June 30, 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:

Connor Group, Inc. is pleased to provide our comments on the Proposed Accounting Standards Update, Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing. Connor Group was founded in 2005 and is a technical accounting advisory firm built of Big 4 alumni and industry executives. We currently have over 400 clients and specialize in helping our clients solve complex technical accounting issues under both US GAAP and IFRS, with revenue recognition being a heavy focus area. Our clients represent industries such as technology, software, Internet, cloud services, life sciences and manufacturing, amongst others. In addition, we assist many of our clients with aspects of their accounting and financial reporting during their IPO filing process.

We have included below our responses to each of the “Questions for Respondents” posed in the Exposure Draft.

Comments on 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?

**Response 1:** We believe it would be helpful to clarify the guidance on series of distinct goods or services, including in particular how entities should determine the duration of distinct services comprising a series. For example, for an entity that sells cloud-based (software as a service, or SaaS) services, an individual service that is combined into a series could be deemed to be the service delivered over (i) a month, (ii) a
week, (iii) a day, (iv) upon each customer click or another activity, or (v) at every instant. Depending on that
duration, different judgments could result regarding whether the performance obligations are satisfied
over time v. at a point in time and whether the services can be aggregated into a series. Also, differences in
revenue recognition pattern could result. There is a related question that could be clarified in this context,
specifically, whether customer activity generating a per-activity fee should be deemed an optional pay-per-
use customer transaction (consistent with the approach in Example 50 in ASU 2009-14), or a contingent fee
embedded into the single performance obligation. Until practice develops, Topic 606 provisions regarding
series of distinct goods or services are subject to diverse interpretations that already effectively make them
somewhat optional for use.

To illustrate our thoughts in the context of the cloud services example, we consider four hypothetical
entities. Entity A might judge that cloud services, including per-transaction billings, represent a series of
daily individual services rendered, because it has concluded that such services meet the criteria for being
recognized over time under 606-10-25-27(a) and therefore are eligible for treatment as a series. Entity B
followed the same approach, but did not aggregate daily services into a series. Entity C concluded that per-
activity billings, while part of the overall cloud service, are a variable pricing element of annual cloud
service performance obligation. Finally, entity D followed the approach in Example 50 and conclude per-
activity billings are per-transaction consideration for optional services. These entities might reach the
following judgments regarding their revenue practices under Topic 606:

<table>
<thead>
<tr>
<th>Entity</th>
<th>Per-activity billings are...</th>
<th>Revenue is recognized...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entity A</td>
<td>Variable consideration for daily services that form a series</td>
<td>As earned</td>
</tr>
<tr>
<td>Entity B</td>
<td>Variable consideration for daily services that does not form a series</td>
<td>Estimated at inception of the arrangement and allocated among multiple performance obligations (each obligation being one day of service) following the pattern of delivery and subject to variable consideration constraint</td>
</tr>
<tr>
<td>Entity C</td>
<td>Variable consideration for annual service performance obligation</td>
<td>Follows pattern of delivery of cloud services, subject to variable consideration constraint</td>
</tr>
<tr>
<td>Entity D</td>
<td>Per-transaction consideration for optional services</td>
<td>As earned</td>
</tr>
</tbody>
</table>

The above diversity in revenue recognition illustrates that, in our opinion, providing additional examples
and guidance would be helpful. Also, we note that the concept of “series” and its implications are complex
and are not currently well understood in the accounting community, resulting in reduced benefits from its
presently required application. Thus, making this approach optional is likely to be the preferred option
selected by many companies. Overall, while making the series guidance optional may potentially result in
increasing diversity in practice, we support this approach as it could potentially decrease costs of
implementing Topic 606 for certain companies, especially in cloud and professional service industries.
**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.

**Response 2:** We strongly support the proposal to allow entities the ability to judge that goods and services are immaterial in the context of the contract in determining their performance obligations. We believe that in the absence of this accommodation, the implementation of the new guidance would likely significantly increase costs of complying with the new guidance due to the burden of evaluating immaterial performance obligations, without a corresponding improvement in the quality of information reported to the financial statement users.

**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.

**Response 3:** While we support the proposal of an accounting policy election whereby the shipping and handling activities (collectively referred to as “shipping activities”) are performed after the customer has obtained control of the good, we believe an additional accommodation would be necessary to accomplish the desired objective. In particular, it would be helpful if the amounts reimbursable by customers for shipping activities rendered by third parties could be attributed directly to such activities, provided those are elected or required to not be treated as performance obligations. Without this additional accommodation, even with 606-10-25-18A, such amounts are required to be estimated for the duration of the customer contract at its inception, included in the transaction price and allocated to various other performance obligations. In our mind, this process does not enhance the quality of information reported in the financial statements, which is what we understand has triggered the issue to be brought to the Board’s attention.

