entities to evaluate whether the consideration payable to the customer exceeds the fair value of distinct goods or services that the entity receives from the same customer for each and every transaction (as might be implied by View A). Those TRG members that supported View B generally expressed the view that a significant underpayment or overpayment in a subsequent contract (that is, one not linked to the original contract by the contract combinations guidance in Topic 606 [IFRS 15]) should be evaluated to determine whether it is a modification of the original contract. Several TRG members noted that they thought that *reasonable* applications of either View A or View B should result in similar financial reporting outcomes in most cases.

19. On Issue 2, some TRG members agreed with the staff view that the guidance on consideration payable to a customer is applicable only to entities within a distribution chain (that is, it applies to the customer and other parties that purchase the entity's goods or services from the customer). Some TRG members highlighted that in the example in the staff paper, the analysis of which entities are in the distribution chain is dependent on how the marketing agent determines its customer. The marketing agent may consider it has more than one customer among the various parties. Many U.S. TRG members thought that this guidance has the same scope as existing U.S. GAAP. However, a couple of U.S. TRG members stated there is some diversity in practice under existing U.S. GAAP because some entities that are marketing agents view the end customer in scenarios like the example in the staff paper as its (or one of its) customer(s).
  
20. On Issue 3, TRG members discussed when the reduction in revenue for consideration payable to a customer should be recognized. The guidance on consideration payable to a customer states that such amounts should be recognized as a reduction of revenue at the later of when the related revenue is recognized or the entity pays or promises to pay such consideration (promises could be implied by customary business practices); however, the guidance on changes in the transaction price in paragraphs 606-10-32-42 [87] through 32-45 [90] states that the transaction price changes when facts or circumstances change the amount of consideration to which an entity *expects* to be entitled. That is, it would require an entity to estimate amounts and reduce the transaction price at the point the entity decides to grant the discount or rebate (and, therefore, no longer would expect to be entitled to the original amount in the contract), which may be before the entity "promises to pay" the consideration.
  
21. TRG members had different views on the interaction of the guidance on changes in the transaction price and consideration payable to a customer. Some TRG members thought that the reduction in revenue should be recognized as of the date management intends to grant the discount, consistent with the guidance applicable to changes in the transaction price, especially in circumstances in which the entity has a past practice of granting a discount. Some TRG members highlighted that the scope of transactions that should be impacted by this issue would be fairly narrow (that is, this

issue should only arise when an entity has no history of granting discounts and has no expectation of granting a discount or rebate as of contract commencement).

22. No conclusions were drawn by the TRG on those three potential implementation issues. Because the discussion on this topic was held separately by TRG members in Norwalk and London due to technology issues and TRG members had different views about the issues, the staff think it would be beneficial for the TRG members to discuss this topic jointly. The staff plan to perform additional research on the issues and an updated staff paper will be discussed at the July 2015 TRG meeting.

**Topic 4: Partial satisfaction of performance obligations prior to identifying the contract ([TRG Agenda Ref No. 33](#))**

23. Entities sometimes commence activities on a specific anticipated contract prior to agreeing on all of the contract terms with the customer or prior to the contract satisfying the criteria in the new revenue standard to apply the revenue recognition model (paragraph 606-10-25-1 [9]). Questions have arisen about how to recognize revenue and costs from those activities that result in the transfer of a good or service to the customer as of the date the contract meets the criteria in paragraph 606-10-25-1 [9].
24. TRG members agreed with the staff view that revenue should be recognized on a cumulative catch-up basis for performance obligations satisfied over time (in accordance with paragraph 606-10-25-27 [35]), reflecting the entity's progress towards complete satisfaction of the performance obligation(s) at the date the contract meets the criteria in paragraph 606-10-25-1 [9]. An entity should consider the requirements in paragraphs 606-10-25-23 [31] through 25-37 [45] to determine the goods or services that the customer controls and, therefore, what portion of the costs should be included in any measure of progress towards satisfaction of a performance obligation that is used to calculate the cumulative catch-up adjustment. For example, this would mean an entity should not include in its measure of progress uninstalled materials that the customer does not control as of the date a contract is identified under the new revenue standard.
25. TRG members agreed with the staff view that costs may be capitalized as costs to fulfill an anticipated contract (subject to the criteria in paragraph 340-40-25-5 [95])



with immediate expensing of those costs at the date the contract is established if the costs relate to progress made to date or to services already transferred to the customer. However, costs that do not satisfy the criteria in other relevant U.S. GAAP or IFRS or in the guidance in paragraph 340-40-25-5 [95] for recognition as an asset would be expensed as incurred in accordance with paragraph 340-40-25-8 [98(a)].

