June 25, 2015

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2015-250

Dear Ms. Cosper:

McGladrey LLP is pleased to comment on the Proposed Accounting Standards Update (ASU), Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing (the “proposed ASU”). Overall, we are very supportive of the actions the Board has taken to address questions and issues arising in the implementation of the new revenue recognition model provided by the Board in ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The work of the Joint Transition Resource Group for Revenue Recognition (TRG) has been very valuable in understanding how certain aspects of ASC 606 should be applied in practice and in identifying those issues that warrant additional standard setting by the Board. The TRG’s discussions and the Board’s additional standard setting will significantly reduce the potential for noncomparability between entities as the new revenue recognition model is implemented.

As it relates to the specific areas of the new revenue recognition model addressed in the proposed ASU, we are supportive of the Board’s efforts to clarify the identification of the performance obligations (i.e., the units of account) in a customer contract and the accounting for licenses of intellectual property. The Board’s proposals in these areas make significant strides in improving the operability of the new revenue recognition model. Provided below for your consideration are our responses to the “Questions for Respondents” on which specific comment was requested. In our responses to these questions, we highlight the more significant issues we identified with the operability of the Board’s proposals and we provide our suggestions on how to address those issues. After our responses to the “Questions for Respondents,” we have included a section with other suggested changes for the Board’s consideration that we believe will further improve or clarify the Board’s proposals.

Responses to Questions for Respondents

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?

We believe the Board should make the guidance in ASC 606-10-25-14(b) through 25-15 (the series provision) an optional practical expedient. If an entity has already concluded that each promised good or service within a series of promised goods or services in its customer contract is distinct, we believe they should be able to account for them as individual performance obligations because doing so would be consistent with a fundamental concept underlying the new revenue recognition model – identifying the
units of account in a customer contract by assessing whether the promised goods or services in the contract are distinct.

In some situations, accounting for each distinct promised good or service within a series of distinct promised goods or services in a contract as individual performance obligations may add complexity to an entity’s accounting without providing commensurate benefits. We believe an entity should have a choice in those situations to elect a practical expedient that allows accounting for the series of distinct promised goods or services as a single performance obligation if the criteria in ASC 606-10-25-15 are met.

We understand treating each distinct promised good or service within a series of distinct goods or services as individual performance obligations instead of a single performance obligation when the criteria in ASC 606-10-25-15 are met could produce different accounting results when dealing with customer contracts involving variable consideration, contract modifications or transaction price changes. However, we do not think those differences warrant requiring a series of distinct goods or services (that meet certain criteria) to be accounted for as a single performance obligation. On balance, we do not expect those differences to have a significant effect on the financial statements in the vast majority of cases and, therefore, would not expect those differences to negatively affect the relevance of the information provided in the financial statements. As such, we believe the positives of allowing the series provision to be applied as a practical expedient (i.e., reduced complexity) outweigh the negatives (i.e., potential lack of comparability).

**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.

We support the overall intent of the amendments to ASC 606-10-25-16A. We believe these amendments would reduce the cost and complexity of applying the new revenue recognition model. Furthermore, we believe specifying that an entity is not required to identify goods or services promised to a customer that are immaterial in the context of the contract is consistent with the guidance that exists today in SAB Topic 13 with respect to inconsequential or perfunctory deliverables, which has not been a source of controversy or concern when considering the relevance of the information provided in the financial statements.

We understand that without the amendments to ASC 606-10-25-16A, some might take the position that an entity would be required to aggregate promised goods or services that are immaterial in the context of the contract to determine whether they are immaterial to the financial statements as a whole before not identifying them as promised goods or services. This position is supported by the discussion in paragraph BC8 of the proposed ASU. We do not believe an entity should be required to aggregate promised goods or services that are immaterial in the context of the contract to determine whether they are immaterial to the financial statements as a whole. The act of aggregating the promised goods or services that are immaterial in the context of the contract to determine whether they are immaterial to the financial statements as a whole negates much of the benefit that would otherwise be gained from not having to apply the new revenue recognition model to those promised goods or services. While we understand the concerns raised by some with respect to the precedent that might be set by not requiring the identification of promised goods or services that are immaterial in the context of the contract, we do not believe these concerns justify the cost and complexity that may otherwise result from not providing such guidance.