**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?

**Response 4:** We believe the clarifications provided in 606-10-25-21, the associated examples and especially background guidance in BC 24 through BC32 are useful in clarifying the Board’s intent with respect to identifying performance obligations, but that additional clarifications would be helpful. For instance, the language about “a combined item (or items) that is greater than (or substantively different from) the sum of those promised (component) goods and services” included in BC27 could be placed directly in 606-10-25-21(a) and serve as a helpful enhancement of the concept. We also encourage the Board to retain the concept of separable risks currently included in BC103 of ASU 2014-09, as we have also found this concept useful in judging about whether performance obligations are separately identifiable. Specifically, we view
the risks as separable when the entity could succeed in performing one of the performance obligations while failing to perform the other. In our mind, this could be added to the guidance in 606-10-25-21 as yet another factor indicating whether performance obligations are separately identifiable. Last, we also found the example ("the fact that the customer could decide to not purchase...") that has been proposed to be deleted from 606-10-25-21(c) helpful when making judgments, and would encourage to retain it as well.

Additionally, we found some of the new examples included in the current exposure draft to be confusing. For instance, in Example 10 Case B an entity is required to deliver multiple units of a specialized device to the customer, for which it procures materials, manages subcontractors, and performs manufacturing and assembly. The conclusion is that individual units are not separately identifiable. However, the activities described can be used to characterize standard manufacturing processes of many entities; they represent a list of internal activities that comprise the manufacturing process. While we agree that these individual activities, even if described in the contract, should not be identified as separate performance obligations, from the context of the example it is not clear to us why individual units produced using those activities are not separable. For instance, the example does not appear to state that the individual units (as opposed to internal activities) are integrated to create a single output for the customer, or otherwise how each of the individual units is significantly affected by the other individual units.

In Example 10 Case C an entity concludes that a three year term license cannot be separated from if-and-when available updates over the license term because “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”. This example implies that if the entity entered instead into a one-year term license bundled with the same updates, it might reach a different accounting conclusion, as, for example, updates over a one year period may not have as much of an impact on software utility. It also implies that (i) the entities should evaluate their customers’ return on investment and make judgments regarding what combinations of performance obligations might meet the “ability to benefit” test spelled in the example, and (ii) the entities could achieve the desired outcome as to separability of performance obligations (e.g., to recognize revenue over time instead of up front) by, for example, “throwing in” two additional years of software updates into the contract to create the “limited benefit” situation. We believe it would be very difficult if at all possible, for an entity to guess its customers’ purchase motivations, return on investment estimates and bundling decisions, and those considerations could lead to significant diversity in practice and accounting judgments often based on uneducated guesses. For example, the customer in Case C in reality might only be buying a three-year update service because the entity has temporarily offered a bundle discount on the item; whereas the entity’s normal practice might be to sell three-year term licenses with one-year at a time of update service only. Please note that conceptually we agree with the outcome judgment of Example 10 Case C; however, we believe its argumentation is confusing.

In Example 11 Case E, an entity concludes that equipment and consumables are separately identifiable. Part of the fact pattern is that customers can purchase consumables from third parties, who are the entity’s resellers. It is not clear how much of an impact the existence of other resellers has on the conclusion, and many companies who sell using this business model may not have reseller networks where consumables could be purchased from. In our mind, equipment and consumables should generally be separated
regardless of whether other vendors of consumables exist. This is because customers are generally expected to purchase consumables throughout the lifecycle over which they use the equipment; however this lifecycle could be highly variable and is a reflection of their individual circumstances, return on investment assessments, frequency of use of equipment, and the like factors. We believe these highly individual factors should not impact how companies recognize revenues. Recognition of revenue for equipment separately from consumables is usually justified, as customers knowingly take on the risk that the consumables may cease being available in the future. Further, customers could also often resell the unit of equipment into a secondary market to recover the investment.

Lastly, we believe the standard would benefit from additional examples illustrating when goods and services could be deemed highly interdependent or highly interrelated, and, in this context, how to interpret the notion of “utility” (that is, each good or service’s ability to provide benefit or value) as stated in BC31. Specifically, we note that “utility” could be assessed from the perspective of a specific customer or a hypothetical member of a particular customer class. Also, we note that assessing whether the impact of certain goods or services on other goods or services is significant enough to conclude they are highly interrelated can be subject to diverse interpretations in the absence of additional guidance and/or examples.

