



EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: May 12, 2015
Comments Due: June 30, 2015

Revenue from Contracts with Customers (Topic 606)

Identifying Performance Obligations and Licensing

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 606 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing written comments to director@fasb.org, or sending a letter to “Technical Director, File Reference No. 2015-250, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

The *FASB Accounting Standards Codification*[®] is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by June 30, 2015. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at [Exposure Documents Open for Comment](#)
- Emailing a written letter to director@fasb.org, File Reference No. 2015-250
- Sending written comments to "Technical Director, File Reference No. 2015-250, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

An electronic copy of this Exposure Draft is available on the FASB's website.

Copyright © 2015 by Financial Accounting Foundation. All rights reserved. Permission is granted to make copies of this work provided that such copies are for personal or intraorganizational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2015 by Financial Accounting Foundation. All rights reserved. Used by permission."

Proposed Accounting Standards Update

Revenue from Contracts with Customers (Topic 606)

Identifying Performance Obligations and Licensing

May 12, 2015

Comment Deadline: June 30, 2015

CONTENTS

	Page Numbers
Summary and Questions for Respondents.....	1–7
Amendments to the <i>FASB Accounting Standards Codification</i> ®	9–48
Background Information, Basis for Conclusions, and Alternative Views.....	49–72
Amendments to the XBRL Taxonomy	73

Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

On May 28, 2014, the FASB and the International Accounting Standards Board (IASB) issued a converged standard on recognition of revenue from contracts with customers. In June 2014, the FASB and the IASB (collectively, the Boards) announced the formation of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG). One of the objectives of the TRG is to inform the Boards about potential implementation issues that could arise when organizations implement the new revenue standard. The TRG also helps some stakeholders to better understand specific aspects of the new revenue standard from others. The TRG does not issue authoritative guidance. Instead, the Boards evaluate the feedback received from the TRG and other stakeholders to determine what action, if any, is necessary for each potential implementation issue.

Implementation questions submitted to the TRG and discussions at TRG meetings informed the Board about a few issues in the guidance on identifying performance obligations and licensing. Those issues include:

1. Identifying Performance Obligations:
 - a. When identifying performance obligations, whether it is necessary to identify and evaluate promised goods or services that are immaterial
 - b. Determining whether promised goods and services are separately identifiable (that is, distinct within the context of the contract)
 - c. Determining whether shipping and handling activities are a promised service in a contract or are activities to fulfill an entity's other promises in the contract.
2. Licensing:
 - a. Determining whether the nature of an entity's promise in granting a license is to provide a right to access the entity's intellectual property, which is satisfied over time and for which revenue is recognized over time, or to provide a right to use the entity's intellectual property, which is satisfied at a point in time and for which revenue is recognized at a point in time
 - b. The scope and applicability of the guidance about when to recognize revenue for sales-based or usage-based royalties promised in exchange for a license of intellectual property
 - c. Whether restrictions of time, geographical region, or use on a license of intellectual property affect the identification of performance obligations.

The Board decided to add a project to its technical agenda to improve Topic 606 to address those issues by reducing:

1. The risk of diversity in practice arising before the guidance is effective
2. The cost and complexity of applying Topic 606 both at transition and on an ongoing basis.

The amendments in this proposed Update are being issued by the FASB. The IASB decided that it would perform additional research and outreach before deciding whether any specific amendments are warranted.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect entities with transactions included within the scope of Topic 606. The scope of that Topic includes entities that enter into contracts with customers to transfer goods or services (that are an output of the entity's ordinary activities) in exchange for consideration.

What Are the Main Provisions and How Are Those an Improvement?

The core principle of the guidance in Topic 606 is that an entity should recognize 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 to in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps:

1. Step 1: Identify the contract(s) with a customer.
2. Step 2: Identify the performance obligations in the contract.
3. Step 3: Determine the transaction price.
4. Step 4: Allocate the transaction price to the performance obligations in the contract.
5. Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The amendments in this proposed Update would not change core principles of the guidance. The amendments in this proposed Update would affect the following two aspects of Topic 606: identifying performance obligations and licensing implementation guidance.

Identifying Performance Obligations

Before an entity can identify its performance obligations in a contract with a customer, the entity first identifies the promised goods or services in the contract. The Board is proposing to reduce the cost and complexity of applying the guidance on identifying promised goods or services by adding the following guidance:

1. An entity would not be required to identify goods or services promised in a contract with a customer that are immaterial in the context of the contract.
2. An entity would be permitted to account for shipping and handling activities that occur after the customer has obtained control of a good as an activity to fulfill the promise to transfer the good rather than as an additional promised service.

To identify performance obligations in a contract, an entity evaluates whether promised goods and services are distinct. Topic 606 includes two criteria for assessing whether promises to transfer goods or services are distinct. One criterion is that the promises are separately identifiable. This proposed Update would improve the guidance on assessing that criterion by:

1. Improving the articulation of the principle for determining whether promises to transfer goods or services to a customer are separately identifiable. An entity would determine whether the nature of its promise in the contract is to transfer each of the goods or services or whether the promise is to transfer a combined item (or items) to which the promised goods and/or services are inputs.
2. Revising the related factors and examples so they align with the improved articulation of the separately identifiable principle.

The Board decided to include a question in this proposed Update about whether paragraphs 606-10-25-14(b) through 25-15 should be optional. The series provision, within the guidance on identifying performance obligations, requires goods or services to be accounted for as a single performance obligation when two criteria are met even though the underlying goods and services are distinct. At the March 30, 2015 TRG meeting, some TRG members noted that they believe the Board included the series provision to make the guidance easier to apply. However, those TRG members noted that making the series provision a requirement might increase complexity for some entities.

Licensing Implementation Guidance

Topic 606 includes implementation guidance on determining whether an entity's promise to grant a license provides a customer with either a right to access the entity's intellectual property (which is satisfied over time) or a right to use the entity's intellectual property (which is satisfied at a point in time). The amendments in this proposed Update are intended to improve the operability and

understandability of the licensing implementation guidance by clarifying the following:

1. An entity's promise to grant a customer a license to 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) does not include supporting or maintaining that intellectual property during the license period. Rather, the nature of the entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists at the time the license is granted unless the entity is expected to undertake activities (that do not transfer a promised good or service to the customer) that will change the functionality of the intellectual property to which the customer has rights. An entity's promise to provide a customer with a right to use the entity's intellectual property is satisfied at the point in time the customer is able to use and benefit from the license, because the entity's promise in granting the license is solely to make the underlying intellectual property available for the customer's use and benefit. Functional intellectual property includes software, biological compounds or drug formulas, and completed media content (for example, films, television shows, or music).
2. An entity's promise to grant a customer a license to symbolic intellectual property (that is, intellectual property that does not have significant standalone functionality) includes supporting or maintaining that intellectual property during the license period. Therefore, the nature of the entity's promise to the customer is both to (a) grant the customer rights to use and benefit from the entity's intellectual property and make that underlying intellectual property available for the customer's use and benefit and (b) support or maintain the intellectual property during the license period (or over the remaining economic life of the intellectual property, if shorter). Consequently, a license to symbolic intellectual property is satisfied over time. Symbolic intellectual property includes brands, team or trade names, logos, and franchise rights.
3. An entity needs to consider the nature of its promise in granting a license that is not a separate performance obligation to apply the other guidance in Topic 606 to a single performance obligation that includes a license and other goods or services (in particular, the guidance on determining whether a performance obligation is satisfied over time or at a point in time and the guidance on how best to measure progress toward the complete satisfaction of a performance obligation satisfied over time).

Topic 606 includes implementation guidance on when to recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property. The amendments in this proposed Update clarify the scope and applicability of this guidance as follows:

1. An entity would not split a sales-based or usage-based royalty into a portion subject to the guidance on sales-based and usage-based royalties and a portion that is not subject to that guidance.
2. The guidance on sales-based and usage-based royalties would apply to a sales-based or usage-based royalty whenever the predominant item to which the royalty relates is a license of intellectual property.

The existing licensing implementation guidance in Topic 606 states that contractual 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. The amendments in this proposed Update would clarify further that contractual restrictions on the customer's rights in the license also do not affect the entity's identification of the promised goods or services in the contract.

When Would the Amendments Be Effective?

The amendments in this proposed Update would affect the guidance in Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this proposed Update would be the same as the effective date and transition requirements in Topic 606.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

Update 2014-09 and IFRS 15, *Revenue from Contracts with Customers*, are the joint FASB-IASB standards that create common revenue recognition guidance for GAAP and IFRS. Although the amendments in this proposed Update are not identical, and some are incremental, to the amendments the IASB is considering for IFRS 15, the FASB expects the proposed amendments would maintain or enhance the convergence that was achieved with the issuance of Update 2014-09 and IFRS 15 by reducing the risk of significant diversity in practice. Significant diversity in application would substantially reduce the benefits achieved by converged guidance.

The amendments in this proposed Update would not change the core principles for revenue recognition in Topic 606. Instead, the proposed amendments would provide (1) more detailed guidance in a few areas and (2) additional implementation guidance and examples based on feedback the FASB received from its stakeholders. The proposed amendments should reduce the degree of judgment necessary to comply with Topic 606, which the FASB expects will reduce the risk of diversity arising in practice and reduce the cost and complexity of applying the guidance. However, the FASB does not expect that the amendments in this proposed Update would result in financial reporting

outcomes that are significantly different from those reported under IFRS for similar transactions.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Paragraphs 606-10-25-14(b) through 25-15 include guidance on accounting for a series of distinct goods or services as a single performance obligation. Should the Board change this requirement to an optional practical expedient? What would be the potential consequences of the series guidance being optional?

Question 2: Paragraph 606-10-25-16A specifies that an entity is not required to identify goods or services promised to a customer that are immaterial in the context of the contract. Would the proposed amendment reduce the cost and complexity of applying Topic 606? If not, please explain why.

Question 3: Paragraph 606-10-25-18A permits an election to account for shipping and handling as an activity to fulfill a promise to transfer a good if the shipping and handling activities are performed after a customer has obtained control of the good. Would the proposed amendment reduce the cost and complexity of applying Topic 606? If not, please explain why.

Question 4: Would the revisions to paragraph 606-10-25-21 and the related examples improve the operability of Topic 606 by better articulating the separately identifiable principle and better linking the factors to that principle? If not, what alternatives do you suggest and why?

Question 5: Would the revisions to paragraphs 606-10-55-54 through 55-64, as well as the revisions and additions to the related examples, improve the operability of the implementation guidance about determining the nature of an entity's promise in granting a license? That is, would the revisions clarify when the nature of an entity's promise is to provide a right to access the entity's intellectual property or to provide a right to use the entity's intellectual property as it exists at the point in time the license is granted? If not, what alternatives do you suggest and why?

Question 6: The revisions to paragraph 606-10-55-57 that state an entity should consider the nature of its promise in granting a license of intellectual property when accounting for a single performance obligation. Does this revision clarify

the scope and applicability of the licensing implementation guidance? If not, why?

Question 7: Would the revisions to paragraph 606-10-55-64 adequately communicate the Board's intent (a) that restrictions of time, geographical region, or use in a license of intellectual property are attributes of the license (and, therefore, do not affect the nature of an entity's promise in granting a license or its assessment of the goods or services promised in a contract with a customer) and (b) about determining when a contractual provision is a restriction of the customer's right to use or right to access the entity's intellectual property? If not, what alternatives do you suggest and why?

Question 8: Would paragraphs 606-10-55-65 through 55-65B and the related example clarify the scope and applicability of the guidance on sales-based and usage-based royalties promised in exchange for a license of intellectual property? If not, what alternatives do you suggest and why?

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–7. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Section 606-10-25

2. Amend paragraphs 606-10-25-16 through 25-17, 606-10-25-19, and 606-10-25-21, add paragraphs 606-10-25-16A and 606-10-25-18A and the heading preceding paragraph 606-10-25-19, and supersede the heading preceding paragraph 606-10-25-18, with a link to transition paragraph 606-10-65-1, as follows:

Revenue from Contracts with Customers—Overall

Recognition

> Identifying Performance Obligations

606-10-25-14 At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation **each promise to transfer to the customer either:**

- a. **A good or service (or a bundle of goods or services) that is distinct**
- b. **A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 606-10-25-15).**

606-10-25-15 A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- a. Each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time.
- b. In accordance with paragraphs 606-10-25-31 through 25-32, the same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

> > Promises in Contracts with Customers

606-10-25-16 A **contract** with a **customer** generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the ~~performance obligations~~ promised goods or services identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer also may include promises that are implied by an entity's customary business practices, published policies, or specific statements if, at the time of entering into the contract, those promises create a ~~valid~~ reasonable expectation of the customer that the entity will transfer a good or service to the customer.

606-10-25-16A An entity is not required to identify promised goods or services that are immaterial in the context of the contract. An entity shall evaluate whether optional goods or services (that is, those subject to a customer option to acquire additional goods or services) provide the customer with a material right in accordance with paragraphs 606-10-55-42 through 55-43.

606-10-25-17 ~~Performance obligations~~ Promised goods or services do not include activities that an entity must undertake to fulfill a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not promised goods or services in the contract with the customer ~~a performance obligation~~.

>> Distinct Goods or Services

606-10-25-18 Depending on the **contract**, promised goods or services may include, but are not limited to, the following:

- a. Sale of goods produced by an entity (for example, inventory of a manufacturer)
- b. Resale of goods purchased by an entity (for example, merchandise of a retailer)
- c. Resale of rights to goods or services purchased by an entity (for example, a ticket resold by an entity acting as a principal, as described in paragraphs 606-10-55-36 through 55-40)
- d. Performing a contractually agreed-upon task (or tasks) for a **customer**
- e. Providing a service of standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides
- f. Providing a service of arranging for another party to transfer goods or services to a customer (for example, acting as an agent of another party, as described in paragraphs 606-10-55-36 through 55-40)
- g. Granting rights to goods or services to be provided in the future that a customer can resell or provide to its customer (for example, an entity

- selling a product to a retailer promises to transfer an additional good or service to an individual who purchases the product from the retailer)
- h. Constructing, manufacturing, or developing an asset on behalf of a customer
 - i. Granting licenses (see paragraphs 606-10-55-54 through ~~55-65~~55-65B)
 - j. Granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs 606-10-55-41 through 55-45).

606-10-25-18A An entity that promises a good to a customer also might perform shipping and handling activities related to that good. If the shipping and handling activities are performed before the customer obtains control of the good (see paragraphs 606-10-25-23 through 25-30 for guidance on satisfying performance obligations), then the shipping and handling activities are not promises to the customer. Rather, shipping and handling are activities to fulfill the promise to transfer the good. If the shipping and handling activities are performed after a customer obtains control of the good, then the entity may elect to account for shipping and handling as activities to fulfill the promise to transfer the good. An entity making this election would not evaluate whether shipping and handling are promised services to the customer. An entity that applies this election shall comply with the accounting policy disclosure requirements in paragraphs 235-10-50-1 through 50-6.

> > Distinct Goods or Services

606-10-25-19 A good or service that is promised to a customer is distinct if both of the following criteria are met:

- a. The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct).
- b. 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 promise to transfer the good or service is distinct within the context of the contract).

606-10-25-20 A customer can benefit from a good or service in accordance with paragraph 606-10-25-19(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value, or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction

with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

606-10-25-21 The objective when assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 606-10-25-19(b) is to determine whether the nature of the entity's overall promise in the contract is to transfer each of those goods or services or whether the promise is to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that an entity's two or more promises promise to transfer a good goods or services service to a customer is are not separately identifiable (in accordance with paragraph 606-10-25-19(b)) include, but are not limited to, the following:

- a. The entity does not provide provides a significant service of integrating the good goods or services service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is not using the good goods or services service as inputs an input to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element, or unit.
- b. One or more of the goods or services significantly modifies or customizes, or is significantly modified or customized by, one or more of the other goods or services promised in the contract. The good or service does not significantly modify or customize another good or service promised in the contract.
- c. The goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. The good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services.

606-10-25-22 If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single **performance obligation**.

Amendments to Section 606-10-55

3. Amend paragraphs 606-10-55-54, 606-10-55-57 through 55-60, and 606-10-55-62 through 55-64, add paragraphs 606-10-55-58A through 55-58C, 606-10-55-63A, and 606-10-55-65A through 55-65B, and supersede paragraph 606-10-55-61, with a link to transition paragraph 606-10-65-1, as follows:

Implementation Guidance and Illustrations

> > Licensing

606-10-55-54 A license establishes a customer's rights to the intellectual property of an entity. Licenses of intellectual property may include, but are not limited to, licenses of any of the following:

- a. Software (other than software that does not meet the criteria in paragraph 985-20-15-5) and technology
- b. Motion pictures, music, and other forms of media and entertainment
- c. Franchises
- d. Patents, trademarks, and copyrights.

606-10-55-55 In addition to a promise to grant a license to a **customer**, an entity may also promise to transfer other goods or services to the customer. Those promises may be explicitly stated in the **contract** or implied by an entity's customary business practices, published policies, or specific statements (see paragraph 606-10-25-16). As with other types of contracts, when a contract with a customer includes a promise to grant a license in addition to other promised goods or services, an entity applies paragraphs 606-10-25-14 through 25-22 to identify each of the **performance obligations** in the contract.

