

# Joint Transition Resource Group tackles new revenue topics

## What you need to know

- ▶ TRG members discussed five implementation issues and expressed diverse views on two of them: licences of IP; and, whether a good or service is distinct within the context of a contract.
- ▶ The Boards are using the group's discussions to determine whether more application guidance is needed for entities to apply IFRS 15 consistently.
- ▶ In an update on the first four issues discussed by the TRG in July 2014, the Boards said their staffs are researching whether improvements can be made to the application guidance on the principal versus agent assessment in arrangements involving intangible goods and services.
- ▶ At the second meeting of the TRG, the FASB's Vice Chairman said the FASB is exploring whether to propose delaying the standard's effective date for US GAAP preparers.

Diverse views were expressed about licences of IP and the determination of whether a good or service is distinct within the context of a contract.

## Highlights

At the second meeting of the Joint Transition Resource Group for Revenue Recognition (TRG) in October 2014, members discussed five implementation issues stakeholders have raised about IFRS 15 *Revenue from Contracts with Customers* at the meeting. Members expressed diverse points of view about two issues: licences of intellectual property (IP); and the determination of whether a good or service is distinct within the context of a contract. The TRG also discussed: when customer options for additional goods and services represent a material right; presentation of contract assets and liabilities; and enforceable rights and contract terminations. The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards) are using the TRG discussions to determine whether more application guidance is needed on implementation issues raised by stakeholders.

During the meeting, James Kroeker, the Vice Chairman of the FASB, said the FASB is exploring whether to propose a delay in the effective date of the new revenue standard for US GAAP preparers and will discuss this project with various stakeholders. Mr Kroeker expects the FASB to decide whether to propose a delay early in the second quarter of 2015.

The IASB did not comment on the effective date for IFRS preparers. However, the FASB will share the results of its outreach with the IASB.

## Hotly debated issues

### Licences of IP

The TRG discussed several issues involving licences of IP. IFRS 15 provides criteria to determine whether a licence of IP is transferred to the customer at a point in time or over time. The TRG first discussed whether this application guidance, which affects the timing of revenue recognition, applies only to distinct licences or whether an entity would apply these criteria if the licence were bundled with other goods or services (i.e., the licence is not a separate performance obligation). TRG members noted that the Boards suggest in the standard's Basis for Conclusions that applying the licences criteria is acceptable if a licence is the 'primary or dominant component' in a bundled arrangement. However, if it is not clear that the licence is the primary or dominant component, TRG members said it was unclear whether the criteria should be applied.

The TRG also discussed the meaning of the requirement to consider whether an entity's activities (that are not part of the licence agreement) "significantly affect the intellectual property to which the customer has rights".<sup>1</sup> In order for an entity to conclude that revenue for the licence would be recognised over time, do those activities have to change the form and/or functionality of the IP or just the value of the IP? The distinction is important, because whether an entity will undertake activities that significantly affect the IP is critical to determining whether a licence of IP will be recognised at a point in time (i.e., a right to use licence) or over time (i.e., a right to access licence).

TRG members expressed different views about how the analysis should be performed. Noting that IFRS 15 does not provide clear guidance, TRG members said two reasonable people could evaluate the same set of facts and circumstances and arrive at different conclusions based on the wording in IFRS 15 and its illustrative examples. However, some Board members indicated that evaluating changes in the value of IP that result from an entity's activities is consistent with the Boards' intent.

The TRG also discussed how licences with certain contractual restrictions on use would be evaluated. For example, a media and entertainment company may license the rights to a customer to show a holiday programme for four years, but only permit the programme to be broadcast on that particular holiday. TRG members could not determine whether such an arrangement would represent: one performance obligation, recognised over the four-year term of the licence; one performance obligation, satisfied at the point in time when control of the licence has transferred to the customer; or four separate performance obligations that would each be recognised at the point in time when the licensed content is aired.

#### How we see it

The TRG has now discussed revenue recognition for licences of IP twice. Because this topic continues to generate diverse views, we are hopeful that the Boards will provide additional application guidance to help constituents implement the requirements of IFRS 15 consistently.