While we support the overall intent of the amendments to ASC 606-10-25-16A, we recommend the Board consider making the following changes:

- Clarify how the proposed guidance on “immaterial in the context of the contract” interacts with the guidance on options to acquire additional goods or services. We believe the following changes
should be made to ASC 606-10-25-16A to clarify how the proposed guidance interacts with the
guidance on options to acquire additional goods or services (suggested content additions are
underlined and suggested content deletions are struck-through):

An entity is not required to identify promised goods or services that are immaterial in the
case of the contract. For purposes of determining whether optional goods or services (that is, those subject to a customer option to acquire
additional goods or services) are immaterial in the context of the contract, an entity
should apply the guidance in accordance with paragraphs 606-10-55-42 through 55-43. If applying that guidance results in a
conclusion that an optional good or service represents a material right to the customer
that it would not receive without entering into that contract, the optional good or service is
not immaterial in the context of the contract.

• Add language that will guard against the proposed guidance on “immaterial in the context of the
contract” resulting in not identifying promised goods or services that are individually immaterial in
the context of the contract, but that are collectively material in the context of the contract. We
believe language should be added to ASC 606-10-25-16A to indicate that if there are multiple
promised goods or services in a customer contract that are individually immaterial in the context
of the contract, that those promised goods or services be evaluated in the aggregate to determine
whether they are collectively immaterial in the context of the contract. If they are not collectively
immaterial in the context of the contract, one or more of the promised goods or services should
be identified as a promised good or service in the contract such that those that are ultimately not
identified as promised goods or services are collectively immaterial in the context of the contract.

• Add guidance on how an entity should account for the costs related to the goods or services that
are not identified because they are immaterial in the context of the contract. We believe cost
accrual guidance should be added for the costs associated with those promised goods or
services not identified because they are immaterial in the context of the contract if those promised
goods and services have not been provided at the point in time that some or all of the transaction
price is otherwise recognized as revenue. For example, consider a situation in which a customer
contract consists of equipment and training on the equipment and the training, which is provided
one month after control of the equipment transfers to the customer, is deemed immaterial in the
context of the contract after an appropriate analysis is performed. We believe the Board should
provide guidance on how to account for the training costs in that situation. We believe the costs of
providing the training should be accrued when the revenue is otherwise recognized, which would
be when control of the equipment transfers to the customer.

**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.

We support the amendments to ASC 606-10-25-18A and believe they would reduce the cost and
complexity of applying ASC 606. We appreciate that providing an election to account for the shipping and
handling of a promised good as a fulfillment activity instead of a promise to transfer a service could affect
comparability among companies. However, we believe the lack of comparability will likely be minimal as
providing this election would essentially allow entities to continue to treat shipping and handling activities
as a fulfillment cost like they do today, which has not been a source of controversy or concern. In
addition, we are sensitive to the significant changes that many entities would need to make to their
systems, processes and internal controls to accommodate treating the shipping and handling activities
related to a promised good for which control has transferred prior to shipment as a performance obligation under the new revenue recognition model. On balance, we do not believe the theoretical accounting purity of treating shipping and handling activities related to a promised good for which control has transferred prior to shipment as a performance obligation justifies the costs of requiring such treatment.

We are sensitive to the concerns expressed about the election producing potentially less relevant information for entities with significant shipping operations. While we do not believe that population of entities is large enough to warrant not providing the election, we would support the Board considering a modification to the election that would further shrink that population of entities without reducing the overall benefits of the election. One such modification that might be worth the Board’s consideration is limiting the election to those situations in which the shipping and handling activities are not the predominant promised good or service in the customer contract. This concept is similar to that used by the Board in its proposal related to clarifying the scope and applicability of the sales-based and usage-based royalty constraint discussed in Question 8. As noted in our response to that question, we support the Board’s proposal and believe employing a similar concept in the context of the shipping and handling activities’ election may alleviate the concern that providing the election could produce less relevant information for entities with significant shipping operations.

Similar to the suggestion we made in our response to Question 2, we believe the Board should provide guidance on how an entity should account for the costs related to shipping and handling activities when control of the promised good to which those activities relate transfers to the customer prior to the occurrence of some or all of those shipping and handling activities. Consistent with our suggestion in our response to Question 2, we believe the costs associated with shipping and handling activities that occur after control of the promised good has transferred to the customer should be accrued when the transaction price allocated to the promised good to which the shipping relates is recognized as revenue.