606-10-55-56 If the promise to grant a license is not distinct from other promised goods or services in the contract in accordance with paragraphs 606-10-25-18 through 25-22, an entity should account for the promise to grant a license and those other promised goods or services together as a single performance obligation. Examples of licenses that are not distinct from other goods or services promised in the contract include the following:

- a. A license that forms a component of a tangible good and that is integral to the functionality of the good
- b. A license that the customer can benefit from only in conjunction with a related service (such as an online service provided by the entity that enables, by granting a license, the customer to access content).

606-10-55-57 An entity should consider the nature of its promise in granting a license (see paragraphs 606-10-55-59 through 55-64) when accounting for a single performance obligation that includes a license of intellectual property and one or more other goods or services (that is, to apply paragraphs 606-10-25-23 through 25-37). ~~If the license is not distinct, an entity should apply paragraphs~~

~~606-10-25-23 through 25-30 to determine whether the performance obligation (which includes the promised license) is a performance obligation that is satisfied over time or satisfied at a point in time.~~

~~606-10-55-58 If the promise to grant the license is distinct from the other promised goods or services in the contract and, therefore, the promise to grant the license is a separate performance obligation, an entity should determine whether the license transfers to a customer either at a point in time or over time. In making this determination, an entity should consider whether the~~ The nature of the entity's promise in granting the license to a customer is to provide the customer with either:

- a. ~~A right to access the entity's intellectual property as it exists throughout the license period (or its remaining economic life, if shorter)~~
- b. ~~A right to use the entity's intellectual property as it exists at the point in time at which the license is granted.~~

606-10-55-58A An entity should account for a promise to provide a customer with a right to access the entity's intellectual property as a performance obligation satisfied over time because the customer simultaneously will receive and consume the benefit from the entity's performance of providing access to its intellectual property as the performance occurs (see paragraph 606-10-25-27(a)). An entity should apply paragraphs 606-10-25-31 through 25-37 to select an appropriate method to measure its progress toward complete satisfaction of that performance obligation to provide access.

606-10-55-58B An entity's promise to provide a right to use the entity's intellectual property is satisfied at a point in time. The entity should apply paragraph 606-10-25-30 to determine the point in time at which the license transfers to the customer.

606-10-55-58C Notwithstanding paragraphs 606-10-55-58A through 55-58B, revenue cannot be recognized from a license of intellectual property before both:

- a. An entity provides (or otherwise makes available) the intellectual property to the customer.
- b. The beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the intellectual property. For example, the entity would not recognize revenue before the beginning of the license period if the entity transfers a copy of the intellectual property before the start of the license period or the customer has a copy of the intellectual property from a previous transaction.

> > Determining the Nature of the Entity's Promise

~~606-10-55-59 To determine whether an entity's promise to grant a license provides a customer with either a right to access an entity's intellectual property or a right to use an entity's intellectual property, an entity should consider~~

~~whether a customer can direct the use of, and obtain substantially all of the remaining benefits from, a license at the point in time at which the license is granted. A customer cannot direct the use of, and obtain substantially all of the remaining benefits from, a license at the point in time at which the license is granted if the intellectual property to which the customer has rights changes throughout the license period. The intellectual property will change (and thus affect the entity's assessment of when the customer controls the license) when the entity continues to be involved with its intellectual property and the entity undertakes activities that significantly affect the intellectual property to which the customer has rights. In these cases, the license provides the customer with a right to access the entity's intellectual property (see paragraph 606-10-55-60). In contrast, a customer can direct the use of, and obtain substantially all of the remaining benefits from, the license at the point in time at which the license is granted if the intellectual property to which the customer has rights will not change (see paragraph 606-10-55-63). In those cases, any activities undertaken by the entity merely change its own asset (that is, the underlying intellectual property), which may affect the entity's ability to provide future licenses; however, those activities would not affect the determination of what the license provides or what the customer controls.~~ To determine whether a license constitutes a right to access an entity's intellectual property or a right to use the entity's intellectual property, the entity should consider the nature of the intellectual property to which the customer will have rights. Intellectual property is either:

- a. Functional intellectual property. 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). Functional intellectual property derives a substantial portion of its utility (that is, its ability to provide benefit or value) from its significant standalone functionality.
- b. Symbolic intellectual property. Intellectual property that does not have significant standalone functionality (that is, intellectual property that is not functional intellectual property). Because symbolic intellectual property does not have significant standalone 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.

606-10-55-60 A customer's ability to derive benefit from a license to symbolic intellectual property depends on the entity continuing to support or maintain the intellectual property. Therefore, a license to symbolic intellectual property grants the customer a right to access the entity's intellectual property, which is satisfied over time (see paragraphs 606-10-55-58A and 606-10-55-58C) as the entity fulfills its promise to both. ~~The nature of an entity's promise in granting a license is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:~~

- a. Grant the customer rights to use and benefit from the entity's intellectual

property by making it available for the customer's use. 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 paragraph 606-10-55-61).~~

- b. Support or maintain the intellectual property. An entity generally supports or maintains symbolic intellectual property by continuing to undertake those activities from which the utility of the intellectual property is derived and/or refraining from activities or other actions that would significantly degrade the utility of the intellectual property. The rights granted by the license directly expose the customer to any positive or negative effects of the entity's activities identified in paragraph 606-10-55-60(a).
- c. Subparagraph superseded by Accounting Standards Update 2015-XX. Those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 606-10-25-17).

606-10-55-61 Paragraph superseded by Accounting Standards Update 2015-XX. Factors that may indicate that a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property include the entity's customary business practices, published policies, or specific statements. Although not determinative, the existence of a shared economic interest (for example, a sales-based royalty) between the entity and the customer related to the intellectual property to which the customer has rights may also indicate that the customer could reasonably expect that the entity will undertake such activities.

606-10-55-62 If the criteria in paragraph 606-10-55-60 are met, an entity should account for the promise to grant a license as a **performance obligation** satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access to its intellectual property as the performance occurs (see paragraph 606-10-25-27(a)). An entity should apply paragraphs 606-10-25-31 through 25-37 to select an appropriate method to measure its progress toward complete satisfaction of that performance obligation to provide access. A license to functional intellectual property grants a right to use the entity's intellectual property as it exists at the point in time at which the license is granted unless both of the following criteria are met:

- a. 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 good or service to the customer (see paragraphs 606-10-25-16 through 25-18).
- b. The customer is contractually or practically required to use the updated intellectual property resulting from criterion (a).

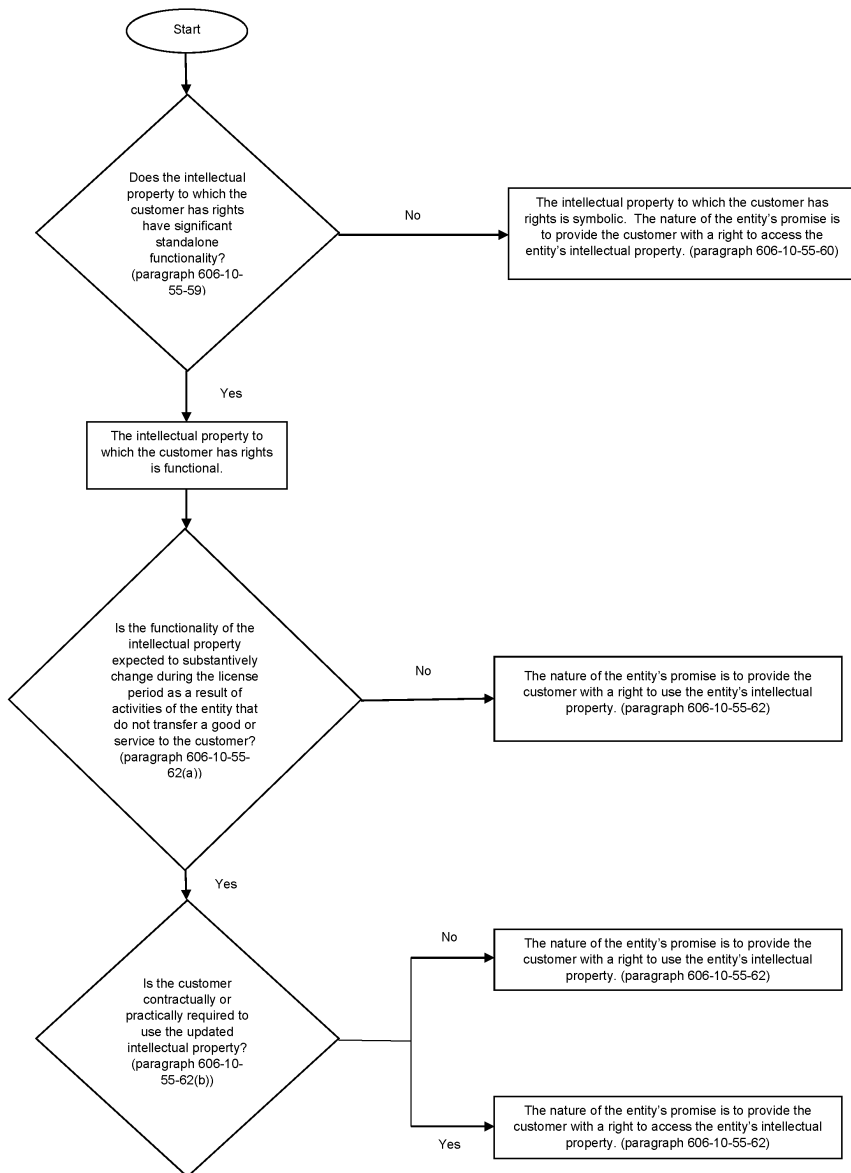
If both of those criteria are met, then the license grants a right to access the entity's intellectual property.

606-10-55-63 Because functional intellectual property has significant standalone

functionality, an entity's activities that do not substantively change that functionality do not significantly affect the utility of the intellectual property to which the customer has rights. Therefore, the entity's promise to the customer in granting a license to functional intellectual property does not include supporting or maintaining the intellectual property. Consequently, if a license to functional intellectual property is a separate performance obligation (see paragraph 606-10-55-55) and does not meet the criteria in paragraph 606-10-55-62, it is satisfied at a point in time (see paragraphs 606-10-55-58B through 55-58C). ~~If the criteria in paragraph 606-10-55-60 are not met, the nature of an entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the license is granted to the customer. This means that the customer can direct the use of, and obtain substantially all of the remaining benefits from, the license at the point in time at which the license transfers. An entity should account for the promise to provide a right to use the entity's intellectual property as a performance obligation satisfied at a point in time. An entity should apply paragraph 606-10-25-30 to determine the point in time at which the license transfers to the customer. However, 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. For example, if a software license 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 recognize revenue before that code has been provided (or otherwise made available).~~

606-10-55-63A The following flowchart depicts the decision process to follow for evaluating whether the nature of an entity's promise in granting a license is to provide the customer with a right to access the entity's intellectual property or a right to use the entity's intellectual property.

[For ease of readability, the new flowchart is not underlined.]



606-10-55-64 An entity should disregard the following factors when determining whether a license provides a right to access the entity's intellectual property or a right to use the entity's intellectual property or when identifying the promises in the contract:

- a. Restrictions of time, geographical region, or use—Those restrictions define the attributes of the promised license. ~~license, rather than~~ Therefore, they do not define whether the entity satisfies its performance obligation at a point in time or over time or affect how many goods or services are promised in the contract. A restriction defines the scope of a customer's right to use or right to access intellectual property. Therefore, an entity assesses whether a contractual provision defines the scope of the customer's right to use or right to access the intellectual property to determine whether that provision is a restriction.
- b. Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorized use—A promise to defend a patent right is not a performance obligation because ~~the act of defending a patent protects the value of the entity's intellectual property assets and it solely~~ provides assurance to the customer that the license transferred meets the specifications of the license promised in the contract.

> > > Sales-Based or Usage-Based Royalties

606-10-55-65 Notwithstanding the guidance in paragraphs 606-10-32-11 through 32-14, an entity should recognize **revenue** for a sales-based or usage-based royalty promised in exchange for a license of intellectual property only when (or as) the later of the following events occurs:

- a. The subsequent sale or usage occurs.
- b. The **performance obligation** to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

606-10-55-65A The guidance on sales-based or usage-based royalties in paragraph 606-10-55-65 applies if the royalty relates only to a license of intellectual property or if a license of intellectual property 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).

606-10-55-65B Revenue from a sales-based or usage-based royalty should be recognized entirely in accordance with either the guidance in paragraph 606-10-55-65 (if paragraph 606-10-55-65A applies) or the guidance on variable consideration in paragraphs 606-10-32-5 through 32-14 (if paragraph 606-10-55-65A does not apply).

4. Amend paragraph 606-10-55-93(s), with a link to transition paragraph 606-10-65-1, as follows:

> Illustrations

606-10-55-93 The Examples are organized as follows:

- s. Licensing
 - Example 54—Right to Use Intellectual Property
 - Example 55—License of Intellectual Property
 - Example 56—Identifying a Distinct License
 - Example 57—Franchise Rights
 - Example 58—Access to Intellectual Property
 - Example 59—Right to Use Intellectual Property
 - Example 60—Sales-Based Royalty Promised in Exchange for a License of Intellectual Property and Other Goods and Services ~~Access to Intellectual Property~~
 - Example 61—Access to Intellectual Property
 - Example 61A—Right to Use Intellectual Property
 - Example 61B—Contractual Provisions That Are (and Are Not) Restrictions.

5. Amend paragraph 606-10-55-137 and add its related heading and paragraphs 606-10-55-139, 606-10-55-141, 606-10-55-143, 606-10-55-145, 606-10-55-147 through 55-148, 606-10-55-153, 606-10-55-155, and the heading preceding paragraph 606-10-55-156 and add paragraphs 606-10-55-140A through 55-140F and their related headings, 606-10-55-150A through 55-150I and their related headings, and 606-10-55-157A, with a link to transition paragraph 606-10-65-1, as follows:

> > Identifying Performance Obligations

606-10-55-136 Examples 10–12 illustrate the guidance in paragraphs 606-10-25-14 through 25-22 on identifying performance obligations.

> > > Example 10—Goods and Services Are Not Distinct

> > > > Case A—Significant Integration Service (Single Item)

606-10-55-137 An entity, a contractor, enters into a contract to build a hospital for a customer. The entity is responsible for the overall management of the project and identifies various promised goods and services ~~to be provided~~, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment, and finishing.

606-10-55-138 The promised goods and services are capable of being distinct in accordance with paragraph 606-10-25-19(a). That is, the customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other

customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling, or holding those goods or services.

606-10-55-139 However, the promises to transfer the goods and services are not separately identifiable distinct within the context of the contract in accordance with paragraph 606-10-25-19(b) (on the basis of the factors in paragraph 606-10-25-21). That is, the entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. This is evidenced by the fact that the entity provides a significant service of integrating the goods and services (the inputs) into the hospital (the combined output) for which the customer has contracted.

606-10-55-140 Because both criteria in paragraph 606-10-25-19 are not met, the goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

> > > Case B—Significant Integration Service (Multiple Items)

606-10-55-140A An entity enters into a contract requiring delivery of multiple units of a highly complex, specialized device to a customer. The initial design of the devices is specific to the customer and was completed before the entity and the customer entered into the contract, and it is not part of the current negotiated exchange. The contract requires the performance and integration of various activities in accordance with the customer's specifications, such as procurement of materials; identifying and managing subcontractors; and performing manufacturing, assembly, and testing. The entity also provides the customer with engineering, logistics, test support, support equipment, and any other supplies or services required by the customer.

606-10-55-140B The entity assesses the promises in the contract and determines that each of the promised devices is capable of being distinct in accordance with paragraph 606-10-25-19(a) because the customer can benefit from each device on its own. This is because each unit can function independently of the other units.

606-10-55-140C The various promises inherent to transferring the devices are not separately identifiable in accordance with paragraph 606-10-25-19(b) because the entity is providing a significant service of integrating those various goods and services (the inputs) to deliver the full complement of devices (the combined output) that meet the customer's specifications. The highly integrated nature of the entity's performance means that a change in one of the entity's activities to fulfill the contract has a significant effect on the other activities such that in this contract the highly specialized devices are highly interrelated and highly interdependent.

> > > Case C—Highly Interrelated

606-10-55-140D An entity grants a customer a three-year term license to antivirus software and promises to provide the customer with when-and-if available updates to that software during the license period. The entity frequently provides updates that are critical to the continued utility of the software. Without the updates, the customer's ability to benefit from the software would decline significantly during the three-year arrangement. In fact, the customer might not enter into a three-year arrangement with the entity without the updates because the software delivered at the beginning of the arrangement would have limited benefit over the entire three-year term.

606-10-55-140E The entity concludes that the software and the updates are each promised services in the contract and are each capable of being distinct in accordance with paragraph 606-10-25-19(a). This is because the customer can derive some economic benefit (but only a minor portion of the benefit it intends to derive from the overall arrangement) from the software on its own throughout the license period (that is, without the updates the software would still provide its original functionality to the customer), while the customer can benefit from the updates together with the software license transferred at the outset of the contract.

606-10-55-140F The entity concludes that its promises to transfer the software license and to provide the critical updates, when-and-if available, are not separately identifiable (in accordance with paragraph 606-10-25-19(b)) because the license and the critical updates are, in effect, inputs to a combined item in the contract. Because the software license would provide the customer with little of its intended benefit absent the updates and because the updates are not functional without the base software, the license and the updates significantly affect each other and are highly interrelated and highly interdependent such that they fulfill a single promise to the customer despite the fact the entity can fulfill its promise to grant the initial software license independent from its promise to subsequently grant updates. Therefore, in this Example, the customer accounts for its promise to transfer the software license and its promise to deliver when-and-if available updates as a single performance obligation.

