STAFF PAPER

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Project	**FASB/IASB Joint Transition Resource Group for Revenue Recognition**		
Paper topic	November 2015 Meeting – Summary of Issues Discussed and Next Steps		
CONTACT(S)	Mary Mazzella	msmazzella@fasb.org	+1 203 956 3434
	Raghava Tirumala	rtirumala@ifrs.org	+44 (0)20 7246 6953

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Purpose

1. The sixth meeting of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) was held on November 9, 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 November 9, 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 November 9, 2015 meeting:

   (a) *Topic 1:* Customer options for additional goods and services

   (b) *Topic 2:* Pre-production activities

(c) *Topic 3:* Licenses – specific application issues about restrictions and renewals

(d) *Topic 4:* Whether fixed odds wagering contracts are included or excluded from the scope of Topic 606.

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 and the IASB 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, stakeholder views, and staff analysis.

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 (TRG Agenda Ref No. 48)

6. Sometimes contracts include an option for the customer to purchase additional goods or services. Some options may be given to a customer as part of an entity's marketing efforts, while other options may be purchased by customers (often implicitly) as part of a present contract and give customers a right to acquire additional goods and services at a discount. Although the customer is not obligated under the contract to purchase additional goods or services, there may be various reasons why the customer is economically compelled to exercise its option.

7. Some stakeholders informed the staff that there are different interpretations of the guidance in the new revenue standard for determining whether customer options to acquire additional goods and services should be accounted for as a material right or as a separate contract, or whether there are situations in which the goods or services underlying the option are part of the initial contract. Furthermore, at the July 13, 2015 TRG meeting, the TRG discussed the applicability of the series provision to long-term service contracts and the accounting for variable consideration included in those contracts (TRG Agenda Ref No. 39). At that meeting, some TRG members questioned whether the consideration in those contracts would be more appropriately characterized as consideration received upon the exercise of an

optional purchase and, therefore, not included in the accounting for the initial contract.

8. TRG members discussed the following issues regarding customer options:

   (a) Optional purchases versus variable consideration (*Issue 1*)

   (b) Customer termination rights and penalties (*Issue 2*)

   (c) Are goods or services underlying an option to purchase additional goods or services a performance obligation? (*Issue 3*)

9. On Issue 1, some stakeholders had questions about distinguishing between a contract that contains an option to purchase additional goods and services and a contract that includes variable consideration based on a variable quantity (such as certain usage-based fees). TRG members agreed that an important first step to distinguishing between optional goods or services and variable consideration for promised goods or services is to identify the nature of the entity's promise to the customer as well as the enforceable rights and obligations of the parties. With an option for additional goods or services, the customer has a present right to choose to purchase additional distinct goods or services (or change the goods and services to be delivered). Prior to the customer's exercise of that right, the vendor is not presently obligated to provide those goods or services and the customer is not obligated to pay for those goods or services. In the case of variable consideration for a promised good or service, the entity and the customer previously entered into a contract that obligates the entity to transfer the promised good or service and the customer to pay for that promised good or service. The future events that result in additional consideration occur after (or as) control of the goods or services have (or are) transferred. When a contract includes variable consideration based on a customer's actions, those actions do not obligate the entity to provide additional distinct goods or services (or change the goods or services to be transferred), but rather, resolve the uncertainty associated with the amount of variable consideration that the customer is obligated to pay the entity. TRG members thought that the staff paper provided a useful framework for evaluating the issue, but that judgment will be required in many cases.

10. At the October 31, 2014 TRG meeting (Agenda Ref No. 10), the TRG discussed the accounting for termination clauses in a contract when *each* party has the unilateral right to terminate the contract by compensating the other party. At that meeting, TRG members supported the view that the legally enforceable contract period should be considered the contract period. Since that meeting, stakeholders have raised further questions (Issue 2) about evaluating a contract when only *one* party has the right to terminate the contract. TRG members agreed with the staff analysis that the views expressed at the October 2014 TRG meeting would be consistent regardless of whether both parties can terminate, or whether only one party can terminate. TRG members highlighted that when performing an evaluation of the contract term and the effect of termination penalties, an entity should consider whether those penalties are substantive. Determining whether a penalty is substantive will require judgement and the examples in the TRG paper do not create a bright line for what is substantive. If the penalty is not substantive, an entity would still evaluate whether the termination right (which is akin to an option for additional goods or services) gives rise to a material right. That is, if the existence of a contractual penalty does not create a longer contract term, it still could impact whether a material right is present for the optional periods (that is, the period not included in the duration of the contract).