**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?

**Response 5:** We support the Board’s effort to clarify the license guidance and the overall direction; however, we find some of the argumentation and details are counter-intuitive. For example, brands in the Topic 606 context are an example of a symbolic license that is recognized over time, as the value is associated with the entity’s past or ongoing activities, and the license includes both grant of the right and a promise to support or maintain the intellectual property. However, it is not clear why the entity’s past activities that created the intellectual property should result in recognition of revenue over a future period. Also, the level of effort to support and maintain the brand could be relatively insignificant compared to the effort of initially creating the brand and brand awareness. Similarly, the decrease in the brand value over the term of the licensing arrangement could be relatively insignificant even if no maintenance activities are undertaken. In this regard, when symbolic (e.g., brand) license is compared with a functional (e.g. movie) license, some of the same fact patterns could be observed. In particular, the entity that sells movie licenses may perform marketing and other promotional activities to support the movie’s awareness in the market, distribution efforts and future DVD, game and other follow-on activities. Just like this would be the case for symbolic licenses, such activities may not represent transfer of goods and services specifically to the customer. Also, from the customer perspective, the pattern in which the value is derived from the two licenses could be very similar. Thus, the differences in revenue recognition between a symbolic license and
a functional license may not be based on sufficiently different underlying fact patterns if the consideration is given to the factors and rationale in the current exposure draft.

Notwithstanding, we do feel the differences in revenue treatment between these two types of licenses are appropriate, however they are based on the concept of retention or transfer of control. A customer who has purchased a symbolic license generally does not have control over the form of the intellectual property they have licensed and are using (benefiting from), as such form generally could undergo changes (e.g. in design) as dictated by the licensing entity and without the customer ability to accept or reject those changes. One could say that the activities that are or could be undertaken by the licensing entity are a form of control that can directly affect the form of the intellectual property licensed and used (benefited from) by every customer at any time, and consequently, that control effectively transfers to customers over time as they consume benefits. On the other hand, a customer who has purchased a functional license, e.g. software, generally has control over the form and functionality of the software it is using, in that it can choose to install or waive software updates, order to add additional custom features and functionality, integrate with its applications, etc. The concept of control and how it transfers to the customer is core to Topic 606 and underpins the principles of how revenue is recognized for all other types of goods and services. In this regard, the original language in 606-10-55-59 (currently proposed for deletion) expressed what we saw as the underlying principle applicable to license arrangements that was consistent with the overall Topic 606 concept of control transfer. We believe using the principle of control, instead of the principle of embedded obligations, could be a more conceptual, and also a more consistent and practical method of rationalizing why symbolic licenses are recognized over time, while most (but not all) functional licenses are recognized at a point in time.

In this regard, we would also like to comment on the new criteria to determine the nature of functional licenses in 606-10-55-62. We suggest that criterion (b) alone should suffice to qualify the license as access to intellectual property over time, provided the entity has the ability to substantively change the functionality of the intellectual property to which the customer has rights. This would imply the customer does not have control over the intellectual property, and effectively, obtains control over time as the benefits of the license are received and consumed. It should not matter whether significant changes to functionality are expected (criterion (a)), just like this does not matter for symbolic licenses (where often no changes to the form are expected), and whether such changes are introduced through transfer of goods or services or otherwise. For example, if a software company requires its customers to implement all recent updates and can enforce this requirement, the customer does not have control over what exact intellectual property it is using, which should be indicative of control transfer over time, even if such updates are delivered via a separate service.

We also note the provisions of 606-10-55-58C(b) that revenue cannot be recognized from a license of intellectual property until the beginning of the period in which the customer is able to use and benefit from the right to access or use the intellectual property. In this regard, we believe the customer ability to use and benefit could be subject to diverse interpretations. For example, if the entity licenses a theatrical show to a customer, with provisions that the customer may put the show on public stage beginning on July 1, 201X, but may start stage preparation, actor casting, rehearsals, private shows, and other preparatory activities on January 1, 201X, one could argue the use and benefit starts on either of the dates noted.
Finally, we also find the term “symbolic” potentially confusing. 606-10-55-56 provides examples of licenses that are not distinct from other goods or services, such as licenses embedded in tangible goods or various services. These licenses have historically been thought of as having no standalone value and something that does not amount to a separate deliverable. The word “symbolic” by its meaning could also be associated with these licenses; however, in the terminology of 606-10-55-59, such licenses would be deemed “functional”. “Symbol-based” or “symbol-related” licenses instead of “symbolic” may be a more transparent descriptor.