**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?

Overall, we believe the revisions to ASC 606-10-25-21 result in a better articulation of the guidance on how to determine whether a promised good or service is distinct within the context of the contract. To further assist in ensuring that the concept of distinct within the context of the contract is appropriately understood and applied, we believe the Board should:

- Focus on the concept of distinct within the context of the contract in ASC 606-10-25-19(b) and 25-21 instead of the concept around whether a promised good or service is separately identifiable from other promises in the contract. We believe the plain-English meaning of separately identifiable may cause some constituents to misunderstand the underlying objective of ASC 606-10-25-19(b) and 25-21. In other words, two or more promised goods or services specifically spelled out in a customer contract (e.g., equipment and installation) would be considered separately identifiable based on the plain-English meaning of that phrase, but may not be considered separately identifiable based on the meaning of that phrase in ASC 606. While we appreciate that ASC 606-10-25-19(b) goes on to say that separately identifiable as used in that criterion means distinct within the context of the contract, and that additional factors are provided in ASC 606-10-25-21 to help assess whether a promised good or service is distinct in the context of the contract, we believe some unnecessary confusion could be eliminated by removing separately identifiable and focusing solely on the concept of distinct within the context of the contract. We do not believe making this change would have any negative effects on the new
revenue recognition model or its application given that distinct within the context of the contract is meant to be synonymous with separately identifiable from other promises in the contract.

- **Revise consideration of the factor in ASC 606-10-25-21(c) in some of the examples to remove reference to whether the promised good or service can be separately obtained from the entity or another entity.** We believe one of the benefits of having the factors in ASC 606-10-25-21 related to assessing whether a promised good or service is distinct within the context of the contract (the criterion in ASC 606-10-25-19(b)) comes from seeing how those factors are applied in the various examples provided in the implementation guidance. We believe the revised examples, as a whole, do a much better job of articulating how to apply the factors in ASC 606-10-25-21. However, in several of the examples, we question how the factor in ASC 606-10-25-21(c) was applied. The factor in ASC 606-10-25-21(c) requires consideration of whether the goods or services are highly interdependent or highly interrelated (i.e., each of the goods or services is significantly affected by one or more of the other goods or services in the contract). If the goods or services are highly interdependent or highly interrelated, they would not be considered distinct within the context of the contract and, therefore, would represent a single performance obligation. In applying this factor in several of the examples, one of the reasons cited for reaching a conclusion that the goods or services were not highly interdependent or highly interrelated was the fact that the customer could obtain one of the goods or services from another entity. For example:
  - **Example 11, Case C.** In ASC 606-10-55-150C, one of the reasons cited for why the promise to provide installation does not significantly affect the customer’s ability to benefit from the equipment is that the customer can obtain the installation services from several alternate providers.
  - **Example 11, Case E.** In ASC 606-10-55-150I, one of the reasons cited for why the promise to provide the consumables does not significantly affect the customer’s ability to derive benefit from the equipment is that the customer can readily obtain the consumables in the contract from other entities.
  - **Example 12, Case A.** In ASC 606-10-55-153, one of the reasons cited for why the equipment and maintenance services were not highly interdependent or highly interrelated is that the customer could obtain maintenance services from the distributor (i.e., a party other than the entity).
  - **Example 57.** In ASC 606-10-55-377, one of the reasons cited for why the promise to provide equipment does not significantly affect the customer’s ability to benefit from the license is that the equipment is readily available from other vendors.

Whether the promised goods or services in a customer contract are sold on their own by the entity or another entity (i.e., whether a customer can obtain the promised goods or services on a standalone basis from the entity or another entity) is the primary consideration in determining whether a promised good or service is capable of being distinct (the criterion in ASC 606-10-25-19(a)). Using that same basis to conclude that the promised goods or services are not highly interdependent or highly interrelated (which is one of the factors evaluated when determining whether a promised good or service is distinct within the context of a contract [the criterion in ASC 606-10-25-19(b)]), blurs the line between the concepts of capable of being distinct and distinct within the context of the contract. In other words, it is unclear why an entity would need to evaluate whether promised goods or services are highly interdependent or interrelated if the same reason can be used to conclude that both: (a) a promised good or service is capable of being distinct and (b) promised goods or services are not highly interdependent or highly...
interrelated. So that the factor requiring consideration of whether the promised goods or services are highly interdependent or highly interrelated stands on its own, we believe consideration of whether the promised goods or services can be obtained from other entities should not be referenced in the analysis of that factor in the examples. Making this change would also alleviate the confusion noted in paragraph BC31 of the proposed ASU that “[s]ome stakeholders have confused the highly interrelated or highly interdependent notion with the ‘capable of being distinct’ criterion in paragraph 606-10-25-19(a).”

**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?

Overall, we believe the revisions to ASC 606-10-55-54 through 55-64 and the related examples improve the operability of the implementation guidance focused on determining whether the nature of an entity’s promise in a granting a license is that of a right to use (in which case revenue is recognized at a point in time) or a right to access (in which case revenue is recognized over time). We believe linking the accounting for a license of intellectual property (IP) to the nature of the IP (i.e., functional or symbolic) makes application of the licenses implementation guidance more operational because there is a relatively clear and understandable distinction between functional IP and symbolic IP.