11. On Issue 3, stakeholders had different views about when, if ever, goods or services underlying an option to purchase additional goods or services should be considered promised goods or services when there are no contractual penalties that compensate the other party if the option is not exercised. TRG members agreed with the staff view that items that as a matter of law are optional from the customer's perspective are not promised goods or services in the contract. The options should instead be assessed to determine whether the customer has a material right. As a result, consideration that would be received for optional goods or services if the customer exercises its right should not be included when determining the transaction price for the initial contract. TRG members discussed scenarios whereby an entity sells goods or services to a customer at a loss with a strong expectation of profit on future orders from that customer. TRG members agreed that if those further purchases are optional, the underlying goods or services would not be considered

promised goods or services in the initial contract with the customer, rather any such options would be evaluated for the existence of a material right.

12. 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: Pre-production activities (TRG Agenda Ref No. 46)

13. Some long-term supply arrangements require an entity to undertake efforts in up-front engineering and design to create new technology or adapt existing technology to the needs of the customer. The pre-production activity is often a pre-requisite to delivering any units under a production contract. TRG members discussed the following questions:

    (a) Question 1: How should an entity assess whether pre-production activities are a promised good or service, or included in the measure of progress towards complete satisfaction of a performance obligation that is satisfied over time?

    (b) Question 2: How should an entity account for pre-production costs that currently are accounted for in accordance with guidance in Subtopic 340-10? (U.S. GAAP Question Only)

    (c) Question 3: Are pre-production costs for contracts that were previously in the scope of Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts, in the scope of cost guidance in Subtopic 340-10 or Subtopic 340-40? (U.S. GAAP Question Only)

14. On Question 1, TRG members agreed with the staff view that an entity should evaluate the nature of its promise with the customer and determine if the pre-production activity is a promised good or service or if it is an activity that does not transfer a good or service to the customer (such as a setup or fulfilment activity). TRG members acknowledged that this may require judgment and agreed with the staff view that if an entity is having difficulty determining if pre-production activities are promised goods or services it is helpful to consider whether control of that good or service would be transferred to the customer. If control would transfer,

the entity would likely conclude that the activities are a promised good or service in the contract. If the activities do not result in the transfer of control of a good or service to the customer, then the pre-production activities might be a fulfilment activity.

15. Questions 2 and 3 are only applicable under U.S. GAAP and were discussed by TRG members in Norwalk. On Question 2, TRG members agreed that because the guidance in Subtopic 340-10, Other Assets and Deferred Costs—Overall, did not change as a result of the new revenue standard, an entity that is applying that guidance appropriately today would continue to do so after implementation of the new revenue standard. On Question 3, TRG members agreed with the staff view that costs related to contracts currently accounted for in the scope of Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts, should be accounted for in accordance with the new guidance in Subtopic 340-40, Other Assets and Deferred Costs—Contracts with Customers, when implementing the new revenue standard. However, some TRG members suggested that the Board consider an improvement to the guidance to ensure this outcome is clear. Some TRG members suggested that the Board could clarify its intent by removing the long-term supply guidance in Subtopic 340-10 from U.S. GAAP.

16. 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 on Topic 606 or IFRS 15. However, on Question 3, the FASB will compile issues such as this and decide at a later date whether to make a technical correction or minor improvement to the guidance.

    [Subsequent to the TRG meeting, the FASB discussed questions 2 and 3 in January 2016 as part of its Technical Corrections and Improvements Project. The FASB tentatively decided to propose to supersede (that is, withdraw) the guidance on pre-production costs related to long-term supply arrangements within Subtopic 340-10. As a consequence, an entity would apply the guidance in Subtopic 340-40.]

Topic 3: Licenses – specific application issues about restrictions and renewals (TRG Agenda Ref No. 45)

17. Stakeholders raised some questions about license renewals and contractual restrictions in the licensing implementation (application) guidance in the new revenue standard. Stakeholders also asked whether provisions in a contract for software that permit a customer to acquire or make additional copies of the software constitute usage-based fees in the scope of the sale-based and usage-based royalties guidance (paragraph 606-10-55-65[B63] or, instead, are options to acquire additional software licenses. Those questions are different from previous licensing questions discussed by the TRG about determining the nature of a license of intellectual property (that is, right to access versus right to use) and the applicability of the exception for sales-based and usage-based royalties promised in exchange for a license of intellectual property, which both Boards are addressing through their respective projects on clarifying the licensing implementation (application) guidance.