As a side note, we would also like to comment on Example 56 Case A. In this example, an entity concludes that because it is the only manufacturer of a drug product, the license is not distinct from the manufacturing activity. However, this conclusion may not be consistent with the definition of “capable of being distinct” in 606-10-25-19(a) and 20. This is because the customer is able to benefit from the license in conjunction with other readily available resources. The readily available resources include goods or services that are sold separately by the entity or another entity. In the example, the customer presumably has the ability to make follow-on purchases of products from the entity, which would represent separate purchase transactions and thus satisfy the requirement. Note that under the current industry practice under Topic 605, which does not allow to use the concept of “readily available resources sold separately by the entity” as part of the argumentation, a similar conclusion (i.e., that the license has standalone value) is usually reached if, for example, the customer has ability to purchase product directly from the contract manufacturing entity typically retained by the vendor in the event the vendor itself cannot deliver the product (e.g. due to bankruptcy). With this in mind, we are somewhat concerned that this example could lead to significant changes in current revenue practices for the affected entities, or could lead such entities to engage in creating costly and otherwise unnecessary secondary sales channels through resellers to sustain their current revenue recognition model.

**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?

**Response 6:** We agree that the proposed revisions help clarify the Board’s intent regarding the scope and applicability of the licensing implementation guidance. However, as we understand the revisions, in the context of superseding BC407 in ASU 2014-09 as discussed in BCS4 in this exposure draft, licenses that are predominant components of a single performance obligation would also be accounted for in accordance with the provisions of 606-10-55-57, i.e. under the general guidance of 606-10-25-23 through 25-37 and not as license performance obligations. However, in our mind, performance obligations where a license is the predominant component should be accounted for as licenses, as this would reflect the substance of such arrangements, and also prevent undesirable situations where insignificant non-substantive deliverables are “thrown in” and change accounting for what is the predominant deliverable in the contract. Therefore, we support adding a specific provision to treat performance obligations that include predominant licenses based on the license guidance, not based on 606-10-25-23 through 25-37. This would also mean consistent treatment with the new provision in 606-10-55-65B that deals with accounting for
royalties, where the royalty accounting applies if the license is either the sole or the predominant item to which the royalty relates.

**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 alternative do you suggest and why?

**Response 7:** We support the intent of the Board to clarify the meaning of restrictions that do not impact accounting for licenses or identification of promises in the contract. However, the primary criterion of “defining the scope” of the customer’s right to use or access intellectual property appears to be vague and difficult to apply in practice. Likewise, Examples 61A and 61B, while they help illustrate the Board’s intent, in our mind do not convey in sufficient detail the underlying concepts of what restrictions might constitute scope definitions v. other factors. For example, it is not clear what principles underlie the judgment in Example 61B as to why the 3-year span after the initial license period is long enough to determine that the additional 3-year license period is a separate license obligation. Accordingly, the rationale in this example could be difficult to apply in other circumstances. It is also not clear why in Example 61A Case B the 5th season license is not combined with the license for the initial 4 seasons into a single license performance obligation just like the licenses for the initial 4 seasons are deemed a single obligation. We understand this is not a function of how the contract is written (i.e. the fact that the contract spells out the existence of two separate licenses instead of one covering all 5 seasons, or instead of five licenses covering one season each), as that would open room for companies to achieve any pattern of revenue recognition they desire by simply splitting the license in the contract into multiple separate licenses. For example, the contract could be written to contain a separate license, with its own effective date, for each episode of each of the 5 seasons of the show to be available to air starting on a predetermined date, arguably resulting in a very different pattern of revenue recognition.

In our mind, additional examples and a conceptual rationale for making judgments about what constitutes “defining the scope” would be helpful. For instance, we would welcome an example that addresses accounting for multiple consecutive-term time-based software licenses for the same product, with the related fees payable on the first day of each license.

In addition, the language proposed to be deleted from 606-10-55-64 regarding protecting “the value of the entity’s intellectual property assets” is actually helpful in making judgments as to whether certain other contractual provisions may not represent performance obligations, if the primary objective of these provisions is protective, e.g., of the value of the entity’s intellectual property assets. Examples of other provisions protecting vendors or customers might include items such as maintaining software code in escrow for customers’ benefit; software “sunset” clauses; patent maintenance which serves to sustain vendor rights in existing intellectual property, and the like. Removal of this language may affect the basis...
for analogizing these provisions to guarantees of validity, and may result in impractical unintended consequences for various entities whereby additional performance obligations may potentially be identified.

**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?

**Response 8:** We support the Board’s approach towards royalty guidance, including applying the guidance to both sole-obligation and predominant-obligation license royalties, and treating the entire related royalty amount in the same manner.

We would be pleased to respond to any questions the FASB or its staff may have concerning our comments. Please direct any questions to Aleks Zabreyko (650-353-7044, aleks.zabreyko@connorgp.com) or Denis Kozhevnikov (650-521-3099, denis.kozhevnikov@connorgp.com), partners in our Accounting Standards and Professional Practice group.

Sincerely,

*Connor Group, Inc.*