While we believe the revisions to the licensing implementation guidance in the proposed ASU represent an improvement, we believe further improvements are warranted through the following additional clarifications or revisions to eliminate any unnecessary confusion that may arise in applying the guidance:

- **Revise the discussion pertaining to whether the entity’s promise in granting a license of IP includes supporting or maintaining the IP.** ASC 606-10-55-60 was amended to indicate that “[a] customer’s ability to derive benefit from a license to symbolic intellectual property depends on the entity continuing to support and maintain the intellectual property.” We agree with the accounting consequences of this statement – a license of symbolic IP represents a right to access IP that should be accounted for over time. In other words, we believe it is appropriate to link the importance of supporting or maintaining symbolic IP over time to the accounting model applied to a license of symbolic IP. However, we do not believe that making this link in the context of licensing symbolic IP means that it is necessary to conclude that a license of functional IP does not include supporting or maintaining the IP over time, which is the conclusion reached by the Board in ASC 606-10-55-63 (underline added for emphasis):

  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).

We believe the statement made in the underlined sentence is inaccurate when considering the terms of a typical license of functional IP. For example, in most cases, there is some expectation that the entity will protect the patents underlying the functional IP that is being licensed. This is a form of supporting and maintaining the functional IP. For the reasons the guidance in ASC 606-
10-55-64 exists, we do not believe these types of support and maintenance activities should affect the accounting model applied to functional IP. However, we do not think it is appropriate to make a blanket statement indicating that the entity’s promise to the customer in granting a license of functional IP does not include supporting or maintaining the IP. Instead, the focus in ASC 606-10-55-63 should be on the remaining guidance included therein. Because that guidance stands on its own absent the underlined sentence, we believe that sentence should be deleted. Similarly, we believe the following sentence should be deleted from paragraph BC45 of the proposed ASU: “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.”

In addition, we believe the conclusions in the examples in ASC 606-10-55-381, 55-386 and 55-397 should clarify that it is the impact of the support and maintenance activities on the customer's ability to derive benefit from the license of IP (and not purely the performance of those activities) that contributes to the conclusion that the entity is granting a license of symbolic IP. Without this clarification, we are concerned that some may infer that any license of IP that includes activities focused on supporting and maintaining the IP are licenses of symbolic IP.

- **Provide explicit guidance indicating that whether a customer simultaneously receives and consumes the benefit from the license of IP as performance occurs is based on the guidance in ASC 606-10-55-59 through 55-63 and not an independent analysis.** ASC 606-10-55-58A indicates the following (underline added for emphasis):

  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.

We appreciate that the purpose of the underlined partial sentence is to tie the accounting for a license representing a right to access IP to one of the three criteria in ASC 606-10-25-27 that must be met to conclude that a performance obligation is satisfied over time. This purpose is supported by explicit statements made in the examples dealing with symbolic IP (see ASC 606-10-55-381A, 55-386 and 55-398) indicating that the consequences of concluding a license of symbolic IP has been granted is that the nature of the entity’s promise in granting the license is a right to access IP for which the performance obligation is satisfied over time in accordance with ASC 606-10-25-27(a). While it is helpful to have these statements in the examples, we believe a general statement should be made in ASC 606-10-55-58A indicating that ASC 606-10-55-59 through 55-63A should be used in determining whether the criterion in ASC 606-10-25-27(a) is satisfied. If this general statement is not provided, we are concerned that some may read ASC 606-10-55-58A to indicate that an entity should perform an independent assessment of its promise in granting a license under ASC 606-10-25-27(a), which may or may not result in the same conclusion based on the assessment of the promise under ASC 606-10-55-59 through 55-63A.

In addition, if it is necessary to explain in ASC 606-10-55-58A that an entity should account for a promise to provide a right to access the entity's IP as a performance obligation satisfied over time because the criterion in ASC 606-10-25-27(a) is met, we believe the Board should consider whether an explanation should be added to ASC 606-10-55-58B indicating that an entity should account for a promise to provide a right to use the entity’s IP as a performance obligation satisfied
at point in time because it does not meet any of the criteria in ASC 606-10-25-27. In addition, for the same reasons stated in the previous paragraph, we believe the Board should consider adding a general statement to ASC 606-10-55-58B indicating that ASC 606-10-55-59 through 55-63A should be used in determining whether any of the criteria in ASC 606-10-25-27 are met. Finally, similar to what was done in the aforementioned examples dealing with symbolic IP, we believe the Board should consider whether an explanation should be added to the examples dealing with functional IP indicating that the consequences of concluding that a license of functional IP has been granted is that the nature of the entity’s promise in granting the license is a right to use IP (unless certain criteria are met) for which the performance obligation is satisfied at point in time because none of the criteria in ASC 606-10-25-27 are met. We believe making these additions to the examples will further illustrate and enhance the understanding of the underpinnings of the licenses implementation guidance.