> > > Example 11—Determining Whether Goods or Services Are Distinct

> > > > Case A—Distinct Goods or Services

606-10-55-141 An entity, a software developer, enters into a contract with a customer to transfer a software license, perform an installation service, and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the license, installation service, software updates, and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management, and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support.

606-10-55-142 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity observes that the software is delivered before the other goods and services and remains functional without the updates and the technical support. Thus, the entity concludes that the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available and the criterion in paragraph 606-10-25-19(a) is met.

606-10-55-143 The entity also considers the factors in paragraph 606-10-25-21 and determines that the promise to transfer each good and service to the customer is separately identifiable from each of the other promises (thus, the criterion in paragraph 606-10-25-19(b) is met). In reaching this determination, the entity considers the promises in the context of the contract and evaluates the principle and the factors in paragraph 606-10-25-21. The entity observes that none of the promised goods or services significantly modify or customize another. Therefore, the entity is not providing a significant service of integrating the software and the services into a combined output. The software and the services are not highly interrelated or highly interdependent because the customer's ability to use and benefit from the software is not significantly affected by any of the services and because the entity can fulfill its promise to grant the initial software license independent from its promise to subsequently grant updates. The installation services do not significantly affect the customer's ability to use and benefit from the software license because they are not complex and can be obtained from alternative providers to the extent the customer cannot perform the installation. In contrast with Example 10 (Case C), the software updates in this contract are not necessary to maintain a high level of utility in the software during the license period. Therefore, the software updates also do not significantly affect the customer's ability to use and benefit from the software license. In particular, the entity observes that the installation service does not significantly modify or customize the software itself, and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output.

606-10-55-144 On the basis of this assessment, the entity identifies four performance obligations in the contract for the following goods or services:

- a. The software license
- b. An installation service
- c. Software updates
- d. Technical support.

606-10-55-145 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each of the performance obligations for the installation service, software updates, and technical support are satisfied at a point in time or over time. The entity also assesses the nature of the entity's promise to transfer the software license in accordance with ~~paragraph 606-10-55-60~~ paragraphs

606-10-55-59 through 55-64 (see Example 54 in paragraphs 606-10-55-362 through 55-363B55-363.

> > > Case B—Significant Customization

606-10-55-146 The promised goods and services are the same as in Case A, except that the contract specifies that, as part of the installation service, the software is to be substantially customized to add significant new functionality to enable the software to interface with other customized software applications used by the customer. The customized installation service can be provided by other entities.

606-10-55-147 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity first assesses whether the criterion in paragraph 606-10-25-19(a) has been met. For the same reasons as in Case A, the entity determines that the software license, installation, software updates, and technical support each meet that criterion. The entity next assesses whether the criterion in paragraph 606-10-25-19(b) has been met by evaluating the principle and the factors in paragraph 606-10-25-21. The entity observes that the terms of the contract result in a promise to provide a significant service of integrating the licensed software into the existing software system by performing a customized installation service as specified in the contract. In other words, the entity is using the license and the customized installation service as inputs to produce the combined output (that is, a functional and integrated software system) specified in the contract (see paragraph 606-10-25-21(a)). In addition, the software is significantly modified and customized by the service (see paragraph 606-10-25-21(b)). ~~Although the customized installation service can be provided by other entities, Consequently,~~ the entity determines that ~~within the context of the contract,~~ the promise to transfer the license is not separately identifiable from the customized installation service and, therefore, the criterion in paragraph 606-10-25-19(b) ~~(on the basis of the factors in paragraph 606-10-25-21)~~ is not met. Thus, the software license and the customized installation service are not distinct.

606-10-55-148 ~~As in Case A, On the basis of the same analysis as in Case A, the entity concludes that the software updates and technical support are distinct from the other promises in the contract. This is because the customer can benefit from the updates and technical support either on their own or together with the other goods and services that are readily available and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises.~~

606-10-55-149 On the basis of this assessment, the entity identifies three performance obligations in the contract for the following goods or services:

- a. Customized installation service (that includes the software license)
- b. Software updates

- c. Technical support.

606-10-55-150 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each performance obligation is satisfied at a point in time or over time.

> > > Case C—Promises Are Separately Identifiable (Installation)

606-10-55-150A An entity contracts with a customer to sell a piece of equipment as well as installation services. The equipment is functional without any customization or modification. The installation required is capable of being performed by several alternative service providers.

606-10-55-150B The entity identifies two promised goods and services in the contract: (a) equipment and (b) installation. The entity evaluates the criteria in paragraph 606-10-25-19 to determine whether each promise is distinct. The entity determines that both promises meet the criterion in paragraph 606-10-25-19(a). The customer can benefit from the equipment on its own, which is evidenced by the entity regularly selling the equipment on a standalone basis. This supports that it has functionality on its own and could be resold by the customer (for more than scrap value) together with other readily available resources (that is, the installation services are available from alternative providers). The customer also can benefit from the installation services together with other resources the customer will already have obtained from the entity (that is, the equipment).

606-10-55-150C The entity further determines that its promises to transfer the equipment and to provide the installation services are each separately identifiable (in accordance with paragraph 606-10-25-19(b)). The entity considers the principle and the factors in paragraph 606-10-25-21 in determining that the equipment and the installation services are not inputs to a combined item in this contract. In this Example, each of the factors in paragraph 606-10-25-21 contributes to, but is not individually determinative of, the conclusion that the equipment and the installation services are not inputs to a combined item in this contract. For example, the entity's installation services will not significantly customize or significantly modify the equipment. The entity also is not providing a significant integration service of creating a combined item derived from the equipment and the installation services. That is, the entity has promised to deliver the equipment and then install it; the entity could fulfill its promise to transfer the equipment separately from its promise to subsequently install it. The entity has not promised to deliver an output that combines the equipment and the installation services into something different. Lastly, although the installation services depend on the successful transfer of the equipment to the customer, those services do not significantly affect the equipment both because the entity can fulfill its promise to transfer the equipment independently of its promise to provide the installation services and also because the installation services are available from several alternate providers. Therefore, because the equipment and the installation services do not each significantly affect the other, they are

not highly interrelated or highly interdependent. Because both criteria in paragraph 606-10-25-19 have been met, the equipment and installation are accounted for as two separate performance obligations.

> > > Case D—Promises Are Separately Identifiable (Contractual Restrictions)

606-10-55-150D Assume the same facts as in Case C, except that the customer is contractually required to use the entity's installation services.

606-10-55-150E The contractual requirement to use the entity's installation services does not change the distinct evaluation in this Example. For the same reasons as in Case C, the entity determines that the equipment and the installation services are each capable of being distinct and, therefore, meet the criterion in paragraph 606-10-25-19(a).

606-10-55-150F The entity determines that its promises to transfer the equipment and to provide the installation services are each separately identifiable (in accordance with paragraph 606-10-25-19(b)) for the same reasons as in Case C. The contractual requirement to obtain the installation services from the entity neither changes the fact that the entity is not providing a significant integration service in the contract nor does the contractual requirement affect the level of interrelation or interdependence between the equipment and the installation services as compared with the level of interrelation or interdependence between the equipment and the installation services in Case C.

> > > Case E—Promises Are Separately Identifiable (Consumables)

606-10-55-150G An entity enters into a contract with a customer to provide a piece of off-the-shelf equipment (that is, it is functional without any significant customization or modification) and to provide specialized consumables for use in the equipment at predetermined intervals over the next three years. The consumables are produced only by the entity but are readily available for purchase from other entities (for example, distributors of the entity's products and some retailers).

606-10-55-150H The entity determines that the customer can benefit from the equipment together with other readily available resources (that is, consumables it could obtain from the entity or other entities) and that the customer can benefit from the consumables that will be delivered under the contract together with the delivered equipment. Therefore, the equipment and the consumables are each capable of being distinct in accordance with paragraph 606-10-25-19(a).

606-10-55-150I The entity determines that its promises to transfer the equipment and to provide consumables over a three-year period are each separately identifiable in accordance with paragraph 606-10-25-19(b). In determining that the equipment and the consumables are not inputs to a combined item in this contract, the entity considers that it is not providing a significant integration

service of producing a combined item using the equipment and consumables as components. Additionally, neither the equipment nor the consumables significantly customizes or modifies the other from the form in which it is sold separately. Lastly, the entity concludes that the equipment and the consumables are not highly interrelated or highly interdependent. The equipment and the consumables do not each significantly affect the other. The entity can satisfy each of the promises in the contract independently of the other, and while the consumables depend on the successful transfer of the equipment (that is, the consumables would be useless separate from the equipment in the context of this contract), the customer can readily obtain the consumables in the contract from other entities. Therefore, its promise to provide the consumables does not significantly affect the customer's ability to derive benefit from the equipment. Consequently, the entity determines that the equipment and the consumables are each distinct and accounts for them as separate performance obligations.

> > > Example 12—Explicit and Implicit Promises in a Contract

606-10-55-151 An entity, a manufacturer, sells a product to a distributor (that is, its customer), who will then resell it to an end customer.

> > > Case A—Explicit Promise of Service

606-10-55-152 In the contract with the distributor, the entity promises to provide maintenance services for no additional consideration (that is, “free”) to any party (that is, the end customer) that purchases the product from the distributor. The entity outsources the performance of the maintenance services to the distributor and pays the distributor an agreed-upon amount for providing those services on the entity's behalf. If the end customer does not use the maintenance services, the entity is not obliged to pay the distributor.

606-10-55-153 The contract with the customer includes two promised goods or services—(a) the product and (b) the maintenance services (because ~~Because~~ the promise of maintenance services is a promise to transfer goods or services in the future and is part of the negotiated exchange between the entity and the distributor). ~~distributor~~ The entity assesses whether each promise represents a performance obligation, in accordance with paragraph 606-10-25-19. The entity determines that both the product and the maintenance services meet the criterion in paragraph 606-10-25-19(a). The entity regularly sells the product on a standalone basis, which indicates that the customer can benefit from the product on its own. The customer can benefit from the maintenance services together with a resource the customer already has obtained from the entity (that is, the product). The entity determines that its promises to transfer the product and to provide the maintenance services are separately identifiable on the basis of an analysis of the principle (in accordance with paragraph 606-10-25-19(b)) and the factors in paragraph 606-10-25-21. The product and the maintenance services are not inputs to a combined item in this contract. The entity is not providing a significant integration service because the presence of the product and the services together in this contract do not result in any additional or combined

functionality. In addition, neither the product nor the services modify the other. Lastly, the product and the maintenance services are not highly interrelated or highly interdependent on one another because the entity can satisfy each of the promises in the contract independent of its efforts to satisfy the other and because the customer could obtain maintenance services from the distributor (that is, without the involvement of the entity) such that the entity's promise to provide maintenance is not necessary for the product to continue to provide significant benefit to the customer. ~~the entity determines that the promise to provide maintenance services is a performance obligation (see paragraph 606-10-25-18(g)). The entity concludes that the promise would represent a performance obligation regardless of whether the entity, the distributor, or a third party provides the service. Consequently, the entity allocates a portion of the transaction price to each of the two performance obligations (that is, the product and the promise to provide maintenance services) in the contract. the promise to provide maintenance services.~~

> > > Case B—Implicit Promise of Service

606-10-55-154 The entity has historically provided maintenance services for no additional consideration (that is, “free”) to end customers that purchase the entity's product from the distributor. The entity does not explicitly promise maintenance services during negotiations with the distributor, and the final contract between the entity and the distributor does not specify terms or conditions for those services.

606-10-55-155 However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity's past ~~practices~~ practice of providing these services ~~create valid~~ creates reasonable expectations of the entity's customers (that is, the distributor and end customers) in accordance with paragraph 606-10-25-16. Consequently, the entity ~~identifies~~ assesses whether the promise of maintenance services ~~as is~~ is a performance obligation. For the same reasons as in Case A, the entity determines that the product and maintenance services are separate performance obligations to which it allocates a portion of the transaction price.

> > > Case C—Services Are Not a Promised Service Performance Obligation

606-10-55-156 In the contract with the distributor, the entity does not promise to provide any maintenance services. In addition, the entity typically does not provide maintenance services, and, therefore, the entity's customary business practices, published policies, and specific statements at the time of entering into the contract have not created an implicit promise to provide goods or services to its customers. The entity transfers control of the product to the distributor and, therefore, the contract is completed. However, before the sale to the end customer, the entity makes an offer to provide maintenance services to any party

that purchases the product from the distributor for no additional promised consideration.

606-10-55-157 The promise of maintenance is not included in the contract between the entity and the distributor at contract inception. That is, in accordance with paragraph 606-10-25-16, the entity does not explicitly or implicitly promise to provide maintenance services to the distributor or the end customers. Consequently, the entity does not identify the promise to provide maintenance services as a performance obligation. Instead, the obligation to provide maintenance services is accounted for in accordance with Topic 450 on contingencies.

606-10-55-157A Although the maintenance services are not a promised service in the current contract, in future contracts with customers the entity would assess whether it has created a business practice resulting in an implied promise to provide maintenance services.

6. Amend paragraphs 606-10-55-309 and 606-10-55-311 through 55-313, as follows:

> > Example 44—Warranties

606-10-55-309 An entity, a manufacturer, provides its customer with a warranty with the purchase of a product. The warranty provides assurance that the product complies with agreed-upon specifications and will operate as promised for one year from the date of purchase. The contract also provides the customer with the right to receive up to 20 hours of training services on how to operate the product at no additional cost. The training services will help the customer optimize its use of the equipment in a short time frame. Therefore, although the training services are only for 20 hours and are not essential to the customer's ability to use the equipment, the entity determines that the training services are material in the context of the contract on the basis of the facts and circumstances of the arrangement.

606-10-55-310 The entity assesses the goods and services in the contract to determine whether they are distinct and therefore give rise to separate performance obligations.

606-10-55-311 ~~The product is distinct because it meets both criteria in paragraph 606-10-25-19. The product and training services are each~~ is capable of being distinct in accordance with paragraphs 606-10-25-19(a) and 606-10-25-20 because the customer can benefit from the product on its own without the training services and can benefit from the training services together with the product that already has been transferred by the entity. The entity regularly sells the product separately without the training services. ~~In addition, the product is distinct within the context of the contract in accordance with paragraphs 606-10-25-19(b) and 606-10-25-21 because the entity's promise to transfer the product is separately identifiable from other promises in the contract.~~

606-10-55-312 ~~In addition, the training services are distinct because they meet both criteria in paragraph 606-10-25-19. The training services are capable of being distinct in accordance with paragraphs 606-10-25-19(a) and 606-10-25-20 because the customer can benefit from the training services together with the product that has already been provided by the entity. In addition, the training services are distinct within the context of the contract in accordance with The entity next assesses whether its promises to transfer the product and to provide the training services are separately identifiable in accordance with paragraphs 606-10-25-19(b) and 606-10-25-21 because the entity's promise to transfer the training services are separately identifiable from other promises in the contract. The entity does not provide a significant service of integrating the training services with the product (see paragraph 606-10-25-21(a)). The training services and product are not do not significantly modify or customize each other modified or customized by the product (see paragraph 606-10-25-21(b)). The product and the training services are not highly dependent on, or highly interrelated with, one another the product as described in paragraph 606-10-25-21(c). The entity can fulfill its promise to transfer the product independent of its efforts to subsequently provide the training services, and the training services do not significantly affect the utility of the product to the customer. Consequently, the entity concludes that its promise to transfer the product and its promise to provide training services are not inputs to a combined item, and, therefore, each promise is separately identifiable.~~

606-10-55-313 The product and training services are each distinct in accordance with paragraph 606-10-25-19 and therefore give rise to two separate performance obligations.

606-10-55-314 Finally, the entity assesses the promise to provide a warranty and observes that the warranty provides the customer with the assurance that the product will function as intended for one year. The entity concludes, in accordance with paragraphs 606-10-55-30 through 55-35, that the warranty does not provide the customer with a good or service in addition to that assurance and, therefore, the entity does not account for it as a performance obligation. The entity accounts for the assurance-type warranty in accordance with the requirements on product warranties in Subtopic 460-10.

606-10-55-315 As a result, the entity allocates the transaction price to the two performance obligations (the product and the training services) and recognizes revenue when (or as) those performance obligations are satisfied.

7. Amend paragraphs 606-10-55-361, 606-10-55-363 through 55-365, 606-10-55-368, 606-10-55-370 through 55-383, 606-10-55-385 through 55-389, 606-10-55-391 through 55-394, and 606-10-55-396 through 55-399 and add paragraphs 606-10-55-363A through 55-363B, 606-10-55-365A, 606-10-55-372A, 606-10-55-381A, and 606-10-55-399A through 55-399O and their related headings, with a link to transition paragraph 606-10-65-1, as follows:

> > Licensing

606-10-55-361 Examples 54–~~61B61~~ illustrate the guidance in paragraphs 606-10-25-14 through 25-22 on identifying performance obligations and paragraphs 606-10-55-54 through 55-~~65B65~~ on licensing. These Examples also illustrate other guidance as follows:

- a. Paragraphs 606-10-25-31 through 25-37 on measuring progress toward complete satisfaction of a performance obligation (~~Example~~Examples 57 and 58)
- b. Paragraphs 606-10-32-39 through 32-41 on allocating variable consideration to performance obligations (Example 57)
- c. ~~Paragraph~~ Paragraphs 606-10-55-65 through 55-~~65B~~ on consideration in the form of sales-based or usage-based royalties on licenses of intellectual property (Examples 57 and 61).