18. The questions discussed at the November 9, 2015 TRG meeting primarily relate to the following guidance that is provided in the new revenue standard *(prior to any amendments resulting from the FASB's and the IASB's recent amendments to the new revenue standard)*:

    (a) Revenue cannot be recognized for a license 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 license (606-10-55-63 [B61])

    (b) An entity should disregard restrictions of time, geographical region or use when determining whether a license provides a right to access or right to use an entity's intellectual property. Those restrictions define the attributes of the promised license, rather than define whether the entity satisfies its performance obligation at a point in time or over time (606-10-55-64 [B62]).

19. Subsequent to the Boards' consideration of previous licensing issues discussed by the TRG and the Boards' issuance of separate exposure drafts proposing clarifications to the guidance in the new revenue standard in response to those issues, some stakeholders informed the staff that there are additional questions

about the licensing implementation guidance. Specifically, stakeholders raised questions about (i) accounting for renewals of time-based licenses that provide the customer with a right to use the entity's intellectual property, (ii) distinguishing attributes of a single license from promises to grant additional licenses, and (iii) software licensing arrangements that include fees based on the number of copies of software that the customer has obtained or made.

20. In response to that feedback, the TRG discussed the following implementation issues:

    (a) When to recognize revenue from renewals of time-based right-to-use (point in time) licenses (*Issue 1*)
    (b) Accounting for distinct rights within a contract (*Issue 2*)
    (c) Accounting for distinct rights added through a modification (*Issue 3*)
    (d) Accounting for a customer's option to purchase or use additional copies of software (*Issue 4*).

21. On Issue 1, TRG members discussed whether revenue from renewals of time-based right-to-use licenses should be recognized as revenue when the parties agree to the extension or, rather, when the extension period begins. Some TRG members expressed the view that renewal revenue should be recognized when the parties agree to the extension. Other TRG members expressed the view that renewal revenue should not be recognized until the extension period begins. TRG members thought that the new revenue standard was not clear in this respect.

22. Issues 2 and 3 relate to the interaction of Step 2, Identifying Performance Obligations, with the licensing implementation guidance. Stakeholders have raised questions about when certain contractual provisions are attributes of a promised license or, instead, give rise to additional promises in the contract (for example, a promise to transfer additional licenses). The TRG discussed a contract in which a customer obtains the right to use intellectual property in two geographical regions, but the right to use the intellectual property in one region is restricted for a period of time after the right to use the intellectual property in the other region has commenced. The staff view that was expressed in the TRG agenda paper was that the guidance in the new revenue standard about restrictions of time, geography, or use in a licensing contract does not alter or override an entity's requirement to

identify the promises to the customer in the contract (Step 2). That is, an entity identifies its promises to the customer (for example, whether there are one or multiple licenses) before it considers the licensing implementation guidance on contractual restrictions. Some TRG members suggested that the staff's views in the paper on Issue 1 and Issues 2-3 raised questions about whether, and if so why, time-based restrictions would be treated differently to geographical and use restrictions.

23. On Issue 4, TRG members discussed how to account for a customer's option to purchase or use additional copies of software. The staff considered the following two views could be acceptable when a customer has an option to acquire additional software rights (such as incremental user seats or incremental copies), depending on the nature of the arrangement. However, this is not to say that selection of the appropriate view is a choice; in some facts and circumstances, one view will be more appropriate that the other.

    (a) View A: An option to acquire additional copies of software is an option to acquire additional licenses. An entity, therefore, would apply the guidance on customer options for additional goods and services (that is, consider whether a material right exists).

    (b) View B: Apply the guidance on sales-based or usage-based royalties. Additional users or copies represent incremental usage of the existing, previously granted license rather than an option to acquire additional licenses. Therefore, the additional usage gives rise to variable consideration (that is, a sales-based or usage-based royalty).

    TRG members agreed that, consistent with practice under previous U.S. GAAP and IFRS, judgment will be needed based on the specific facts and circumstances of the arrangement to determine whether rights to additional copies, seats, or users represent a right to acquire additional licenses or variable consideration with respect to an existing license and thought the staff paper provided a useful framework for making those judgments.

24. Because the discussion about Issue 4 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 principles of the standard, the staff recommend that the Boards take no further action.