- **Reconsider the screen used to determine whether a license of functional IP represents a right to access IP instead of a right to use IP.** We found the guidance in ASC 606-10-55-62, which provides a screen by which to evaluate whether the license of functional IP should be accounted for as a right to access IP instead of a right to use IP, to be somewhat confusing. For ease of discussion, ASC 606-10-55-62 is reproduced below:

  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.

  Our confusion stems from criterion 62(a) because we cannot think of a situation in which the functionality of IP would substantively change during the license period as a result of activities undertaken by the entity that do not transfer a good or service. Consider Example 10, Case C, beginning at ASC 606-10-55-140D, in which an entity grants the 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. For the reasons provided in the example, the entity concludes that the software and when-and-if-available updates are highly interrelated and highly interdependent. As a result, they are not distinct and must be accounted for together with the software as a single performance obligation. In taking this example the next step, we believe the software and when-and-if-available updates should be considered functional IP. As a result, the nature of the entity’s promise in granting the license is a right to use the IP unless both of the criteria in ASC 606-10-55-62 are met. In analyzing criterion 62(a) in this example, we would conclude it is not met because the functionality of the IP (i.e., antivirus software) is expected to substantively change during the license period as a result of activities of the entity that transfer a good (i.e., when-and-if-available updates) to the customer. While the when-and-if-available updates are not distinct, they are a promised good or service. As a result of failing criterion 62(a), the nature of the entity’s promise in granting the license is a right to use the software, which results in revenue being recognized at a point in time. Intuitively, we do not think that should be
the outcome for the single performance obligation in this example. In other words, we think revenue should be recognized over time because the customer is simultaneously receiving and consuming the benefits provided by the antivirus software and when-and-if-available updates over the license term (which is one of the criterion in ASC 606-10-25-27 used to determine whether a performance obligation is satisfied over time). Because applying criterion 62(a) results in a conclusion that is inconsistent with the guidance on determining whether a performance obligation is satisfied at a point in time or over time (ASC 606-10-25-27), we believe it needs to be changed. We have captured one potential change to the criterion below (suggested content additions are underlined and suggested content deletions are struck-through):

   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 distinct good or service to the customer (see paragraphs 606-10-25-16 through 25-189).

Applying this version of criterion 62(a) to Example 10, Case C, would result in the entity meeting the criterion because the antivirus software is expected to substantively change during the license period as a result of the when-and-if-available updates, which are not distinct. However, based on the following excerpt from paragraph BC47 of the proposed ASU, our proposed revision may not be consistent with the Board’s intention:

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).

While not explicitly stated in paragraph BC47 or the example itself, the logical extension of what is said in that paragraph is that the single performance obligation in Example 10, Case C, is satisfied at a point in time. We do not agree with this conclusion because it would result in the recognition of revenue related to a when-and-if-available update that is not a distinct good or service at a point in time (along with the revenue related to the IP), while the revenue related to a when-and-if available update that is a distinct good or service would be recognized over time.

In summary, we believe the Board needs to reconsider the screen in ASC 606-10-55-62 to determine whether a license of functional IP represents a right to access IP instead of a right to use IP. In addition, we believe the Board should revise the examples referred to in paragraph BC47 (and any other relevant examples) to illustrate the application and effects of applying ASC 606-10-55-59 through 55-62 by explaining: (a) whether the IP is functional or symbolic and (b) if the IP is functional, whether it represents a right to access IP instead of a right use IP based on applying the screen in ASC 606-10-55-62.

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?
We believe the revisions to ASC 606-10-55-57 clarify the scope and applicability of the licensing implementation guidance to single performance obligations that include a license of IP and one or more other promised goods or services. However, we believe the screen in ASC 606-10-55-62 could produce counterintuitive results when applied to single performance obligations consisting of a license of functional IP and one or more other promised goods or services (refer to our response to Question 5 for concerns about the screen in ASC 606-10-55-62). The Board’s intent with respect to how ASC 606-10-55-57 and 55-62 would affect the accounting for a single performance obligation consisting of a license of functional IP and one or more other promised goods or services was not clear to us because there were no examples that illustrated how to apply the licensing implementation guidance to those situations. While there are several examples involving such single performance obligations (e.g., Example 10, Case C; Example 11, Case B; Example 55; Example 56, Case A), they stop after concluding that a single performance obligation exists. In other words, there is no analysis provided with respect to how the nature of the entity’s promise in granting the license of IP should affect whether the single performance obligation is satisfied at a point in time or over time. Given the importance of the examples to understanding how the guidance should be applied, we believe the Board should enhance those examples to provide this analysis.