> > > Example 54—Right to Use Intellectual Property

606-10-55-362 Using the same facts as in Case A in Example 11 (see paragraphs 606-10-55-141 through 55-145), the entity identifies four performance obligations in a contract:

- a. The software license
- b. Installation services
- c. Software updates
- d. Technical support.

606-10-55-363 The entity assesses the nature of its promise to transfer the software license. The entity first concludes that the software to which the customer obtains rights as a result of the license is functional intellectual property. This is because the software has significant standalone functionality from which the customer can derive substantial benefit regardless of the entity's ongoing business activities. in accordance with paragraph 606-10-55-60. The entity observes that the software is functional at the time that the license transfers to the customer, and the customer can direct the use of, and obtain substantially all of the remaining benefits from, the software when the license transfers to the customer. Furthermore, the entity concludes that because the software is functional when it transfers to the customer, the customer does not reasonably expect the entity to undertake activities that significantly affect the intellectual property to which the license relates. This is because at the point in time that the license is transferred to the customer, the intellectual property will not change throughout the license period. The entity does not consider in its assessment of the criteria in paragraph 606-10-55-60 the promise to provide software updates because they represent a separate performance obligation. Therefore, the entity concludes that none of the criteria in paragraph 606-10-55-60 are met and that the nature of the entity's promise in transferring the license is to provide a right to use the entity's intellectual property as it exists at a point in time—that is, the intellectual property to which the customer has rights is static.

~~Consequently, the entity accounts for the license as a performance obligation satisfied at a point in time.~~

606-10-55-363A The entity further concludes that while the functionality of its software is expected to change during the license period as a result of the entity's continued development efforts, the functionality of the software to which the customer has rights (that is, the customer's instance of the software) will change only as a result of the entity's promise to provide when-and-if available software updates. The entity's promise to provide software updates represents an additional promised service in the contract. Therefore, the entity's activities to fulfill that promise are not considered in evaluating the criterion in paragraph 606-10-55-62(a). The entity further notes that the customer has the right to install, or not install, software updates when they are provided (that is, the criterion in 606-10-55-62(b) would not be met even if the entity's activities to develop and provide software updates had met the criterion in paragraph 606-10-55-62(a)).

606-10-55-363B Therefore, the entity concludes that it has provided the customer with a right to use its software as it exists at the point in time the license is granted, and the entity accounts for the software license performance obligation as a performance obligation satisfied at a point in time. The entity recognizes revenue on the software license performance obligation in accordance with paragraphs 606-10-55-58B through 55-58C.

> > > **Example 55—License of Intellectual Property**

606-10-55-364 An entity enters into a contract with a customer to license (for a period of three years) intellectual property related to the design and production processes for a good. The contract also specifies that the customer will obtain any updates to that intellectual property for new designs or production processes that may be developed by the entity. The updates are essential to the customer's ability to derive benefit from use the license because the customer operates in an industry in which technologies change rapidly. ~~The entity does not sell the updates separately, and the customer does not have the option to purchase the license without the updates.~~

606-10-55-365 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity determines that the customer can benefit from (a) the license on its own without the updates and (b) the updates together with the initial license. Although the benefit the customer can derive from the license on its own (that is, without the updates) is limited because the updates are critical to the customer's ability to continue to use the license in the rapidly changing technological environment in which the customer operates, the license can be used in a way that generates some economic benefits. Therefore, the criterion in paragraph 606-10-25-19(a) is met for the license and the updates. ~~The entity determines that although the entity can conclude that the customer can obtain benefit from the license on its own without the updates (see paragraph 606-10-25-19(a)), that benefit would be limited because the updates~~

~~are critical to the customer's ability to continue to make use of the license in the rapidly changing technological environment in which the customer operates. In assessing whether the criterion in paragraph 606-10-25-19(b) is met, the entity observes that the customer does not have the option to purchase the license without the updates and the customer obtains limited benefit from the license without the updates. Therefore, the entity concludes that the license and the updates are highly interrelated and the promise to grant the license is not distinct within the context of the contract because the license is not separately identifiable from the promise to provide the updates (in accordance with the criterion in paragraph 606-10-25-19(b) and the factors in paragraph 606-10-25-21).~~

606-10-55-365A The fact that the benefit the customer can derive from the license on its own (that is, without the updates) is limited (because the updates are critical to the customer's ability to continue to use the license in the rapidly changing technological environment) is integral to assessing whether the criterion in paragraph 606-10-25-19(b) is met. Because the benefit the customer obtains from the license without the updates is significantly limited, the entity's promises to grant the license and to provide the expected updates are highly interrelated in this contract despite the fact the entity can fulfill its promise to grant the initial license independent from its promise to subsequently provide updates. The two promises are, in effect, inputs to a combined item. That is, it is effectively a subscription to the entity's intellectual property for a period of time. Therefore, the entity concludes that its promises to grant the license and to provide updates are not separately identifiable (in accordance with the criterion in paragraph 606-10-25-19(b)).

606-10-55-366 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether the performance obligation (which includes the license and the updates) is satisfied at a point in time or over time. The entity concludes that because the customer simultaneously receives and consumes the benefits of the entity's performance as it occurs, the performance obligation is satisfied over time in accordance with paragraph 606-10-25-27(a).

> > > Example 56—Identifying a Distinct License

606-10-55-367 An entity, a pharmaceutical company, licenses to a customer its patent rights to an approved drug compound for 10 years and also promises to manufacture the drug for the customer. The drug is a mature product; therefore, there is no expectation that the entity will not undertake any activities to change support the drug (for example, to alter its chemical composition), which is consistent with its customary business practices.

> > > Case A—License Is Not Distinct

606-10-55-368 In this case, no other entity can manufacture this drug because of the highly specialized nature of the manufacturing process. As a result, the license cannot be purchased separately from the manufacturing service services.

606-10-55-369 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity determines that the customer cannot benefit from the license without the manufacturing service; therefore, the criterion in paragraph 606-10-25-19(a) is not met. Consequently, the license and the manufacturing service are not distinct, and the entity accounts for the license and the manufacturing service as a single performance obligation.

606-10-55-370 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether the performance obligation (that is, the bundle of the license and the manufacturing ~~services~~) is a performance obligation satisfied at a point in time or over time.

> > > Case B—License Is Distinct

606-10-55-371 In this case, the manufacturing process used to produce the drug is not unique or specialized, and several other entities also can ~~also~~ manufacture the drug for the customer.

606-10-55-372 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct, and it concludes that the criteria in paragraph 606-10-25-19 are met for the license and the manufacturing service. The entity concludes that the criterion in paragraph 606-10-25-19(a) is met because the customer can benefit from the license together with readily available resources other than the entity's manufacturing service (that is, because there are other entities that can provide the manufacturing service) and can benefit from the manufacturing service together with the license transferred to the customer upfront in accordance with paragraph 606-10-25-19. Because the manufacturing process can be provided by other entities, the entity concludes that the customer can benefit from the license on its own (that is, without the manufacturing service) and that the license is separately identifiable from the manufacturing process (that is, the criteria in paragraph 606-10-25-19 are met). Consequently, the entity concludes that the license and the manufacturing service are distinct and the entity has two performance obligations:

- a. License of patent rights
- b. Manufacturing service.

606-10-55-372A The entity also concludes that its promises to grant the license and to provide the manufacturing service are separately identifiable (that is, the criterion in paragraph 606-10-25-19(b) is met). The license and the manufacturing service are not inputs to a combined item in this contract on the basis of an evaluation of the relevant factors in paragraph 606-10-25-21. Neither the license nor the manufacturing service is significantly modified or customized by the other. Therefore, the entity is not providing a significant service of integrating those items into a single, combined item. The entity further concludes that the license and the manufacturing service are not highly interrelated or

highly interdependent because the entity could separately purchase the license without significantly affecting its ability to benefit from the license and can fulfill its promise to grant the license independent of fulfilling its promise to subsequently manufacture the drug for the customer. Thus, although the manufacturing service necessarily depends on the license in this contract (that is, the entity would not contract for the manufacturing service without the license), the license and the manufacturing service do not significantly affect each other. Consequently, the entity concludes that its promises to grant the license and to provide the manufacturing service are distinct and that there are two performance obligations:

- a. License of patent rights
- b. Manufacturing service.

606-10-55-373 The entity assesses, in accordance with paragraph 606-10-55-60, the nature of the entity's promise to grant the license. The entity concludes that the patented drug formula is functional intellectual property (that is, as a mature drug, it has significant standalone functionality in the form of its ability to treat a disease or condition). There is no expectation that the entity will undertake activities to change the functionality of the drug formula during the license period. Because the intellectual property has significant standalone functionality, any other activities the entity might undertake (for example, promotional activities like advertising or activities to develop other drug products) would not significantly affect the utility of the licensed intellectual property. Consequently, the nature of the entity's promise in transferring the license is to provide a right to use the entity's functional intellectual property, and it accounts for the license as a performance obligation satisfied at a point in time. The entity recognizes revenue for the license performance obligation in accordance with paragraphs 606-10-55-58B through 55-58C. The drug is a mature product (that is, it has been approved, is currently being manufactured, and has been sold commercially for the last several years). For these types of mature products, the entity's customary business practices are not to undertake any activities to support the drug. Consequently, the entity concludes that the criteria in paragraph 606-10-55-60 are not met because the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the intellectual property to which the customer has rights. In its assessment of the criteria in paragraph 606-10-55-60, the entity does not take into consideration the separate performance obligation of promising to provide a manufacturing service. Consequently, the nature of the entity's promise in transferring the license is to provide a right to use the entity's intellectual property in the form and the functionality with which it exists at the point in time that it is granted to the customer. Consequently, the entity accounts for the license as a performance obligation satisfied at a point in time.

606-10-55-374 In its assessment of the nature of the license, the entity does not consider the manufacturing service because it is an additional promised service in the contract. The entity applies paragraphs 606-10-25-23 through 25-30 to

determine whether the manufacturing service is a performance obligation satisfied at a point in time or over time.

> > > Example 57—Franchise Rights

606-10-55-375 An entity enters into a contract with a customer and promises to grant a franchise license that provides the customer with the right to use the entity's trade name and sell the entity's products for 10 years. In addition to the license, the entity also promises to provide the equipment necessary to operate a franchise store. In exchange for granting the license, the entity receives a fixed fee of \$1 million, as well as a sales-based royalty of 5 percent of the customer's monthly sales for the term of the license. The fixed consideration for the equipment is \$150,000 payable when the equipment is delivered.

> > > Identifying Performance Obligations

606-10-55-376 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity observes that the entity, as a franchisor, has developed a customary business practice to undertake activities such as analyzing the customer's changing preferences and implementing product improvements, pricing strategies, marketing campaigns, and operational efficiencies to support the franchise name. However, the entity concludes that these activities do not directly transfer goods or services to the customer ~~because they are part of the entity's promise to grant a license and, in effect, change the intellectual property to which the customer has rights.~~

606-10-55-377 The entity determines that it has two promises to transfer goods or services: a promise to grant a license and a promise to transfer equipment. In addition, the entity concludes that the promise to grant the license and the promise to transfer the equipment are each distinct. This is because the customer can benefit from each good promise (that is, the ~~promise of the~~ license and ~~the promise of the~~ equipment) on its ~~their~~ own or together with other resources that are readily available (see paragraph 606-10-25-19(a)). ~~(That is, the~~ The customer can benefit from the license together with the equipment that is delivered before the opening of the franchise and is available from sources other than the entity, and the equipment can be used in the franchise or sold for an amount other than scrap ~~value. value.~~) The entity also determines that the promises to grant the franchise license and to transfer the equipment are separately identifiable in accordance with the criterion in paragraph 606-10-25-19(b). ~~606-10-25-19(b), because none of the factors in paragraph 606-10-25-21 are present.~~ The entity concludes that the license and the equipment are not inputs to a combined item because the entity is not providing a significant service of integrating the license and the equipment into a combined item (that is, the licensed intellectual property is not a component of, and does not significantly modify, the equipment). Additionally, the license and the equipment are not highly interrelated or highly interdependent. The entity can fulfill either promise (that is, to grant the license or to transfer the equipment) independently of the

other and neither the license nor the equipment significantly affects the customer's ability to benefit from the other given that the equipment is readily available from other vendors and the equipment has significant value separate from its use in this franchise arrangement. Consequently, the entity has two performance obligations:

- a. The franchise license
- b. The equipment.

> > > Allocating the Transaction Price

606-10-55-378 The entity determines that the transaction price includes fixed consideration of ~~\$1,150,000~~\$150,000 and variable consideration (5 percent of ~~customer~~ the customer's sales from the franchise store).

606-10-55-379 The entity applies paragraph 606-10-32-40 to determine whether the variable consideration should be allocated entirely to the performance obligation to transfer the franchise license. The entity concludes that the variable consideration (that is, the sales-based royalty) should be allocated entirely to the franchise license because the variable consideration relates entirely to the entity's promise to grant the franchise license. In addition, the entity observes that allocating \$150,000 to the equipment and allocating the sales-based royalty (as well as the additional \$1 million in fixed consideration) to the franchise license would be consistent with an allocation based on the entity's relative standalone selling prices in similar contracts. That is, the standalone selling price of the equipment is \$150,000 and the entity regularly licenses franchises in exchange for 5 percent of customer sales and a similar upfront fee. Consequently, the entity concludes that the variable consideration (that is, the sales-based royalty) should be allocated entirely to the performance obligation to grant the franchise license.

> > > Licensing

606-10-55-380 The entity assesses, ~~in accordance with paragraph 606-10-55-60,~~ the nature of the entity's promise to grant the franchise license. The entity concludes that the nature of its promise is to provide a right to access the entity's symbolic intellectual property. The trade name and logo have limited standalone functionality; the value of the products developed by the entity largely is derived from the products' association with the franchise brand. Substantially all of the utility inherent in the trade name, logo, and product rights granted under the license stems from the entity's past and ongoing activities of establishing, building, and maintaining the franchise brand. The value of the license is its association with the franchise brand and the related demand for its products. ~~the criteria in paragraph 606-10-55-60 are met and the nature of the entity's promise is to provide access to the entity's intellectual property in its current form throughout the license period. This is because:~~

- ~~a. The entity concludes that the customer would reasonably expect that the entity will undertake activities that will affect the intellectual property to which the customer has rights. This is on the basis of the entity's customary business practice to undertake activities such as analyzing the customer's changing preferences and implementing product improvements, pricing strategies, marketing campaigns, and operational efficiencies. In addition, the entity observes that because part of its compensation is dependent on the success of the franchisee (as evidenced through the sales-based royalty), the entity has a shared economic interest with the customer that indicates that the customer will expect the entity to undertake those activities to maximize earnings.~~
- ~~b. The entity also observes that the franchise license requires the customer to implement any changes that result from those activities and thus exposes the customer to any positive or negative effects of those activities.~~
- ~~c. The entity also observes that even though the customer may benefit from the activities through the rights granted by the license, they do not transfer a good or service to the customer as those activities occur.~~

606-10-55-381 The entity is granting a license to symbolic intellectual property; therefore, the entity's promise to the customer includes both (consistent with paragraph 606-10-55-60):

- a. Granting the customer rights to use and benefit from the entity's intellectual property by making it available for the customer's use
- b. Supporting or maintaining the intellectual property.

~~Because the criteria in paragraph 606-10-55-60 are met, the entity concludes that the promise to transfer the license is a performance obligation satisfied over time in accordance with paragraph 606-10-25-27(a).~~

606-10-55-381A Consequently, the entity's performance obligation to transfer the license is satisfied over time in accordance with paragraph 606-10-25-27(a). The entity recognizes the fixed consideration allocable to the license performance obligation in accordance with paragraph 606-10-55-58A and paragraph 606-10-55-58C. This includes applying paragraphs 606-10-25-31 through 25-37 to identify the method that best depicts the entity's performance in the license (see paragraph 606-10-55-382).

606-10-55-382 The entity also concludes that because ~~Because~~ the consideration ~~that~~ is in the form of a sales-based royalty ~~relates specifically to the franchise license (see paragraph 606-10-55-379), the entity applies paragraph 606-10-55-65 to account for that consideration and, after the transfer of the franchise license, the entity recognizes revenue as and when those sales occur.~~ The entity recognizes revenue from the sales-based royalty as and when the sales occur on the basis of the guidance in paragraph 606-10-55-18. The entity concludes that the ratable recognition of the fixed franchise fee plus the periodic

royalty fees earned corresponds directly with the value to the customer of the entity's performance in satisfying the franchise license performance obligation and, therefore, represents an appropriate measure of progress toward the complete satisfaction of the performance obligation.

> > > Example 58—Access to Intellectual Property

606-10-55-383 An entity, a creator of comic strips, licenses the use of the images and names of its comic strip characters in three of its comic strips to a customer for a four-year term. There are main characters involved in each of the comic strips. However, newly created characters appear and disappear regularly and the images of the characters evolve over time. The customer, an operator of cruise ships, can use the entity's characters in various ways, such as in shows or parades, within reasonable guidelines. ~~The contract requires the customer to use the latest images of the characters.~~

606-10-55-384 In exchange for granting the license, the entity receives a fixed payment of \$1 million in each year of the 4-year term.