### Distinct in the context of the contract

IFRS 15 establishes a two-step process for determining whether a promised good or service (or a bundle of goods and services) is distinct: (1) the good or service is capable of being distinct; and (2) the good or service is distinct within the context of the contract (i.e., it is separable from other promises in the contract). IFRS 15 provides three indicators to help entities with the second step. Much of the TRG discussion focused on how to interpret the third indicator, which reads "the good or

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<sup>1</sup> IFRS 15.B57

service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract”.<sup>2</sup>

The TRG discussed whether any individual fact pattern (e.g., a complex and/or customised design, learning curve costs) could be determinative in the evaluation of whether a good or service is distinct within the context of a contract. While TRG members expressed varying levels of support for each of the factors in isolation, they said that all facts and circumstances would need to be considered.

Without further clarification of the requirements, TRG members said there would most likely be diversity in practice.

## **Other issues discussed**

### **Customer options for additional goods or services**

The TRG discussed the requirement to determine when customer options for additional goods and services (e.g., future sales incentives, loyalty programmes, renewal options) represent a material right that gives rise to a performance obligation. This discussion also covered whether the material right evaluation would be only performed in relation to the current transaction or whether it would consider past and future transactions with the same customer. TRG members said that the fact that customers can accumulate incentives in programmes (such as loyalty programmes) should be taken into account when determining whether an option represents a material right. The TRG did not believe the evaluation would only be performed in relation to the current transaction. Furthermore, TRG members agreed that the evaluation would consider both quantitative and qualitative factors.

### **Contract assets and liabilities**

TRG members agreed that contract assets and liabilities would be determined at the contract level, rather than at the performance obligation level. This means that an entity would not separately recognise an asset or liability for each performance obligation within a contract, but would aggregate them into a single contract asset or liability. TRG members also agreed that the contract asset or liability would be combined (i.e., presented net) for different contracts with the same customer (or a related party of the customer) if an entity is required to combine those contracts under IFRS 15. However, TRG members acknowledged that this analysis may be operationally difficult for some entities because their systems will generally capture data at the performance obligation level in order to comply with the recognition and measurement requirements of the standard.

The TRG also discussed whether an entity would offset contract assets and liabilities against other balance sheet items (e.g., accounts receivable) related to the same contract and/or contract assets and liabilities from an unrelated contract. TRG members agreed that, because IFRS 15 does not provide requirements for offsetting, entities will need to apply the requirements of other IFRSs to determine whether offsetting is appropriate.

### **Contract enforceability and termination clauses**

The TRG discussed how termination clauses in a contract would be evaluated when determining the duration of a contract. For example, if a contract with a stated contractual term can be terminated at any time by either party for no consideration, would the arrangement be treated as a month-to-month contract? Another issue discussed was whether the presence of a termination payment in a contract indicates that the duration of the contract ought to be equal to the stated contractual term (or up until the time when a termination payment would not be due).

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<sup>2</sup> IFRS 15.29(c)

Overall, TRG members did not disagree with the conclusions reached in the examples included in the staffs' issue paper on this topic. However, one TRG member said a termination payment needs to be substantive to be considered a determinative indicator of the duration of a contract. Another TRG member commented that evaluating the contract term is difficult for some entities, particularly those that sell equipment with month-to-month service arrangements.

### Update on TRG issues discussed in July 2014

The Boards have instructed their staffs to research whether improvements can be made to the application guidance on the principal versus agent assessment for arrangements involving intangible goods and services. No further action is planned for two other issues that the TRG previously discussed (i.e., gross versus net revenue for amounts billed to customers and impairment testing of capitalised contract costs), except for a possible technical correction to clarify the Boards' intent relating to impairment testing.

However, in their summary of the discussion of gross-versus-net revenue for amounts billed to customers, the Boards noted TRG members' observations. Specifically, that, in order to implement the new standard, an entity may need to evaluate taxes billed to customers in each jurisdiction in which the entity operates to determine whether a tax is levied on the entity or the customer. Current US GAAP allows a policy election for the presentation of sales and other taxes collected from customers. As a result, adopting the new standard could require significant additional implementation effort for some US GAAP preparers. One TRG member asked whether the Boards might consider adding a requirement, similar to current US GAAP, to make it easier for entities to apply this requirement.

The Boards plan to provide an update on sales and usage-based royalties on licences of IP after reviewing the TRG's discussion of other licensing matters at the October meeting.

### Next steps

The Boards will provide a status update on the five new issues discussed at the October meeting on, or before, the next TRG meeting on 26 January 2015. This could include a decision to reconsider an issue. Stakeholders can find a log of submissions made to-date, and can submit issues for the TRG to discuss, on the [IASB](#) or [FASB](#) websites.

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