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?

We believe the revisions to ASC 606-10-55-64 are helpful in communicating the Board’s intent. However, we do not believe those revisions provide enough guidance to reach the conclusion in Example 61B, beginning at ASC 606-10-55-399K.

ASC 606-10-55-64(a) indicates that an entity has to determine whether a contractual provision is a restriction on the time, geographical region or use of the IP. The effects of the contractual provision on the scope of the license are considered in this regard. If the contractual provision represents a restriction on the time, geographical region or use of the IP, it does not affect the identification of the promises in the contract.

In Example 61B, the entity grants a license to a customer for functional IP (a movie). The terms of the license are such that the customer can use the movie for one week each year in years 1 through 3 and years 8 through 10 of the contract term. The customer cannot use the movie in years 4 through 7. The conclusion is reached in the example that the contract provision restricting the customer’s rights to only use the movie one week each year does not affect the identification of the promised goods or services in the contract. In other words, the entity does not have six promised goods or services (one for each week in each year that the customer has rights to use the movie). However, another conclusion reached in the example is that the contract provision restricting the customer’s rights to only use the movie in years 1 through 3 and years 8 through 10 does affect the identification of the promised goods or services in the contract. As such, the customer’s right to use the movie in years 1 through 3 represents one promised good or service and the customer’s right to use the movie in years 8 through 10 represents a second promised good or service.

With respect to the conclusions reached in Example 61B, we do not believe there is sufficient guidance in ASC 606-10-55-64(a) to understand why the restriction on which week the IP can be used does not affect the identification of the promised goods or services in the contract, but the restriction on which years the IP can be used does affect the identification of the promised goods or services in the contract. Based solely on the guidance in ASC 606-10-55-64(a), we believe a reasonable conclusion in Example 61B
could have been that neither the restriction on which week nor which years the IP can be used would affect the identification of the promised goods or services in the contract. However, based on the analysis in Example 61B and the discussion in paragraph BC39 of the proposed ASU, that was clearly not the Board’s intent. For purposes of reaching the conclusion that the restrictions on which years the movie can be used results in the identification of two promised goods or services in the contract, the analysis in Example 61B draws on the exclusive nature of the license in Years 1 through 3 and Years 8 through 10 and the effective revocation of the customer’s rights in Years 4 through 7, which represents a substantive period of time during which the entity can grant the same rights to a different customer. These factors are also mentioned in paragraph BC39 of the proposed ASU as reasons why a contract provision would not represent a restriction of the type in ASC 606-10-55-64(a). To make the Board’s intent clear, guidance should be added to ASC 606-10-55-64(a) to help understand when a contract provision restricting the customer’s right to use IP should affect the identification of the promised goods or services in the contract. However, we caution against relying on exclusivity as a basis for concluding that a restriction is not of the type in ASC 606-10-55-64(a) because of the potential unintended consequences of doing so.

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?

We believe the revisions to ASC 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 IP. While judgment will need to be exercised in determining whether the predominant item to which the royalty relates is the license of IP, we do not believe it will be a particularly complex judgment to make in the vast majority of cases. In addition, we believe the alternative proposed by the Board has a conceptual basis that strikes an appropriate balance between the other alternatives the Board considered, but rejected.

Other suggested changes

For the Board’s consideration, what follows is a list of other suggested changes that we believe will further improve or clarify the Board’s proposals. To the extent specific guidance from the proposed ASU is included in the list, the changes proposed by the Board to that guidance have been “accepted” for purposes of our discussion. Any incremental suggested changes we have to that guidance are shown by underlining suggested content additions and striking through suggested content deletions.

- **ASC 606-10-25-21.** We believe the following guidance from paragraph BC30 of the proposed ASU should be brought into ASC 606-10-25-21 because it provides incremental guidance helpful to understanding how to apply the guidance on “distinct within the context of 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)."

- **ASC 606-10-55-58B.** We believe the following edits should be made to this paragraph to make it consistent with ASC 606-10-55-58:

  "An entity’s promise 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 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."
• **ASC 606-10-55-60.** We believe the concepts in the following sentence from paragraph BC40 of the proposed ASU should be incorporated in ASC 606-10-55-60 because they provide additional insight into how support or maintenance of symbolic IP should be considered when applying the licenses implementation guidance:

> 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).