606-10-55-385 In accordance with paragraph 606-10-25-19, the entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity concludes that it has no other performance obligations other than the promise to grant a license. That is, the additional activities associated with the license do not directly transfer a good or service to the customer ~~because they are part of the entity's promise to grant a license and, in effect, change the intellectual property to which the customer has rights.~~

606-10-55-386 The entity assesses the nature of ~~the entity's~~ its promise to transfer the license and concludes that the nature of its promise is to grant the customer the right to access the entity's symbolic intellectual property. The entity determines that the licensed intellectual property (that is, the character names and images) is symbolic because it has no standalone functionality (the names and images cannot process a transaction, perform a function or task, or be played or aired separate from significant additional production that would, for example, use the images to create a movie or a show) and the utility of those names and images is derived from the entity's past and ongoing activities such as producing the weekly comic strip that includes the characters. Therefore, because the entity is granting a license to symbolic intellectual property, its promise to the customer includes both (consistent with paragraph 606-10-55-60):

- a. Granting the customer rights to use and benefit from the entity's intellectual property by making it available for the customer's use
- b. Supporting or maintaining the intellectual property.

~~in accordance with paragraph 606-10-55-60. In assessing the criteria the entity considers the following:~~

- ~~a. The customer reasonably expects (arising from the entity's customary business practices) that the entity will undertake activities that will affect~~

~~the intellectual property to which the customer has rights (that is, the characters). Those activities include development of the characters and the publishing of a weekly comic strip that includes the characters.~~

- ~~b. The rights granted by the license directly expose the customer to any positive or negative effects of the entity's activities because the contract requires the customer to use the latest characters.~~
- ~~c. Even though the customer may benefit from those activities through the rights granted by the license, they do not transfer a good or service to the customer as those activities occur.~~

606-10-55-387 ~~Consequently, the entity concludes that the criteria in paragraph 606-10-55-60 are met and that the nature of the entity's promise to transfer the license is to provide the customer with access to the entity's intellectual property as it exists throughout the license period. Consequently, the entity accounts for the promised license as a performance obligation satisfied over time (that is, the criterion in paragraph 606-10-25-27(a) is met).~~

606-10-55-388 The entity recognizes the fixed consideration allocable to the license performance obligation in accordance with paragraphs 606-10-55-58A and 606-10-55-58C. The entity applies ~~considers~~ paragraphs 606-10-25-31 through 25-37 ~~to identify~~ in identifying the method that best depicts its performance in the license. Because the contract provides the customer with unlimited use of the licensed characters for a fixed term, the entity determines that a time-based method would be the most appropriate measure of progress toward complete satisfaction of the performance obligation.

> > > Example 59—Right to Use Intellectual Property

606-10-55-389 An entity, a music record label, licenses to a customer a ~~1975~~ recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio, and online advertisements for two years in Country A. In exchange for providing the license, the entity receives fixed consideration of \$10,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is noncancellable.

606-10-55-390 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity concludes that its only performance obligation is to grant the license.

606-10-55-391 In determining that its promise to a customer is to grant the customer a right to use its intellectual property, the entity considers the following:

- a. First, the classical symphony recording has significant standalone functionality because the recording can be played in its present, completed form without the entity's further involvement. The customer can derive substantial benefit from that functionality regardless of the

entity's further activities or actions. Therefore, the nature of the licensed intellectual property is functional rather than symbolic.

- b. Second, the contract does not require and the customer does not reasonably expect that the entity will undertake activities to change the licensed recording (that is, the criteria in paragraph 606-10-55-62 are not met).

~~In accordance with paragraph 606-10-55-60, the entity assesses the nature of the entity's promise to grant the license. The entity does not have any contractual or implied obligations to change the licensed recording. Thus, the intellectual property to which the customer has rights is static. Consequently, the entity concludes that the nature of its promise in transferring the license is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the license is a performance obligation satisfied at a point in time. The entity recognizes all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.~~

606-10-55-392 Because the nature of the entity's promise is to grant the customer a right to use the entity's intellectual property, that promise is a performance obligation satisfied at a point in time. The entity recognizes revenue from the satisfaction of that performance obligation in accordance with paragraphs 606-10-55-58B through 55-58C. Additionally, because ~~Because~~ of the length of time between the entity's performance (at the beginning of the period) and the customer's monthly payments over two years (which are noncancellable), the entity considers the guidance in paragraphs 606-10-32-15 through 32-20 to determine whether a significant financing component exists.

> > Example 60—Sales-Based Royalty Promised in Exchange for a License of Intellectual Property and Other Goods and Services~~Access to Intellectual Property~~

606-10-55-393 An entity, a movie distribution company, licenses Movie XYZ to a customer. The customer, an operator of cinemas, has the right to show the movie in its cinemas for six weeks. Additionally, the entity has agreed to provide memorabilia from the filming to the customer for display at the customer's cinemas before the beginning of the six-week airing period and to sponsor radio advertisements for Movie XYZ on popular radio stations in the customer's geographical area throughout the six-week airing period. In exchange for providing the license and the additional promotional goods and services, the entity will receive a portion of the operator's ticket sales for Movie XYZ (that is, variable consideration in the form of a sales-based royalty). ~~In exchange for providing the license, the entity will receive a portion of the operator's ticket sales for Movie XYZ (that is, variable consideration in the form of a sales-based royalty). The entity concludes that its only performance obligation is the promise to grant the license.~~

606-10-55-394 The entity does not evaluate whether the license and the other promotional goods and services are distinct or whether the promise to grant the license represents a right to access the entity's intellectual property or a right to use the entity's intellectual property. This is because, regardless of whether those promised goods or services are separate performance obligations or a single performance obligation and regardless of the nature of the license, the entity concludes that the license to show Movie XYZ is the predominant item to which the sales-based royalty relates. The entity concludes that the customer would ascribe significantly more value to the license than to the related promotional goods or activities. Therefore, the entity will recognize revenue from the sales-based royalty, the only fees to which the entity is entitled under the contract, in accordance with paragraph 606-10-55-65. The entity observes that regardless of whether the promise to grant the license represents a right to access the entity's intellectual property or a right to use the entity's intellectual property, the entity applies paragraph 606-10-55-65 and recognizes revenue as and when the ticket sales occur. This is because the consideration for its license of intellectual property is a sales-based royalty and the entity has already transferred the license to the movie to which the sales-based royalty relates.

> > > Example 61—Access to Intellectual Property

606-10-55-395 An entity, a well-known sports team, licenses the use of its name and logo to a customer. The customer, an apparel designer, has the right to use the sports team's name and logo on items including t-shirts, caps, mugs, and towels for one year. In exchange for providing the license, the entity will receive fixed consideration of \$2 million and a royalty of 5 percent of the sales price of any items using the team name or logo. The customer expects that the entity will continue to play games and provide a competitive team.

606-10-55-396 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity concludes that its only promise is to grant the license. The additional activities associated with the license—that is, continuing to play games and provide a competitive team—do not directly transfer a good or service to the customer. Therefore, there is only one performance obligation in the contract. The entity concludes that its only performance obligation is to transfer the license. That is, the additional activities associated with the license do not directly transfer a good or service to the customer because they are part of the entity's promise to grant the license and, in effect, change the intellectual property to which the customer has rights.

606-10-55-397 To determine whether the license grants the customer a right to access the entity's intellectual property or a right to use the entity's intellectual property, the entity assesses the nature of the intellectual property to which the customer obtains rights. The entity concludes that the intellectual property to which the customer obtains rights is symbolic intellectual property. The utility of the team name and logo to the customer is derived from the entity's past and

ongoing activities of playing games and providing a competitive team (that is, those activities effectively give value to the intellectual property). Absent those activities, the team name and logo would have little or no utility to the customer because they have no standalone functionality (that is, no ability to perform or fulfill a task separate from their role as symbols of the entity's past and ongoing activities). Therefore, in accordance with paragraph 606-10-55-60, the entity's promise to the customer includes both:

- a. Granting the customer rights to use and benefit from the entity's intellectual property by making it available for the customer's use
- b. Supporting or maintaining the intellectual property.

~~The entity assesses the nature of the entity's promise to transfer the license in accordance with paragraph 606-10-55-60. In assessing the criteria, the entity considers the following:~~

- ~~a. The entity concludes that the customer would reasonably expect that the entity will undertake activities that will affect the intellectual property (that is, the team name and logo) to which the customer has rights. This is on the basis of the entity's customary business practice to undertake activities such as continuing to play and providing a competitive team. In addition, the entity observes that because some of its consideration is dependent on the success of the customer (through the sales-based royalty), the entity has a shared economic interest with the customer, which indicates that the customer will expect the entity to undertake those activities to maximize earnings.~~
- ~~b. The entity observes that the rights granted by the license (that is, the use of the team's name and logo) directly expose the customer to any positive or negative effects of the entity's activities.~~
- ~~c. The entity also observes that even though the customer may benefit from the activities through the rights granted by the license, they do not transfer a good or service to the customer as those activities occur.~~

606-10-55-398 Consequently, the nature of the entity's promise to the customer is to grant the customer the right to access the entity's intellectual property throughout the license period. Therefore, the entity accounts for the promised license as a performance obligation satisfied over time because the customer will be able to consume and receive benefit from the license throughout the license period (that is, the criterion in paragraph 606-10-25-27(a) is met).~~The entity concludes that the criteria in paragraph 606-10-55-60 are met and the nature of the entity's promise to grant the license is to provide the customer with access to the entity's intellectual property as it exists throughout the license period. Consequently, the entity accounts for the promised license as a performance obligation satisfied over time (that is, the criterion in paragraph 606-10-25-27(a) is met).~~

606-10-55-399 The entity recognizes the fixed consideration allocable to the license performance obligation in accordance with paragraphs 606-10-55-58A

and 606-10-55-58C. The entity considers paragraphs 606-10-25-31 through 25-37 in identifying the method that best depicts its performance in satisfying the license. ~~The entity then applies paragraphs 606-10-25-31 through 25-37 to determine a measure of progress that will depict the entity's performance for the fixed consideration.~~ For the consideration that is in the form of a sales-based royalty, paragraph 606-10-55-65 applies because the sales-based royalty relates solely to the license that is the only performance obligation in the contract. The entity recognizes revenue from the sales-based royalty as and when the sales occur on the basis of the guidance in paragraph 606-10-55-18. The entity concludes that the periodic recognition of the fixed fee plus the periodic royalty fees earned corresponds directly with the value to the customer of the entity's performance in satisfying the license performance obligation and, therefore, represents an appropriate measure of progress toward the complete satisfaction of the performance obligation. ~~applies; therefore, the entity recognizes revenue as and when the sales of items using the team name or logo occur.~~

> > > Example 61A—Right to Use Intellectual Property

606-10-55-399A An entity, a television production company, licenses the episodes from the first four seasons of a television show to a customer. The show is presently in its fifth season, and the television production company is producing episodes for that season at the time the contract is entered into, as well as promoting the show to attract further viewership.

> > > Case A—License Is the Only Promise in the Contract

606-10-55-399B The customer obtains the right to broadcast Seasons 1–4, in sequential order, over a period of two years. The show has been successful through Seasons 1–4, and the customer is both aware that Season 5 is already in production and aware of the entity's continued promotion of the show. The customer will make fixed monthly payments of an equal amount throughout the two-year license period.

606-10-55-399C The entity assesses the goods and services promised to the customer. The entity concludes that the rights to Seasons 1–4 constitute a single license because the entity will satisfy its promise at the same time (that is, it will convey rights to and transfer the intellectual property for all four seasons to the customer at the same time). The contractual requirement to broadcast the episodes in sequential order is a restriction of the nature described in paragraph 606-10-55-64 and, therefore, is an attribute of the license that does not affect the nature of the entity's promise in granting the license or how many licenses the entity is granting. The entity concludes that there are no other promised goods or services other than the license to Seasons 1–4. The entity's activities to produce Season 5 and its continued promotion of the show do not transfer a promised good or service to the customer. Therefore, there is only one performance obligation in this contract.

606-10-55-399D To determine whether the nature of the entity's promise is to grant the customer a right to use its intellectual property or a right to access its intellectual property, the entity evaluates the intellectual property that is the subject of the license. The completed episodes have substantial standalone functionality at the point in time they are transferred to the customer because the episodes can be aired, in the form transferred, without any further participation by the entity. Therefore, the customer can derive substantial benefit from the license without any further activities of the entity. The entity further observes that the episodes that comprise Seasons 1–4 are complete and not subject to further change. Therefore, there is no expectation that the functionality of the intellectual property to which the customer has rights will change (that is, the criteria in paragraph 606-10-55-62 are not met). Therefore, the entity concludes it has granted the customer a right to use its functional intellectual property.

606-10-55-399E Consequently, the entity's promise to grant the license is a performance obligation satisfied at a point in time in accordance with the guidance in paragraphs 606-10-55-58B through 55-58C. That is, the entity recognizes revenue for the license on the date that the customer is first permitted to air the first licensed episode, assuming the content is made available to the customer before that date. The date the customer is first permitted to air the first licensed episode is the beginning of the period during which the customer is able to use and benefit from its right to use the intellectual property in accordance with paragraph 606-10-55-58C. Because of the length of time between the entity's performance (at the beginning of the period) and the customer's annual payments over two years (which are noncancellable), the entity considers the guidance in paragraphs 606-10-32-15 through 32-20 to determine whether a significant financing component exists.

> > > Case B—Contract Includes Two Promises

606-10-55-399F The contract provides the customer with the right to broadcast Seasons 1–4, in sequential order, over a period of two years. The contract also provides the customer with the right to broadcast Season 5 once it is completed. The contract states separate fixed fees for the license to Seasons 1–4 and the license to Season 5. The stated price for each is commensurate with each promise's standalone selling price.

606-10-55-399G The entity assesses the goods and services promised to the customer. The entity concludes that it has made two promises in the contract:

- a. The promise to grant a license to existing Seasons 1–4 (see paragraph 606-10-55-399C)
- b. The promise to grant a license to Season 5, when available.

606-10-55-399H The entity then evaluates whether the license to existing Seasons 1–4 is distinct from the license to Season 5. The entity concludes that the two licenses are distinct from each other and, therefore, separate performance obligations. This conclusion is based on the following analysis:

- a. Each license is capable of being distinct because the customer can benefit from its right to air the existing seasons on its own and can benefit from the right to air Season 5, when available, on its own and together with the right to air Seasons 1–4.
- b. Each of the two promises in the contract also is distinct in the context of the contract (that is, separately identifiable). None of the seasons modify or customize another season, and the seasons do not result in combined functionality or changed content. The right to air Seasons 1–4 and the right to air Season 5, when available, are not highly interrelated or highly interdependent because the entity's ability to fulfill its promise to transfer either license is unaffected by its promise to transfer the other and whether the customer or another licensee had rights to air the future episodes would not be expected to significantly affect the customer's license to Seasons 1–4 (for example, viewers' desire to watch Seasons 1–4 on the customer's network generally would not be significantly affected by whether the customer, or another network, had the right to broadcast Season 5). Therefore, the seasons are not inputs that together make a combined item.

606-10-55-399I The entity assesses the nature of its separate performance obligations to transfer a license to Seasons 1–4 and to transfer a license to Season 5. To determine whether the promises in the contract grant the customer rights to use the entity's intellectual property or rights to access the intellectual property, the entity evaluates the nature of the intellectual property that will be licensed. In determining the nature of the intellectual property that is the subject of the licenses, the entity considers the following:

- a. The licensed intellectual property (that is, completed episodes in Seasons 1–4 and in Season 5, when completed) has significant standalone functionality separate from the entity's ongoing business activities, such as in producing additional intellectual property (for example, future seasons) or in promoting the show, and completed episodes can be aired without the entity's further involvement.
- b. There is no expectation that the entity will substantively change the licensed episodes once they are completed and transferred to the customer for broadcast (that is, the criteria in paragraph 606-10-55-62 are not met).
- c. The activities expected to be undertaken by the entity to produce and transfer the right to air the yet-to-be-completed episodes in Season 5 constitute an additional promised good or service in the contract and, therefore, do not affect the nature of the entity's promise in granting the license to completed Seasons 1–4.

606-10-55-399J Therefore, the entity concludes that the separate licenses to Seasons 1-4 and Season 5, respectively, grant the customer the right to use its functional intellectual property as it exists at the point in time the license is granted. As a result, the entity recognizes the transaction price allocated to each

license at a point in time in accordance with paragraphs 606-10-55-58B through 55-58C. That is, the entity recognizes revenue for each license on the date that the customer is first permitted to air the first episode included in the license. That date is the beginning of the period during which the customer is able to use and benefit from its right to use the licensed intellectual property.

> > Example 61B—Contractual Provisions That Are (and Are Not) Restrictions

606-10-55-399K An entity, a movie production company, grants a customer the right to broadcast a classic holiday movie the week leading up to that holiday for a period of three years. During that three-year period, the entity is not permitted to grant those same rights to any other customers in the customer's broadcast territory. The contract also provides the customer with the right to broadcast that same movie, under the same terms, for a second period of three years that begins four years after the first airing period ends. During the four-year intervening period, the entity has the right, and expects, to license the movie on similar terms to one or more other customers. The customer pays a fixed fee to the entity at the beginning of each three-year airing window.