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

**Topic 5: Warranties ([TRG Agenda Ref No. 29](#))**

27. Step 2 of the model in the new revenue standard requires an entity to identify the performance obligations in a contract with a customer, which may include a warranty. The TRG members discussed how to evaluate whether a warranty is a performance obligation and whether the corresponding accounting is the same as, or is different from, existing revenue guidance under U.S. GAAP and IFRS.
28. TRG members agreed with the staff analysis of the guidance on accounting for warranties. The staff analysis concluded that, under the new revenue standard:
  - (a) An entity would account for a warranty as a performance obligation if it has an option to purchase the warranty, such as when it is separately priced or negotiated.
  - (b) Warranties also would be accounted for as performance obligations if the warranty provides the customer with a service in addition to the assurance that the product complies with agreed upon specifications. Therefore, the accounting for warranties under the new revenue standard is different from existing U.S. GAAP and IFRS. Entities might account for some warranties as performance obligations under the new revenue standard that are not separate deliverables (or elements) under existing revenue guidance.
29. The evaluation of whether a warranty provides a service in addition to the assurance that the product complies with agreed-upon specifications will require judgment

based on the facts and circumstances. The Boards included factors in paragraph 606-10-55-33 [B31] to assist entities in making judgments in this area.

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

**Topic 6: Significant financing components ([TRG Agenda Ref No. 30](#))**

31. In Step 3 of the model in the new revenue standard, an entity determines the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods or services in the contract to a customer. In determining the transaction price, an entity considers the effects of various items including significant financing components. TRG members discussed the following six questions related to significant financing components:
- (a) How should the factor in paragraph 606-10-32-17(c) [62(c)] be applied in determining when the difference between promised consideration and cash selling price is not related to a significant financing component? (*Issue 1*)
  - (b) If the promised consideration is equal to the cash selling price, does a financing component exist? (*Issue 2*)
  - (c) Does the standard preclude accounting for financing components that are not significant? (*Issue 3*)
  - (d) How should entities determine if the practical expedient can be applied in scenarios in which there is a single payment stream for multiple performance obligations? (*Issue 4*)
  - (e) How should an entity calculate the adjustment of revenue in arrangements that contain a significant financing component? (*Issue 5*)
  - (f) How should the significant financing guidance be applied when there are multiple performance obligations? (*Issue 6*)
32. On Issue 1, TRG members agreed that there is no presumption in the standard that a significant financing component exists or does not exist when there is a difference in

timing between when goods and services are transferred and when the promised consideration is paid. An entity will need to apply judgment to determine whether the payment terms are providing financing or are for another reason. TRG members discussed the factor in paragraph 606-10-32-17(c) [62(c)] relating to whether the difference in promised consideration and cash selling price is for a reason other than financing, noting that it might be more likely that an advance payment would meet that factor compared to payments in arrears. However, TRG members also agreed that there is no presumption as to whether advance payments do or do not contain significant financing components and that advance payments should be assessed under the new revenue standard. However, several members stressed that when entities consider whether the difference in promised consideration and cash selling price is for a reason other than financing, they also must consider whether the difference between those amounts is proportional to the reason for the difference. Many TRG members noted that it will require significant judgment in some circumstances to determine whether a transaction does, or does not, include a significant financing component, and they thought that when the Boards developed the new revenue standard they understood judgment may often be required in this area.

33. On Issue 2, TRG members agreed with the staff view that the difference, if any, between the amount of promised consideration and the cash selling price is only one indicator (because it is one of two factors in paragraph 606-10-32-16 [61] in a list that is stated to be non-exhaustive), not a presumption, in determining whether a significant financing component exists.
  
34. Some TRG members asked the staff to provide clarification on the intention of the analysis in paragraph 26 of the staff paper which states “However, if the list price, the cash selling price, and the promised consideration are all, in fact, equal (including after careful consideration of whether the list price is the cash selling price), that might indicate that the contract does not include a significant financing component.” The staff clarified that the intention of this was not to imply that if list price, cash selling price, and promised consideration are equal that a financing component *cannot* exist. Rather, this paragraph was written in the context of suggesting entities carefully evaluate whether those items are all, in fact, equal. Determining a “cash

selling price” may require judgment and the fact that an entity provides “zero interest financing” does not necessarily mean that the cash selling price is the same as the price another customer will pay over time. Entities would consider the cash selling price as compared to the promised consideration in making the evaluation based on the overall facts and circumstances of the arrangement.

35. On Issue 3, TRG members agreed with the staff view that the standard does not preclude accounting for financing components that are not significant in the context of the contract.
  
36. TRG members discussed the example in the staff paper on Issue 4 as to how to determine whether or not the practical expedient in paragraph 606-10-32-18 [63] may be applied. That practical expedient allows an entity not to adjust promised consideration for the amount of a significant financing component when the period between when the entity transfers a promised good or service to a customer and when a customer will pay for that good or service will be one year or less. TRG members discussed the difficulty in determining when a customer has paid for a particular good or service in a contract with a customer because of the fungible nature of cash. In some circumstances, it may not be clear whether cash collected relates to a specific performance obligation in a contract. In other instances, it may be clear that a cash payment is related to a specific performance obligation based on the terms of the contract. The overall view was that judgment will need to be applied to determine whether or not the practical expedient may be applied based on the facts and circumstances.
  