• **ASC 606-10-55-62.** Contingent on what other changes are made to this paragraph as a result of our responses to Questions 5 and 6, we believe the following edits should be made to this paragraph to better articulate the concept:

  b. The customer is contractually or practically required or otherwise compelled to use the updated intellectual property resulting from criterion (a).

• **ASC 606-10-55-64.** We believe the following edits should be made to this paragraph because the focus in that paragraph is on whether certain factors should affect the identification of promises in the contract:

  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 promised good or service because it solely provides assurance to the customer that the license transferred meets the specifications of the license promised in the contract.

• **Example 10, Case B (ASC 606-10-55-140A through 55-140C).** This examples addresses the accounting for a customer contract in which the entity promises to provide the customer with multiple units of a highly complex, specialized device. In analyzing whether the promised goods or services in the customer contract are capable of being distinct in accordance with ASC 606-10-25-19(a), the analysis focuses on whether each device is capable of being distinct. Conversely, in analyzing whether the promised goods or services are distinct within the context of the contract in accordance with ASC 606-10-25-19(b), the analysis focuses on whether the various promises inherent to transferring the devices to the customer are distinct within the context of the contract. We believe the analyses under ASC 606-10-25-19(a) and 25-19(b) should start from a consistent point. In addition, we believe the conclusion in this example should be clarified to indicate whether: (a) all of the devices represent a single performance obligation or (b) each device represents a performance obligation. It would also be helpful to explain whether the performance obligation(s) are satisfied at a point in time or over time.

• **Example 11, Case A (ASC 606-10-55-141 through 55-145).** The facts in ASC 606-10-55-141 refer to the software in this example remaining functional without the updates and the technical support that are also included in the customer contract. The analysis in ASC 606-10-55-142 relies on this fact in reaching a conclusion that the software is capable of being distinct. We believe the degree of functionality the software has without the updates and technical support should be emphasized in the facts and analysis to differentiate the conclusion reached in this example from the conclusion reached in Example 10, Case C. In other words, both the software in Example 11, Case A, and Example 10, Case C, have some functionality without the updates. However, in Example 10, Case C, it is specifically noted that the software provides little benefit to the customer without the updates, which results in a conclusion that the software and updates are not
distinct. To bolster the analysis in Example 11, Case A, and further support the conclusion that the software is capable of being distinct, we believe the facts and analysis should clearly state that the software has significant functionality without the updates and technical support.

The analysis in ASC 606-10-55-142 only evaluates whether the software is capable of being distinct and does not evaluate whether the installation service, software updates or technical support are capable of being distinct. We believe the analysis needs to be revised to address whether each of the promised goods or services in the customer contract are capable of being distinct.

The analysis in ASC 606-10-55-143 evaluates whether the software, installation service and software updates are distinct within the context of the contract. However, there is no analysis as to whether the technical support is distinct within the context of the contract. We believe the analysis needs to be revised to address whether the technical support is distinct within the context of the contract.

- **Example 11, Case B (ASC 606-10-55-146 through 55-150).** For purposes of concluding that the software updates and technical support in this example are distinct from the other promises in the contract, ASC 606-10-55-148 refers to the analysis in Example 11, Case A. As mentioned in the previous bullet point, we believe the analysis in Example 11, Case A, should be revised to include an analysis of whether each promised good or service in the customer contract is distinct. For purposes of relying on the analysis in Example 11, Case A, when reaching a conclusion in Example 11, Case B, about whether the promised goods or services are distinct, consideration should be given to how the significant customization of the software provided in Example 11, Case B, would affect the analysis. In other words, consideration should be given to whether more should be said in Example 11, Case B, about how the entity concludes that each promised good or service is distinct rather than merely referring to the analysis in Example 11, Case A.

- **Example 11, Case C (ASC 606-10-55-150A through 55-150C).** Given the frequency with which customer contracts involving equipment and installation arise in practice, we appreciate the Board adding this example to the implementation guidance. In the example, the equipment and installation are considered distinct. We believe it would be helpful for the Board to add another example in which equipment and installation are not considered distinct because they are considered highly interdependent and highly interrelated.

- **Example 12, Case A (ASC 606-10-55-152 through 55-153).** In this example, the customer contract includes a product and maintenance services related to the product. In analyzing whether the product and maintenance services are distinct within the context of the contract, a statement is made in ASC 606-10-55-153 that neither the product nor the services modify the other. We believe that statement needs to be qualified given the inherent nature of maintenance services. We believe an appropriate qualification would be to indicate that the maintenance services do not significantly modify the product.