606-10-55-399L The entity assesses the goods and services promised to the customer. The entity first considers whether the provision limiting the customer's right to broadcast the movie to only the holiday week in Years 1–3 and Years 8–10 is a contractual restriction in accordance with paragraph 606-10-55-64(a). The entity concludes that the airing provision is an attribute of the customer's license (that is, it defines the scope of the customer's rights). Given the nature of the movie, centered around that specific holiday, the customer has valuable rights that cannot be granted to another entity (for example, any rights to air the holiday movie at other times during the year when the customer does not have rights would be considerably less valuable). Therefore, the entity concludes that the airing provision is a contractual restriction in accordance with paragraph 606-10-55-64(a). Consequently, it does not affect the entity's identification, or the nature, of its promise(s) in the contract.

606-10-55-399M The entity then considers whether the provision prohibiting the customer from airing the movie during Years 4–7 constitutes a contractual restriction. The entity concludes that the four-year break in the customer's rights is not a contractual restriction because it does not merely define the scope of the customer's license. Instead, the terms of the contract effectively revoke the customer's rights that it has in Years 1–3 and permits the entity to grant those same rights to another customer in Years 4–7. The customer only obtains the right to broadcast the movie again in Year 8.

606-10-55-399N In identifying the promised goods or services in the contract with the customer, the entity considers that the customer will not be able to use and benefit from the intellectual property during Years 4–7, which the entity concludes is a substantive period of time during which it expects to be able to grant a similar license to another customer. After considering all the facts and

circumstances in the contract, the entity concludes that it has promised to transfer two licenses to the customer:

- a. A license to broadcast the movie during the holiday week in Years 1–3
- b. A license to broadcast the movie during the holiday week in Years 8–10.

606-10-55-399O The entity concludes the two licenses are each distinct and, therefore, are separate performance obligations on substantially the same basis that the entity reaches that conclusion in Example 61A, Case B (paragraph 606-10-55-399H). The entity also concludes that the nature of each license is to provide the customer with a right to use its functional intellectual property. Its evaluation in this regard is substantially the same as that in Example 59 (paragraph 606-10-55-391). As a result, the entity recognizes the transaction price allocated to each license at a point in time in accordance with paragraphs 606-10-55-58B through 55-58C. The entity recognizes revenue for each license on the first date that the customer is permitted to air the movie (that is, at the beginning of the holiday week in Year 1 for the first license and at the beginning of the holiday week in Year 8 for the second license).

The amendments in this proposed Update were approved for publication by five members of the Financial Accounting Standards Board. Messrs. Linsmeier and Siegel voted against publication of the amendments. Their alternative views are set out at the end of the basis for conclusions.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas. J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information, Basis for Conclusions, and Alternative Views

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. On May 28, 2014, the FASB issued Update 2014-09 and the IASB issued IFRS 15 (collectively, the new revenue standard). The new revenue standard is largely converged for GAAP and IFRS. In June 2014, the FASB and the IASB announced the formation of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG). One of the objectives of the TRG is to inform the Boards about potential implementation issues that could arise when organizations implement the new revenue standard. The TRG also helps some stakeholders to better understand specific aspects of the new revenue standard from others. The TRG does not issue guidance. Instead, the Boards evaluate the feedback received from the TRG and other stakeholders to determine what action, if any, is necessary for each potential implementation issue.

BC3. Identifying performance obligations and licensing were discussed at TRG meetings on July 18, 2014; October 31, 2014; and January 26, 2015. Those discussions informed the Boards about potential challenges with consistent application of those aspects of the new revenue standard. Following the TRG meetings, the FASB and the IASB directed their respective staffs to perform additional research and outreach on identifying performance obligations and licensing. The focus of the additional research and outreach was to understand whether there were specific improvements each Board could make that would assist stakeholders with consistent application of the new revenue standard.

BC4. The updates in this proposed Update are being issued by the FASB. The IASB decided that it would perform additional research and outreach and potentially issue an Exposure Draft at a later date.

BC5. The FASB concluded that the benefits of a converged standard on revenue would be diminished if there is significant diversity in applying main aspects of the standard. Therefore, the benefits of a converged standard would be enhanced by amending Topic 606 to promote greater consistency in application

within and across jurisdictions by enhancing the operability and understandability of the guidance before it becomes effective as long as the financial reporting outcomes of applying Topic 606 and IFRS 15 are substantially consistent, even if the *articulation* of the guidance in GAAP and IFRS would not be identical. Additionally, the Board expects the amendments will help reduce the cost and complexity of implementation by enhancing the operability and understandability of the guidance.

Scope

BC6. The scope of the proposed guidance is the same as Topic 606 (see paragraphs 606-10-15-1 through 15-5).

Identifying Performance Obligations

Identifying Promised Goods or Services (Paragraphs 606-10-25-16 through 25-18)

BC7. Paragraph BC87 in Update 2014-09 explains that, generally, an entity should identify those goods or services promised in the contract before it can evaluate whether those goods or services are distinct. Stakeholders questioned whether an entity should identify items or activities as promised goods or services that are not identified as deliverables under the existing revenue guidance. Some stakeholders indicated that they are unsure whether “promised good or service” and “deliverable” are similar notions. Those stakeholders also suggested that the Board’s decision not to include the U.S. Securities and Exchange Commission’s (SEC) guidance on inconsequential or perfunctory obligations in Topic 606 indicates that the guidance might require an entity to identify significantly more promised goods or services than the entity identified as deliverables under existing guidance. The SEC guidance on inconsequential or perfunctory obligations is included in Staff Accounting Bulletin Topic 13A, “Selected Revenue Recognition—Issue 3C: Inconsequential or Perfunctory Performance Obligations.”

BC8. Many of the implementation questions about this area result from paragraph BC90 in Update 2014-09. That paragraph states that the Boards decided not to exempt an entity from accounting for promised goods or services that the entity might regard as being perfunctory or inconsequential. Instead, an entity should assess whether those promised goods or services are immaterial to its financial statements as described in FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, or IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC9. The Board observes that it did not intend to imply that each and every activity performed in satisfying a contract must be a promised good or service for

purposes of applying Topic 606. The Board previously decided to exclude an exemption for inconsequential or perfunctory promises because it considered that notion to be similar to immateriality. Therefore, including that notion in the performance obligations guidance could have been viewed as duplicating the materiality concepts in other GAAP.

BC10. As described in paragraph BC84 in Update 2014-09, the Board intended the notion of a promised good or service to be similar to the notion of deliverables, components, or elements of a contract in previous revenue guidance. The Board did not intend that an entity would identify significantly more promised goods and services that result in performance obligations than under existing revenue guidance except that certain marketing incentives that are not identified as deliverables under existing revenue guidance would be identified as performance obligations under the new revenue standard.

BC11. The Board decided to amend Topic 606 to state that immaterial items are not required to be identified as promised goods or services for purposes of identifying performance obligations (that is, for purposes of applying Step 2 of the revenue model in Topic 606). The Board decided that an entity would be required to consider whether a promised good or service is material only at the contract level because it would be unduly burdensome to require an entity to aggregate and determine the effect on its financial statements of those items or activities determined to be immaterial at the contract level. This notion of determining material promised goods or services at the contract level also is used in Topic 606 for significant financing components and customer options for additional goods or services. As it is used in paragraph 606-10-25-16A, the term *immaterial* refers to the general notion of materiality. That is, an entity would consider the relative significance or importance of a particular promised good or service in the contract to the arrangement as a whole. In applying this notion, an entity would consider both the quantitative and the qualitative nature of the promised goods or services in the contract.

BC12. Identifying only those goods or services promised to a customer that are material is consistent with the objective of identifying the nature of an entity's performance obligation(s) to the customer. Identifying immaterial goods or services might obscure, rather than clarify, the nature of an entity's performance obligation(s) in the contract. An entity would not be required to allocate revenue to promised goods or services that are immaterial in the context of the contract.

BC13. Assessing whether promised goods or services are immaterial at the contract level will require the use of judgment. Many entities routinely make similar judgments about (a) materiality in applying other GAAP and (b) whether an obligation to a customer is inconsequential or perfunctory. Assessing the materiality of promised goods or services in a contract with a customer should include an assessment of quantitative and qualitative factors. For example, an entity ordinarily will find it useful to consider the nature of its arrangement with a customer.

BC14. The Board decided that the guidance in paragraph 606-10-25-16A would not be applicable to customer options for additional goods and services. The Board determined that when assessing whether optional goods and services provide the customer with a material right, an entity would apply the guidance in paragraphs 606-10-55-42 through 55-43. The entity would apply the guidance in those paragraphs to determine whether an option gives rise to a material right that a customer would not receive without entering into that contract.

BC15. The Board considered whether to include a requirement in Topic 606 that would have required an entity to accrue the costs, if any, to transfer immaterial goods or services to the customer in instances in which the costs will be incurred after the satisfaction of the performance obligation and recognition of revenue. The Board decided not to include an explicit requirement in Topic 606. An entity should apply the guidance in other GAAP (for example, Topic 405, Liabilities) to determine whether or not a liability exists.

BC16. The Board considered an alternative approach that would have included the existing SEC guidance on inconsequential or perfunctory obligations in Topic 606. This approach was not pursued because of its potential disadvantages. The existing SEC guidance, which is an interpretation of existing GAAP, includes factors to be met in determining that an obligation is inconsequential or perfunctory. In practice, this could be a more costly approach than the approach in this proposed Update, and the Board expects it would not significantly change the quality of the information reported to financial statement users.

BC17. The guidance in paragraph 606-10-25-16 states that an implied promise in a contract with a customer may exist if a promise creates a *valid* expectation of the customer that an entity will transfer a good or service to the customer. The Board changed this term from *valid* to *reasonable* because stakeholders questioned what the Board intended for an expectation to be *valid* because paragraph BC87 in Update 2014-09 states that implied promises do not need to be enforceable by law.

Shipping and Handling Activities

BC18. Stakeholders have diverse views about whether and when Topic 606 requires shipping and handling activities (collectively referred to as shipping) that occur after the transfer of control of the good to the customer to be accounted for as a promised service or as a fulfillment activity. Under existing revenue guidance, many entities do not account for shipping provided in conjunction with the sale of their goods as an additional deliverable.

BC19. Requiring shipping to be accounted for as a promised service would be a significant change in practice for many entities because shipping generally is not a deliverable under existing guidance for arrangements involving the sale of goods. At present, there are many manufacturers, retailers, and others that do not consider their arrangements to include multiple deliverables (that is, a good and a shipping service). Consequently, they do not have the systems, processes,

and internal controls to account for those arrangements as multiple-element arrangements. Requiring shipping to be identified as a performance obligation separate from the transfer of the good might diminish the usefulness of the information provided to financial statement users because users may combine the two pieces of revenue for their analyses. The Board decided to provide an election to account for shipping as a fulfillment activity because a change in practice for entities that do not account for shipping as a deliverable under existing revenue guidance would be costly to implement and apply going forward while providing financial statement users with little or no benefit.

BC20. In instances in which an entity is providing shipping along with a good, the shipping may or may not be a promised service depending on the facts and circumstances of the contract. The Board is proposing an election that would allow an entity to account for shipping as an activity to fulfill the promise to transfer goods. The Board expects that this election will improve the operability of Topic 606 because an entity would not be required to assess whether the shipping is a promised service. Furthermore, the Board expects that this election would not diminish the information provided to users of financial statements. This election is not intended to suggest that shipping that occurs after the transfer of control of a good is always a promised service. The Board decided that this should be an election, rather than a requirement, because it determined that an entity should not be precluded from accounting for shipping as a promised service if doing so would be more consistent with the nature of the arrangement with a customer.

BC21. The Board clarified that in instances in which shipping activities are performed before the transfer of control of a good (see paragraphs 606-10-25-23 through 25-30 for guidance on satisfying performance obligations), shipping is not a promised service to the customer in the contract. Rather, shipping is a fulfillment activity, and the costs are incurred to facilitate the sale of the good to the customer. The shipping relates to an entity's asset and not the customer's asset because control of the good has not been transferred. The entity's effort to deliver a good to the customer is no different from its effort to procure raw materials, manufacture the good, or ship the finished product from the entity's manufacturing facility to its warehouse. Therefore, electing not to evaluate whether shipping is an additional service in the contract would be applied only in instances in which shipping is performed after the customer has obtained control of the good.

BC22. The Board considered whether the election should be limited to shipping or whether it should be applied more broadly to other activities that may occur after an entity transfers control of the good or goods. The Board decided to limit the scope of this guidance to shipping. Accordingly, it would be inappropriate for an entity to apply the election by analogy to activities other than shipping. However, an entity would consider whether those other activities transfer a promised good or service to a customer in accordance with paragraph 606-10-

25-17, or it may consider whether those activities are immaterial in the context of the contract in accordance with paragraph 606-10-25-16A.

BC23. The Board explored an alternative approach that would have provided specific implementation guidance on shipping to distinguish when shipping is a fulfillment activity and when it is a promised service. This approach would have been similar in concept to the implementation guidance that the Board provided for warranties in paragraphs 606-10-55-30 through 55-35 (that is, providing guidance on when a warranty is a performance obligation versus a fulfillment activity). To pursue this approach, the Board would have needed to decide if the implementation guidance would require that shipping is never a promised service or whether there are certain instances in which it is a promised service. The Board would have had to develop guidance to distinguish when shipping is a fulfillment activity versus when it is an additional promised service. The Board observed that the objective of addressing this issue is to reduce the cost and complexity of implementing and applying Topic 606 and that approach would not have reduced cost and complexity as much as the approach in this proposed Update.

Identifying When Promises Represent Performance Obligations (Paragraphs 606-10-25-19 through 25-22)

BC24. Topic 606 requires distinct goods or services to be identified as performance obligations. There are two criteria that must be met for a good or service to be distinct. The first criterion is that a customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct). The second criterion is that an entity's promise to transfer a good or service to a customer is separately identifiable from other promises in the contract (that is, the promise to transfer the good or service is distinct within the context of the contract).

BC25. The criterion in paragraph 606-10-25-19(b) as well as the principle and the factors in paragraph 606-10-25-21 were developed with the understanding that application would require the exercise of judgment. This was in direct response to stakeholders' feedback received during the development of Topic 606. Stakeholders expressed concerns that the proposed separation guidance in the 2010 and 2011 proposed Updates did not appropriately address the wide variety of revenue arrangements that existed in practice across all industries. Stakeholders asserted that the separation guidance might have resulted in the identification of performance obligations that do not appropriately reflect the arrangement with a customer.

BC26. Stakeholders requested, and the Board decided to establish, guidance that would permit judgment in this area. The Board observed that identifying separate deliverables or separate elements under existing revenue guidance also is challenging and judgmental, especially in particular industries. Although

judgment is required, the Board has observed different interpretations of the criterion in paragraph 606-10-25-19(b) and the guidance in paragraph 606-10-25-21. For those reasons, the Board decided to clarify that guidance by better articulating the principle. Although the language describing the separately identifiable principle would be expanded, the amendments would better describe the Board's intentions and would not be a change in the underlying principle. Even with the improvements in this proposed Update, the Board recognizes that judgment will be needed to determine whether promised goods or services are distinct.

BC27. The Board intends to convey that an entity should evaluate whether the contract is to deliver (a) multiple goods or services or (b) a combined item or items that is comprised of the individual goods or services promised in the contract. That is, the analysis should evaluate whether the multiple promised goods or services in the contract are outputs or, instead, are inputs to a combined item (or items). The inputs to a combined item (or items) concept might be further explained, in many cases, as those in which an entity's promise to transfer the promised goods or services results in a combined item (or items) that is greater than (or substantively different from) the sum of those promised (component) goods and services.

BC28. As an alternative approach, the Board considered whether the principle should be based on the concept of separable risks. Under this alternative, individual goods or services in a bundle would not have been distinct if the risk that an entity assumes to fulfill its obligation to transfer one of those promised goods or services to the customer was inseparable from the risk relating to the transfer of the other promised goods or services in that bundle. The explanation in paragraph BC103 of Update 2014-09 highlights that when evaluating whether an entity's promise to transfer a good or service is separately identifiable from other promises in the contract, one should consider the relationship between the various goods or services within the contract in the context of the process of fulfilling the contract. The Board decided to exclude this terminology in Topic 606 because the Board understood from previous outreach efforts throughout the course of the development of Topic 606 that the concept was not well understood by stakeholders. However, the Board acknowledges that the notion of separable risks continues to influence the separately identifiable concept.

BC29. To assist an entity in applying the separately identifiable principle, paragraph 606-10-25-21 in this proposed Update includes three factors that indicate that an entity's promises to transfer goods or services to a customer are not separately identifiable. Those factors are not an exhaustive list, and not all of the factors need to be met to conclude that the entity's promises to transfer goods or services are not separately identifiable.