25. The discussion on Issues 1 through 3 helped to inform the Boards about the challenges that are expected to arise in applying the new revenue standard with respect to licenses of intellectual property. The Boards each plan to discuss this topic as part of redeliberations of their respective licensing proposals.

[Subsequent to the TRG meeting, the FASB discussed this topic at a Board meeting in January 2016. The FASB observed that the application guidance on licensing does not override the five-step revenue recognition model in Topic 606. An entity is expected to apply the guidance for identifying performance obligations to determine whether a contract includes one or multiple licenses. Contractual provisions (whether written as restrictions or otherwise) that require the entity to fulfil additional promises to the customer (for example, transfer additional licenses) should be distinguished from provisions that define attributes of a promise already identified in the contract and do not require further performance by the entity. The FASB also clarified that the use and benefit guidance applies to both the initial license of intellectual property and renewals of that licence. The FASB included clarifications on those issues in its Accounting Standards Update on performance obligations and licensing.]

[The IASB discussed this topic at a Board meeting in December 2015. The IASB also observed that the application guidance on licensing does not override the five-step revenue recognition model in IFRS 15. An entity is expected to apply the general requirements for identifying performance obligations to identify whether a contract includes one or multiple licences. Similarly, the entity would evaluate whether a licence renewal or extension should be treated as a new licence or as a modification to a licensing contract, to which the contract modifications guidance of IFRS 15 should be applied.]

Topic 4: Whether fixed odds wagering contracts are included or excluded from the scope of Topic 606 (TRG Agenda Ref No. 47)

26. Gaming entities participate in games of chance with customers whereby the gaming entity and the customer have the chance to win or lose money or other items of economic value based on the outcome of the game. Those activities are referred to

as "gaming activities." Examples of gaming activities include table games, slot machines, keno, bingo, sports and non-pari-mutuel[1] race betting. The payout for wagers placed on gaming activities typically is known at the time the wager is placed. This form of wagering is referred to as "fixed odds wagering."

27. Some stakeholders informed the FASB staff that there were questions about whether fixed odds wagering contracts are in the scope of the new revenue standard. This question applies only to U.S. GAAP because today gaming entities apply the guidance in Subtopic 924-605, Entertainment—Casinos—Revenue Recognition, to fixed odds wagering contracts. That guidance was superseded by the new revenue standard. Some stakeholders requested that the FASB clarify whether fixed odds wagering contracts are in the scope of the new revenue standard or in the scope of Topic 815, Derivatives and Hedging.

28. TRG members in Norwalk discussed whether fixed odds wagering contracts are included or excluded from the scope of Topic 606. Most TRG members thought it was the FASB's intent that those transactions are in the scope of the new revenue standard. However, some TRG members raised the point that the transactions might meet the definition of a derivative in Topic 815. Some TRG members, therefore, requested the Board clarify its intent through an amendment to the guidance.

29. As a result of the feedback from the TRG and other outreach, the FASB staff recommends that the FASB clarify that fixed odds wagering contracts are not in the scope of Topic 815 and should be accounted for as revenue transactions. The FASB staff recommends that the FASB compile the technical correction that would result from this issue with other technical corrections or minor improvements and decide at a later date whether to make those amendments.

    [Subsequent to the TRG meeting, the FASB discussed this topic in January 2016 as part of its Technical Corrections and Improvements Project. The FASB tentatively decided to propose to add a new Subtopic, 924-815, Entertainment—Casinos—Derivatives and Hedging, that would include a scope exception from derivatives

[1] Pari-mutuel betting is a betting system in which all bets are placed together in a pool. Payoff odds are not fixed at the time a wager is placed. Rather, the final payout is determined when the pool is closed and is shared among all winning bets. A gaming entity acts only as an agent in these arrangements and collects a fee for administering the bets.

guidance for fixed odds wagering contracts of entities within the scope of Topic 924.]

[In TRG agenda paper 47, the IASB staff explained their view that wagering contracts (or part thereof) that meet the definition of a financial instrument within the scope of IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement* if the entity has not yet applied IFRS 9) are excluded from the scope of IFRS 15.]

Research Update

30. At the 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 five TRG meetings have been resolved at those meetings without any further action needed. However, standard setting has been required on a few of the issues. The Boards have jointly discussed each of those issues at public board meetings and have each made tentative decisions how to proceed with each issue. Refer to the FASB and IASB websites for the most recent status of standard setting activities of each Board.