- **Example 12, Case C (ASC 606-10-55-156 through 55-157A).** We believe an explanation is needed as to why the entity’s subsequent promise to provide maintenance services to any party that purchases the product from the distributor does not represent a contract modification.

- **Example 44 (ASC 606-10-55-309 through 55-315).** One of the promised goods or services in the customer contract in this example is training services. Language was added to ASC 606-10-55-309 to indicate that the training services are material in the context of the contract. It is unclear why adding this language was necessary. In addition, adding the language in this example raises the question as to whether similar language should be added to other examples. We believe the
language added to ASC 606-10-55-309 indicating that the training services are material in the context of the contract should be removed. If the language is not removed, we believe additional explanation is warranted regarding how the entity arrived at the conclusion that the training services were material in the context of the contract.

If the Board’s intent in adding material in the context of the contract language to this example was to illustrate how the immaterial in the context of the contract guidance covered by Question 2 should be applied, we believe such an illustration would best be provided in a separate example where the conclusion is that a promised good or service is immaterial in the context of the contract.

- Example 56 (ASC 606-10-55-367 through 374). The facts in ASC 606-10-55-367 were revised to indicate that there is no expectation that the entity will undertake activities to change the drug that has been licensed to the customer. In addition, the analysis in ASC 606-10-55-373 makes reference to that fact. We do not understand why this revision to the facts was necessary. We believe that whether the entity will undertake activities to change the drug that has been licensed to the customer is only relevant if the customer has rights to those changes. If the customer has rights to those changes, then they should be included in the facts and analyzed as any other promised good or service in the customer contract would be analyzed. We do not believe there is a need to discuss whether the entity expects to make changes to the drug if the customer does not have rights to those changes. In addition, we do not believe it is necessary to specify in the facts (or rely on in the analysis) that the drug is a mature product. Whether the drug is new or mature should not affect the analysis as to whether the nature of the license represents a right to use IP or a right to access IP.

- Example 57 (ASC 606-10-55-375 through 55-382). We believe the following edits should be made to ASC 606-10-55-379 to clarify the concepts involved in allocating the transaction price to performance obligations:

  In addition, the entity observes concludes 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, is appropriate because 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.

  The analysis in ASC 606-10-55-382 indicates that the entity recognizes revenue from the sales-based royalty in this example as and when the sales occur on the basis of the guidance in ASC 606-10-55-18. We believe an explanation should be provided regarding why ASC 606-10-55-18 is relevant to this example as it is currently not clear. In addition, consideration should be given to also (or only) referring to ASC 606-10-55-65 in this context given that it addresses when sales-based royalties should be recognized. We have the same comments related to the reference to ASC 606-10-55-18 in ASC 606-10-55-399.

- Example 58 (ASC 606-10-55-383 through 55-388). In this example, the entity licenses the use of the images and names of comic strip characters in three of its comic strips. In ASC 606-10-55-383, reference is made to newly created characters regularly appearing in and disappearing from the comic strip and to the images of the characters evolving over time. However, there is no indication as to whether the customer has rights to the newly created characters or revised images of the characters as they change over time. We believe the facts should be clarified to
indicate whether the customer has these rights and, if so, we believe the example should be modified to address the existence of the when-and-if-available updates.

In ASC 606-10-55-385, reference is made to the additional activities associated with the license not directly transferring a good or service to the customer. However, there is no mention of what those additional activities might be until ASC 606-10-55-386 refers to ongoing activities such as producing the weekly comic strip. We believe the facts should be clarified regarding the nature of any ongoing activities related to the comic strip that will affect the IP to which the customer has rights.

In ASC 606-10-55-388, reference is made to recognizing the fixed consideration allocable to the license. Because the only performance obligation in the customer contract is the license, we believe reference should be made to the customer contract’s transaction price instead of the fixed consideration allocable to the license performance obligation.

- **Example 61A, Case B (ASC 606-10-55-399A and 55-399F through 55-399J).** We believe the following edits should be made to ASC 606-10-55-399F to maintain consistency with the language used throughout the related guidance:

  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 promised right’s standalone selling price.

  We believe the following edits should be made to ASC 606-10-55-399J to be consistent with the guidance in ASC 606-10-55-58C:

  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 license of intellectual property is provided to the customer and 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 (ASC 606-10-55-399K through 55-399O).** In addition to any changes made in connection with Question 7, we believe the following edits should be made to ASC 606-10-55-399O to be consistent with the guidance in ASC 606-10-55-58C:

  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 license of intellectual property is provided to the customer and 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).

We appreciate this opportunity to provide feedback on the proposed ASU and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Rick Day at 563.888.4017 or Brian H. Marshall at 203.312.9329.

Sincerely,

McGladrey LLP