BC30. The Board decided to reframe the existing factors in paragraph 606-10-25-21 to more clearly align the factors with the separately identifiable principle. This change primarily would involve evaluating the separately identifiable

principle in the context of the bundle of promised goods or services in the contract rather than in the context of each individual promised good or service. The effect of the singular structuring of the factors in Topic 606 diluted the notion that the separately identifiable assessment is that for a *bundle* of goods and services to be a combined output, those goods or services should significantly affect each other. The Board has observed that the way the factors currently are written in Topic 606 is capturing contract scenarios in which only one good or service is significantly affecting the other. The separately identifiable principle is intended to consider the level of integration, interrelation, or interdependence among promises to transfer goods or services. That is, the separately identifiable principle is intended to evaluate when an entity's performance in transferring a bundle of goods or services in a contract is, in substance, fulfilling a single promise to a customer. Therefore, the entity should evaluate whether two or more promised goods or services (for example, a delivered item and an undelivered item) each significantly affect the other (and, therefore, are highly interrelated or highly interdependent) in the contract. The entity should not merely evaluate whether one item, by its nature, depends on the other (for example, an undelivered item that would never be obtained by a customer absent the presence of the delivered item in the contract or the customer having obtained that item in a different contract). Furthermore, the Board concluded that it may be clearer to structure those factors to identify when the promises in a bundle of promised goods or services are *not* separately identifiable and, therefore, constitute a single performance obligation.

BC31. In addition to reframing the factors in the context of a bundle of goods or services, the Board also:

- a. Revised the factor relating to a significant integration service in paragraph 606-10-25-21(a) to clarify that (1) the factor is not only applicable to circumstances that result in a single output and (2) a combined output may include more than one phase, element, or unit.
- b. Decided to clarify that the evaluation of whether two or more promises in a contract are highly interrelated or highly interdependent in accordance with paragraph 606-10-25-21(c) considers *both* fulfillment and beneficial interdependence. An entity may be able to fulfill its promise to transfer each good or service in the contract independently of the other, but each good or service may significantly affect the other's utility (that is, its ability to provide benefit or value) to the customer. For example, in Example 10, Case C, or in Example 55, the entity's ability to transfer the initial license is not affected by its promise to transfer the updates, but the provision (or not) of the updates will significantly affect the utility of the licensed intellectual property to the customer such that the license and the updates are not separately identifiable. They are, in effect, inputs to the combined solution for which the customer contracted. Some stakeholders have confused the highly interrelated or highly interdependent notion with the "capable of being distinct" criterion

in paragraph 606-10-25-19(a). The “capable of being distinct” criterion also considers the utility of the promised good or service, but merely establishes the baseline level of economic substance a good or service must have to be “capable of being distinct.” Utility also is relevant in evaluating whether two or more promises in a contract are separately identifiable. This is because even if two or more goods or services are capable of being distinct because the customer can derive some measure of economic benefit from each one, the customer’s ability to derive its intended benefit from the contract may depend on the entity transferring each of those goods or services.

BC32. The Board decided to include some additional examples about identifying performance obligations. The additional examples and revisions to the existing examples in Topic 606 in this proposed Update demonstrate how the Board intends for the separation guidance to be applied. The additional examples are based on fact patterns that some stakeholders thought were challenging to assess under Topic 606, as issued. No single fact or circumstance in the additional (or revised) examples should be viewed as determinative to the evaluation. Rather, the facts and circumstances presented, as well as the evaluation of the factors in paragraph 606-10-25-21, each contribute to the conclusion reached in accordance with the principles in paragraph 606-10-25-19.

Licensing

BC33. The licensing implementation guidance that was issued in Update 2014-09 included criteria for determining when an entity’s promise in granting a license is to provide a right to access the entity’s intellectual property because the intellectual property to which a customer has rights is expected to change on the basis of the entity’s activities that do not transfer a good or service to the customer. If those criteria were not met, the nature of the entity’s promise in granting a license is to provide a right to use the entity’s intellectual property as it exists at the point in time at which the license is granted. The guidance also included the effect of contractual restrictions on determining the nature of the entity’s promise in granting a license.

BC34. Paragraph 606-10-55-65 of the issued guidance in Update 2014-09 provides an exception to the general guidance on variable consideration for sales-based and usage-based royalties promised in exchange for a license of intellectual property.

BC35. After the issuance of Update 2014-09, stakeholders raised concerns about the licensing implementation guidance. The principal concerns raised related to:

- a. Determining the nature of the entity’s promise in granting a license of intellectual property
- b. The scope and applicability of the sales-based and usage-based royalties exception

- c. The effect of certain contractual restrictions in a license on identifying the performance obligations in the contract
- d. When the guidance on determining the nature of the entity's promise in granting a license applies.

BC36. Each of the sections below explains stakeholders' concerns and how the revisions to the licensing implementation guidance (including the licensing examples in the implementation guidance) in this proposed Update attempt to address those concerns by improving the operability and understandability of the guidance in Topic 606.

Identifying Performance Obligations

BC37. The Board previously observed that all contracts require an assessment of the promises in the contract and the criteria for identifying performance obligations (see paragraphs 606-10-25-14 through 25-22). This would include an assessment of whether a customer can benefit from the license on its own or together with other resources that are readily available (see paragraph 606-10-25-19(a)) and whether the license is separately identifiable from other goods or services in the contract (see paragraph 606-10-25-19(b)). The Boards observed that this assessment might sometimes be challenging.

BC38. Identifying separate deliverables (or elements) in licensing arrangements is often challenging under existing GAAP (for example, in many software or biotechnology arrangements), and it was never the Board's intention to eliminate judgment in this area. While stakeholders in industries that engage in significant licensing activities have questioned this, the Board believes that no additional guidance on identifying performance obligations specifically tailored to entities that license intellectual property is necessary. The Board believes that the improvements in this proposed Update would assist all entities in applying the general identifying performance obligations guidance in paragraphs 606-10-25-14 through 25-22, including entities that license intellectual property.

BC39. Some stakeholders suggested that it was unclear whether certain types of contractual restrictions would affect an entity's efforts to identify the goods or services it promises in a contract with a customer. One example presented to the Board was an arrangement in which a customer licenses a well-known television program or movie for a period of time (for example, three years) but is restricted to showing that licensed content only once per year during each of those three years. Some stakeholders thought that while paragraph 606-10-55-64 clarifies that restrictions of time, geography, or use do not affect the licensor's determination about whether the license is satisfied over time or at a point in time, it is unclear whether contractual restrictions affect the entity's identification of its promises in the contract (that is, whether the airing restrictions affect whether the entity has granted one license or three licenses). To resolve this question, the Board decided to add guidance to paragraph 606-10-55-64 that would specify that contractual restrictions of the nature in paragraph 606-10-55-

64(a) are attributes of the license (that is, they define the scope of the license). Therefore, they do not affect the assessment of the promises in the contract. In other words, the Board decided that an entity should not reach a different conclusion about its promises in the contract than it would if the entity had unrestricted airing rights to the licensed television program or movie for three years. The Board also considered that not all contractual provisions should be characterized as restrictions of the customer's right of use or right of access. For example, an entity might grant a customer a license to use or access its intellectual property for two distinct and substantive periods of time. Between those two periods of time, the customer relinquishes those rights for a substantive period of time, and the entity can grant those rights to another customer. A provision of this nature is different from a contractual restriction on the customer's right to use or right to access the intellectual property because it effectively revokes the customer's rights under the license for a substantive period of time and in such a manner that the entity is practically able to grant those rights to a third party. Some judgment may be involved in determining whether a contractual provision is a restriction on the customer's right to use or right to access the entity's intellectual property.

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

BC40. Implicit to the licenses implementation guidance in Update 2014-09 is that intellectual property is inherently different from other goods or services because of its uniquely divisible nature. The licenses guidance in Update 2014-09 recognizes that intellectual property can be licensed to multiple customers at the same time (for example, franchise rights or rights to use an entity's brand name or logo can be licensed to multiple customers concurrently) and can continue to be used by the entity during the license period for its own benefit (for example, a sports team continues to use its team name and logo throughout the license period so that it can continue to play games and sell tickets or television rights to those games). Therefore, in entering into a license contract, a customer may reasonably expect an entity to undertake activities from which the customer would expect to derive substantial benefit and that significantly affect its license but that do not transfer a promised good or service specifically to that customer (that is, the activities also benefit the entity and/or its other licensees).

BC41. The licenses implementation guidance is premised on the view that an entity's promise (explicit or implicit) to support or maintain the intellectual property to which the customer has rights is an inseparable component of its larger promise to the customer in granting a license when the entity's promise to do so *significantly* affects the utility of the intellectual property (that is, its ability to provide benefit or value) to the customer. The notion that the entity's promise includes supporting or maintaining the intellectual property if the entity's fulfillment of that promise significantly affects the customer's ability to benefit from the license is broadly consistent with the overall separation guidance in

Step 2 of the revenue model (identifying performance obligations). The guidance on identifying performance obligations similarly indicates that two or more promised goods or services may not be separable if the customer's ability to benefit from each good or service is significantly affected by the other (see paragraph BC31).

BC42. The guidance in Update 2014-09 was intended to characterize the significance of those activities a customer would reasonably expect an entity to undertake in the context of whether those activities “change” the intellectual property to which the customer has rights. Since the issuance of Update 2014-09, stakeholders have communicated that the issued implementation guidance is unclear about whether changes in the intellectual property refer solely to changes in the form or functionality of the intellectual property or also to changes in the value of intellectual property. This has resulted in different interpretations of when that guidance results in a right to access (satisfied over time) versus a right to use (satisfied at a point in time) intellectual property. Because those interpretations are different, entities entering into substantially equivalent license arrangements are reaching significantly different accounting conclusions about how they should recognize revenue for licensing arrangements. The Board's decision in this proposed Update to refer to the effect of an entity's activities or other actions on a customer's license in the context of “utility,” and to define that term in the manner in the previous paragraph and in paragraph 606-10-55-59(a), is expected to resolve the confusion about what attributes of the intellectual property (that is form, functionality, and/or value) affect the nature of the entity's promise in granting a license.

BC43. The revised guidance in this proposed Update does not revisit the accounting approach to licenses of intellectual property included in Update 2014-09 (as described in paragraphs BC40 and BC41 above). Additionally, it does not change the fact that many licenses would be recognized over time on the basis of the proposed licensing implementation guidance while many other licenses would be recognized at a point in time (if separate performance obligations). However, the amendments in this proposed Update attempt to more clearly articulate the licensing implementation guidance to enhance operability and ensure a more consistent application to similar facts and circumstances by more clearly delineating when an entity's promise to a customer in granting a license includes both of the following:

- a. Granting the customer rights to use and benefit from the entity's intellectual property by making its intellectual property available for the customer's use
- b. Supporting or maintaining the intellectual property to which the customer has rights.

BC44. Supporting or maintaining the intellectual property to which a customer has rights generally includes undertaking activities (that do not transfer a good or service to the customer) for which the performance or nonperformance

significantly affects the utility of the intellectual property (for example, a sports team continuing to play games as in Example 61 or a comic strip producer continuing to produce a weekly comic strip as in Example 58), as well as not undertaking activities or otherwise taking actions that would significantly degrade the utility of the intellectual property.

BC45. The Board decided that whether an entity's promise to a customer includes supporting or maintaining the intellectual property to which the customer has rights largely depends on whether the intellectual property has significant standalone functionality (for example, the ability to process a transaction, perform a function or task, or be played or aired). An entity's ongoing activities that do not substantively change that functionality may affect the utility of functional intellectual property, but would not *significantly* affect its utility. Therefore, continuing to support or maintain the intellectual property is not part of the promise to the customer in granting a license to functional intellectual property. Functional intellectual property generally includes intellectual property such as software, biological compounds or drug formulas, and completed media content (for example, films, television shows, or music). Patents underlying highly functional items (for example, a patent to a specialized manufacturing process that the customer can employ as a result of the patent regardless of the entity's ongoing activities) also would be functional intellectual property.

BC46. Symbolic intellectual property is intellectual property that does not have significant standalone functionality. Therefore, substantially all of its utility is derived from its association with an entity's past or ongoing activities that do not transfer a promised good or service to a customer, including its ordinary business activities. Symbolic intellectual property generally includes intellectual property such as brands, team or trade names, logos, and franchise rights. The absence of significant standalone functionality means that the utility of symbolic intellectual property largely depends on the entity supporting or maintaining that intellectual property (for example, a license to a sports team's name and logo typically will have limited residual value if the team quits playing games). Therefore, the entity's promise to a customer is both to (a) grant the customer rights to use and benefit from the entity's intellectual property and make that underlying intellectual property available for the customer's use and (b) support or maintain the intellectual property. Therefore, a license to symbolic intellectual property is satisfied over time as its promise to the customer is fulfilled. In determining the period over which a performance obligation to grant a license to symbolic intellectual property is satisfied, the entity's obligation to support or maintain the intellectual property exists for the duration of the license period unless the license period is longer than the remaining economic life of the intellectual property. It is reasonable to assume an entity will not support or maintain intellectual property past the end of its economic life.

BC47. Licenses to functional intellectual property if separate performance obligations, generally will be satisfied at a point in time. However, the Board included paragraph 606-10-55-62 in this proposed Update because it would have

been inconsistent with the broader rationale for the Board's revisions to the licensing guidance to conclude that an entity's expected activities that will (a) substantively change the functionality of functional intellectual property (that is, in a more than minor way) without transferring a good or service to the customer and (b) directly affect the customer because the customer is subject to those changes in functionality (for example, because of contractual or practical restrictions on using an unmodified version of the intellectual property) do not significantly affect the utility of the intellectual property to the customer. In those cases, the entity is, in effect, only granting the customer the right to access its intellectual property in its present form. The customer does not obtain control of the license when it is first granted rights to the intellectual property. This is because when the rights are first granted the customer obtains rights to intellectual property for which it will not have rights for the full license period and the entity continues to perform throughout the license period by making the changed intellectual property (for example, changed code, content, or design) available to the customer. The Board expects that the criteria in paragraph 606-10-55-62 will be met only infrequently, if at all. This is because when an entity provides updates to functional intellectual property, the provision of those updates typically is a promised service to the customer and, therefore, the entity's activities involved in providing those updates would not meet the criterion in paragraph 606-10-55-62(a). For example an entity's activities to develop and provide software updates (such as in Example 10, Case C; Example 11; and Example 55) or provide software customization services (Example 11, Case B) would not meet the criterion in paragraph 606-10-55-62(a) because the updates and the customization services are additional promised services to the customer (that is, in addition to the license).

BC48. The Board did not amend the guidance in paragraph 606-10-55-64 because it relates to determining the nature of an entity's promise in granting a license. The Board retains its previous conclusion that an entity would exclude the factors specified in paragraph 606-10-55-64 for the following reasons:

- a. Restrictions of time, geographical region, or use that define the attributes of the asset conveyed in a license—An entity would not consider restrictions of time, geographical region, or use because they define attributes of the rights transferred rather than the nature of the underlying intellectual property and the rights provided by the license. Consider, for example, a term license that permits a customer to show a movie in its theater six times over the next two years. The restrictions determine the nature of the asset that the entity has obtained (that is, six showings of the movie), rather than the nature of the underlying intellectual property (that is, the underlying movie).
- b. The entity's guarantees that it has a valid patent to intellectual property and that it will defend and maintain that patent—Guarantees that the entity has a valid patent would not be included in the assessment of the criteria for determining the rights in a license because those promises

are part of the entity's representation that the intellectual property is legal and valid (this notion was previously included in the 2011 Exposure Draft).

BC49. The Board considered an alternative approach to clarifying the guidance on determining the nature of the entity's promise in granting a license. Consistent with the amendments in this proposed Update, this approach would have clarified that:

- a. Expected effects on form, functionality, and value all affect the nature of the entity's promise in granting a license (and introduced the term *utility* to capture this).
- b. When intellectual property has significant standalone functionality, an entity's activities that do not change that functionality do not significantly affect its utility.
- c. The utility of intellectual property that does not have significant standalone functionality typically is derived from, and dependent on, the entity's ongoing activities, including its ordinary business activities.

BC50. In contrast to the amendments in this proposed Update, this alternative approach would not have categorized the underlying intellectual property as either functional or symbolic or have derived the expectation of whether an entity's promise includes continuing to support or maintain the intellectual property from that categorization. Instead, the entity would evaluate, for each license granted, whether the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the utility of the licensed intellectual property.

BC51. Those stakeholders who supported the alternative approach during outreach suggested that the amendments in this proposed Update have the potential to result in some licenses of symbolic intellectual property being recognized over time even though there is no expectation that the entity will have to perform after making the intellectual property available to the customer to fulfill its promise to the customer.

BC52. While the Board acknowledges those stakeholders' concerns, the Board decided in favor of the amendments in this proposed Update, rather than the alternative approach, for the following reasons:

- a. Outreach suggested that the number of licensing arrangements for which the outcome would be likely to differ between the two approaches is very small. This is because most licensors continue to be involved with their symbolic intellectual property throughout its economic life.
- b. Outreach also suggested that the approach in this proposed Update would be more operable, particularly for entities with a significant number of licensing arrangements and entities with diversified operations. This is because the presumption of continuing support or maintenance by the entity created by the functional versus symbolic

categorization will eliminate the requirement that would exist under the alternative approach for those entities to evaluate whether a customer reasonably would expect the entity to undertake activities that could affect the utility of the licensed intellectual property and whether those activities would *significantly* affect that intellectual property for each license (and maintain related processes and controls). Because research and outreach have suggested that the number of licensing arrangements for which the outcome would be likely to differ between the two approaches is very small, the Board decided that the amendments in this proposed Update would be a more practical way to draw the line between those licenses that include an implied promise to continue to support or maintain the intellectual property to which the customer has rights and those that do not.