37. TRG members acknowledged that calculating the adjustment of revenue in arrangements that contain a significant financing component (Issue 5) and how to apply the significant financing component guidance when there are multiple performance obligations (Issue 6) may be complex in some scenarios. However, TRG members agreed that the standard provides a framework to deal with those issues. In calculating the impact of the significant financing component, the new revenue standard includes guidance on selecting a discount rate and other U.S. GAAP (Subtopic 835-30) and IFRS (IFRS 9) provide guidance on subsequent accounting.

38. As it relates to Issue 6, the standard is clear that when determining the transaction price, the effect of financing is excluded from the transaction price prior to the allocation of the transaction price to performance obligations. TRG members agreed with the staff view that it may be reasonable in some circumstances to attribute a significant financing component to one or more, but not all, of the performance obligations in the contract. Some TRG members agreed that, practically, this might be in a manner analogous to the guidance on allocating variable consideration or allocating a discount.
39. 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 consistent with the standard, the staff recommend that the Boards take no further action.

**Topic 7: Whether contributions are included or excluded from the scope**  
**([TRG Agenda Ref No. 26](#))**

40. TRG members discussed whether contributions<sup>2</sup> are in the scope of the new revenue standard. TRG members agreed with the staff view that contributions are not in the scope of the new revenue standard and that the standard includes adequate guidance to come to this conclusion. Some TRG members highlighted that a not-for-profit organization may have arrangements in which amounts received could relate to both a contribution and a good or a service. In those cases, an entity would need to evaluate the facts and circumstances to determine the nature of the arrangement. Non-U.S.

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<sup>2</sup> As defined by U.S. Accounting Standards Codification Master Glossary: An unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately equal value; from investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners; and from other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers. In a contribution transaction, the value, if any, returned to the resource provider is incidental to potential public benefits. In an exchange transaction, the potential public benefits are secondary to the potential proprietary benefits to the resource provider. The term contribution revenue is used to apply to transactions that are part of the entity's ongoing major or central activities (revenues), or are peripheral or incidental to the entity (gains).

TRG members did not comment on this issue because IFRS does not provide specific guidance for not-for-profit organizations.

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

#### **Topic 8: Series of distinct goods or services ([TRG Agenda Ref No. 27](#))**

42. TRG members discussed how to determine whether an entity is providing a series of distinct goods or services (referred to as the “series provision”) within Step 2, Identifying Performance Obligations, of the revenue model. For a series provision, an entity must have already identified the promised goods or services in the contract with the customer and determined that two or more of those goods or services are distinct, because otherwise the goods and services would be accounted for as a single performance obligation. Whether an entity determines a single performance obligation comprising a series of distinct goods or services (606-10-25-14b [22b]), or a single performance obligation comprising goods or services that are not distinct from each other, impacts various other areas of the new revenue standard including the allocation of variable consideration, contract modifications, and changes in the transaction price.
43. TRG members agreed that entities should evaluate the criteria in paragraphs 606-10-25-14(b) [22b] and 25-15 [23] and that it is not necessary that (a) the goods will be delivered or services will be performed consecutively or (b) the accounting result would be the same as if the underlying distinct goods and services each were accounted for as a separate performance obligations.
44. Some TRG members expressed the view that the intent of the series provision is to simplify application of the revenue guidance, but that, in practice, this is not always going to be the result. Therefore, although TRG members agreed with the staff that the requirements of the standard are clear, some TRG members requested that the Boards consider whether the series provision could be amended to be a practical expedient, rather than a requirement. Board members directed the staff to perform

additional research on this topic. The objective of the research is to obtain an understanding of the potential consequences if the series provision were changed to a practical expedient.

### Research Update

45. At the March 30, 2015 TRG meeting, the staff provided a research update on issues raised at previous TRG meetings. The majority of the implementation questions discussed at the first three TRG meetings have been resolved at those meetings without any further action needed. However, the Boards directed the staff to perform research on certain issues. Two of those issues, identifying performance obligations and licensing, were discussed at a joint Board meeting on February 18, 2015. Refer to the [FASB's Tentative Board Decisions](#) and the [IASB Update](#) for further details. Some other issues, which included new practical expedients and narrow scope clarifications were discussed at a joint Board meeting on March 18, 2015. Refer to the [FASB's Tentative Board Decisions](#) and the [IASB Update](#) for further details. At the joint Board meeting on March 18, 2015 the Boards also discussed research on the principal versus agent assessment. The staff is continuing to perform research on this topic.
46. As of the date of the March TRG meeting, the only other topic not yet discussed at a public Board meeting relates to the effective date of the standard. The FASB discussed this on April 1, 2015. Refer to the [FASB's Tentative Board Decisions](#) for further details. The IASB discussed this topic at a public Board meeting on April 28, 2015. Refer to the [IASB Update](#) for further details.