When to Consider the Nature of an Entity's Promise in Granting a License

BC53. After the issuance of Update 2014-09, some stakeholders questioned when the guidance on determining the nature of an entity's promise applies. For example, paragraph 606-10-55-57 in Update 2014-09 could be read to suggest that an entity would consider the nature of its promise in granting a license only when the license is distinct. Some stakeholders noted that an entity would have to consider the nature of its promise in granting a license even when the license is not distinct to appropriately (a) determine whether a combined performance obligation that includes a license of intellectual property is satisfied over time or at a point in time and (b) measure progress toward complete satisfaction of that combined performance obligation if it is satisfied over time. The Board agreed with those stakeholders and, therefore, is proposing to revise the guidance in paragraph 606-10-55-57. The proposed amendments state that an entity should consider the nature of its promise in granting a license to appropriately apply the 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 and other goods or services (that is, to apply paragraphs 606-10-25-23 through 25-37). The Board believes that not considering the nature of the entity's promise in granting the license would result in accounting that does not best reflect the entity's performance in some cases. For example, if an entity grants a 10-year license that is not distinct from a 1-year service arrangement, the Board believes that it would be inappropriate to conclude that the combined performance obligation is satisfied over the one-year service period if the nature of the entity's promise in granting the license would be that of a right to access the entity's intellectual property (that is, satisfied over time) if the license was a separate performance obligation.

BC54. The proposed amendments to paragraph 606-10-55-57 were made for many of the same reasons that paragraph BC407 was included in Update 2014-09. The Board considered the example included in BC53, and other similar examples, when it drafted paragraph BC407. Therefore, the proposed amendments to paragraph 606-10-55-57 and the discussion in the preceding paragraph of this proposed Update would supersede the discussion in paragraph BC407 in Update 2014-09.

Consideration in the Form of Sales-Based or Usage-Based Royalties

BC55. The Boards decided in Update 2014-09 that for a license of intellectual property for which the consideration is based on a customer's subsequent sales or usage, an entity should not recognize any revenue for the variable amounts until the uncertainty is resolved (the royalties constraint). Revenue derived from a sales-based or usage-based royalty is not recognized until (a) the customer's subsequent sales or usage occurs or (b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

BC56. The Boards proposed a similar requirement in the 2011 proposed Update because both users and preparers of financial statements indicated that it would not be useful for an entity to recognize a minimum amount of revenue for those contracts. This is because that approach inevitably would have required the entity to report, throughout the life of the contract, significant adjustments to the amount of revenue recognized at inception of the contract as a result of changes in circumstances even though those changes in circumstances are not related to the entity's performance. The Boards observed that this would not result in relevant information, particularly in contracts in which the sales-based or usage-based royalty is paid over a long period of time. Entities also reported that such accounting would be operably difficult and subject to significant judgments because of the long-term nature of many licensing arrangements (for example, 10 years, 20 years, or longer).

BC57. Since the issuance of Update 2014-09, stakeholders have communicated to the Board that it is unclear when a sales-based or usage-based royalty is "promised in exchange for a license." Some stakeholders have interpreted this provision broadly and concluded that the royalties constraint applies whenever the royalty relates to a license of intellectual property, regardless of whether the royalty also is consideration for other goods or services in the contract. Other stakeholders have a more narrow view and suggested that the royalties constraint applies only when the royalty relates solely to a distinct license or only when the license is the primary or dominant item to which the royalty relates. In addition to questions about when a royalty is promised in exchange for a license, stakeholders also have communicated that the guidance is unclear about whether a single sales-based or usage-based royalty should ever be split between a portion to which the royalties constraint would apply and a portion to

which it would not (and, therefore, to which the general guidance on variable consideration applicable to goods and services other than licenses would apply), such as when a royalty relates to a license and another good or service that is not a license.

BC58. To enhance understandability and promote consistency in application, the Board decided to clarify that both:

- a. An entity should not account for a single royalty under two accounting models (that is, the entity should not split a single royalty between a portion to which the royalties constraint would apply and a portion to which it would not).
- b. A sales-based or usage-based royalty is promised in exchange for a license and, therefore, the royalties constraint would apply whenever a license is the sole or predominant item to which the royalty relates. This would include a situation in which no single license is the predominant item to which the royalty relates but the royalty predominantly relates to two or more licenses promised in the contract.

BC59. The Board decided that an entity should not account for a single royalty in accordance with two accounting models (that is, split a royalty) because doing so would be overly complex for preparers. The Board concluded that it would be more complex than accounting for the royalty under either one of those two models (that is, the royalties constraint or the general guidance on variable consideration), without providing more useful information to financial statement users. In fact, the financial reporting results from splitting a royalty might result in financial statement users receiving less useful information. The Board observed in paragraph BC415 in Update 2014-09 that the general guidance on variable consideration would not result in relevant information to users for contracts in which the sales-based or usage-based royalty is paid over a long period of time. However, some other stakeholders stated that any constraint (whether the general constraint applicable to all variable consideration or the royalties constraint) will result in delayed revenue recognition to later periods, thereby disassociating reported revenue from an entity's performance in satisfying a performance obligation. A split royalty likely would satisfy none of those stakeholders because the amount recognized at contract inception would reflect neither the amount to which the entity expects to be entitled based on its performance nor amounts to which the entity has become legally entitled during the period.

BC60. In deciding that a royalty is promised in exchange for a license and, therefore, that the royalties constraint should apply, the Board decided that applying the royalties constraint only when the royalty relates solely to a license that is a separate performance obligation would overly restrict its application whenever a license is the predominant item to which the sales-based or usage-based royalty relates. Because the Board previously decided that the royalties constraint generally would provide more useful information to users in licensing

arrangements that contain sales-based and usage-based royalties, the Board decided that applying the royalties constraint to those royalty arrangements in which the license is the predominant feature to which the royalty relates would provide more useful information to those users that are likely to view those arrangements as licensing arrangements. The Board further considered that restricting application of the royalties constraint to only those cases in which the royalty relates solely to a distinct license likely would result in an entity frequently reporting throughout the life of the contract significant adjustments to the amount of revenue recognized at inception of the contract as a result of changes in circumstances (unrelated to the entity's performance), although the arrangement is predominantly a licensing arrangement. Therefore, while the Board acknowledges judgment will be required to determine when a license is the predominant item to which a sales-based or usage-based royalty relates, the judgment and complexity resulting from that determination are likely to be less than the judgment and complexity required to apply the general variable consideration guidance to those arrangements to which the royalties constraint would not apply under a narrower application.

BC61. The Board decided against expanding the royalties constraint beyond those situations in which a license is the predominant item to which a royalty relates because it inevitably would expand to arrangements for which the Board previously decided in Update 2014-09 that the guidance should not apply (for example, sales of tangible goods that include intellectual property, such as end-user software to which the customer obtains a license as part of the sale).

Benefits and Costs

BC62. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC63. The Board does not anticipate that entities will incur significant costs as a result of the amendments in this proposed Update because it would amend guidance that currently is not effective. The objective of this proposed Update is to reduce the risk of diversity in practice before organizations implement Topic 606, which should benefit financial statement users by providing more comparable information. Additionally, the amendments in this proposed Update

should reduce the cost and complexity of applying Topic 606 both at transition and on an ongoing basis.

Alternative Views

BC64. Messrs. Linsmeier and Siegel do not support the Board's proposed amendments on identifying performance obligations and licensing for three primary reasons. First, they believe that the proposed amendment that permits an entity not to identify goods or services promised to the customer that are immaterial in the context of the contract is a potentially broad-reaching precedent. They are concerned that this proposal may be the first step in effectively redefining an accounting error and see no reason why the Board should not consider whether to apply this decision more broadly to disclosures, leases, capitalization policies, and other accounting matters. Second, Messrs. Linsmeier and Siegel are concerned that the proposed amendment that would permit an entity, as an accounting policy election, to account for shipping and handling that occur after the customer has obtained control of a good as a fulfillment activity would introduce potential noncomparability, hindering the comparison of financial information across entities. Third, they believe that the proposals relating to licenses override the core principle of the licensing implementation guidance in Topic 606 that an entity's promise to grant a license provides a customer either a right to access or a right to use an entity's intellectual property on the basis of whether the entity is expected to undertake activities that significantly affect the intellectual property to which the customer has rights and whether those activities expose the customer to positive or negative effects that do not result in the transfer of a good or service to the customer. In particular, they are concerned that the proposed amendments change the focus away from whether the entity undertakes activities that significantly affect the intellectual property to a focus primarily on whether the underlying intellectual property has the ability to process a transaction, perform a function or task, or be played or aired, which to Messrs. Linsmeier and Siegel represents a substantive change in the guidance. They also note that each of these decisions would result in further divergence (and with regards to licenses significant divergence) in the articulation of the revenue recognition guidance in GAAP versus IFRS.

BC65. Messrs. Linsmeier and Siegel believe that many of the issues that stakeholders raised about immaterial performance obligations are not entirely caused by the guidance in the core standard, but may be arising as a result of paragraphs BC89 and BC90 of the basis for conclusions for Update 2014-09. Their understanding is that some stakeholders believe that these paragraphs essentially require them to assess each and every possible good or service in the contract no matter how insignificant. Messrs. Linsmeier and Siegel believe that preparers' and auditors' concerns are heightened in this area as a result of audit requirements about the accumulation of unrecorded immaterial items and

communications with audit committees of the boards of directors. Messrs. Linsmeier and Siegel believe that it is unnecessary to amend Topic 606 as a result of concerns not stemming from the guidance, but instead from the basis for conclusions of Update 2014-09 and audit requirements about immaterial items.

BC66. Messrs. Linsmeier and Siegel also are concerned that this proposed amendment could set a far-reaching precedent for the Board and implies that there is significant confusion about the application of the “materiality box,” which is codified in paragraph 105-10-05-6 as “the provisions of the Codification need not be applied to immaterial items.” They believe that including this sentence in the Codification avoids the need for the Board to prescribe in Topic 606 that “an entity is not required to identify goods or services promised to the customer that are immaterial in the context of the contract.” Furthermore, Messrs. Linsmeier and Siegel are concerned that if the Board needs to prescribe that immaterial promises need not be identified, they see no reason why the Board would not need to specify that immaterial lease obligations need not be recognized in the statement of financial position, as well as immaterial capital expenditures. They note that after the Board decided to make the amendments in this proposed Update, the Board decided to propose an amendment to Topic 235, Notes to Financial Statements, on how to apply materiality in the context of disclosures. Specifically, the Board decided, in part, “if an entity does not provide a GAAP disclosure because management has decided the information is not material, the omission should not be considered an accounting error.” Messrs. Linsmeier and Siegel believe that those isolated decisions represent a fundamental shift in thinking about materiality and accounting errors and that the Board should deliberate them more holistically, in conjunction with a broader discussion among the interested parties, such as the U.S. Securities and Exchange Commission and the U.S. Public Company Accounting Oversight Board.

BC67. In the interim, Messrs. Linsmeier and Siegel would have addressed stakeholders’ concerns about identifying immaterial performance obligations by describing the discussion in the TRG minutes that, generally, TRG members believe that other than for certain marketing incentives, Update 2014-09 would not require recognition of significantly more promised goods or services than those that are identified as deliverables in today’s practice. Furthermore, Messrs. Linsmeier and Siegel believe that the Board could highlight in the basis for conclusions in this proposed Update the Board’s thinking in this area, as well as the substance of the TRG discussion confirming the Board’s intent in issuing Update 2014-09. They believe that those two steps would be sufficient without amending the Codification.

BC68. Regarding the decision about shipping and handling, Messrs. Linsmeier and Siegel agree with the Board’s decision to clarify that shipping and handling that occur before a customer obtains control of the good is a fulfillment activity. However, they disagree that the decision represents an improvement in financial reporting to provide an accounting policy election to account for shipping and handling as a fulfillment activity even if it occurs after a customer obtains control

of the good. They believe that this proposed amendment would create an exception to the model and potentially introduces noncomparability between entities. Because this policy election would be available to all entities, they are concerned that entities with significant shipping operations could make different elections in this regard, which would make the comparison of one entity to another by users much more difficult. Messrs. Linsmeier and Siegel would have preferred that, because the Board found it appropriate to clarify that entities are not required to identify goods or services promised to a customer that are immaterial in the context of the contract, the Board rely on that provision to alleviate the issue without creating a new exception to the new revenue recognition model and introduce a policy election. They believe that shipping and handling activities that are material should be analyzed like other material promises in the contract and accounted for in a similar manner.

BC69. Messrs. Linsmeier and Siegel believe that stakeholders have correctly identified some challenges with the application of the licensing guidance in Update 2014-09 that necessitate that the Board make changes to Topic 606 to make the licensing guidance more operable. However, they believe that the amendments in this proposed Update go too far, overriding the basic principle of the licensing guidance in Topic 606 that was jointly agreed upon by the Boards and increasing the potential that the final licensing guidance in Topic 606 will diverge significantly from that finalized in IFRS 15 even if it is modified by the IASB to address these operability concerns.

BC70. Messrs. Linsmeier and Siegel believe that the outcome of the proposed amendments is a presumption that revenue should be recognized over time for all licenses except licenses of intellectual property for which one or both of the following criteria are not met:

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

BC71. Messrs. Linsmeier and Siegel believe that this outcome represents a fundamental and significant change in the licensing guidance that is inconsistent with the TRG process and objectives. They also believe that if these amendments are finalized as proposed, they could be written more directly and succinctly, consistent with the language above. Writing the proposed amendments in this manner also would make it clear that the amendments represent a change in the fundamental principle by focusing primarily on the nature of the intellectual property (that is, whether or not the intellectual property has the ability to process a transaction, perform a function or task, or be played or aired) and not on whether the entity is expected to undertake activities that

significantly affect the utility of the intellectual property to which the customer has rights.

BC72. Messrs. Linsmeier and Siegel agree with the proposed amendments that address stakeholders' operability concerns by making it clear that revenue should be recognized at a point in time if (a) the licensed intellectual property has the ability to process a transaction, perform a function or task, or be played or aired (that is, its standalone functionality) and (b) a customer is not contractually or practically required to use the updated intellectual property as that functionality changes over time on the basis of activities undertaken by the entity that do not transfer a good or service to the customer. Messrs. Linsmeier and Siegel agree with those proposed amendments because they continue to focus on whether or not the entity is expected to undertake activities that significantly affect the utility of the intellectual property to which the customer has rights, while making the evaluation more operable by permitting the entity to focus only on activities that change the standalone functionality of intellectual property that has the ability to process a transaction, perform a function or task, or be played or aired. They believe that those activities are most likely to expose the customer to positive or negative effects that do not result in the transfer of a good or service to the customer and, therefore, find it a cost-beneficial accommodation to permit the entity to ignore other activities undertaken by the entity that are unrelated to changes in the standalone functionality of the intellectual property.

BC73. In contrast, Messrs. Linsmeier and Siegel disagree with the proposed amendments that address stakeholders' operability concerns by no longer requiring an evaluation for each license as to whether an entity is expected to undertake activities that significantly affect the utility of the intellectual property to which a customer has rights for all licenses of intellectual property that do not have the ability to process a transaction, perform a function or task, or to be played or aired. Messrs. Linsmeier and Siegel believe that change would override the core principle of the licensing implementation guidance in Topic 606 that was agreed upon jointly by the Boards and, instead, would create a presumption that those activities always will occur when that intellectual property is licensed. They note that the IASB also disagreed with this presumption. They further note that IASB members expressed a willingness to converge with the revised guidance substantially in-line with the alternative approach that was considered by the Board (see paragraphs BC49 and BC50). That alternative approach for licenses of intellectual property that do not have the ability to process a transaction, perform a function or task, or be played or aired would continue to require that an entity determine whether the entity's promise in granting a license provides a customer with either a right to access or a right to use the entity's intellectual property on the basis of whether the entity is expected to undertake activities that significantly affect the utility of the intellectual property to which the customer has rights without resulting in the transfer of a good or service to the customer. This also is the approach preferred by Messrs. Linsmeier and Siegel.

BC74. Messrs. Linsmeier and Siegel also recognize that some have asserted that differences in financial reporting outcomes likely will be minimal between their preferred alternative and the proposed amendments. They are uncomfortable with that assertion, however, given the wide variety of licenses that exist today and, more important, of the potential for even a wider variety of licenses to arise in the future. For those reasons, they prefer that the core principle for differentiating licenses in Topic 606 be retained for licenses of intellectual property that does not have the ability to process a transaction, perform a function or task, or be played or aired.

BC75. Messrs. Linsmeier and Siegel also disagree with the proposed amendments that unnecessarily would introduce two classes of intellectual property (functional and symbolic). They believe that this change may cause confusion because those two classes fail to capture differences in the nature of all licenses and, therefore, stakeholders may find it difficult to classify intellectual property as either functional or symbolic. Messrs. Linsmeier and Siegel would have preferred that the proposed amendments differentiate between intellectual property on the basis of whether or not it has the ability to process a transaction, perform a function or task, or be played or aired (which is how standalone functionality is described in the proposed amendments), rather than labeling some intellectual property as functional (that is, having significant standalone functionality) and the remainder as symbolic.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would not require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Any stakeholders who believe that changes to the Taxonomy are required should provide their comments and suggested changes through [ASU Taxonomy Changes](#) provided at www.fasb.org.