IFRS | FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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Project	**FASB/IASB Joint Transition Resource Group for Revenue Recognition**
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The following implementation questions and potential interpretations were submitted to the TRG by a stakeholder.

Question 1: Should the factor in paragraph 606-10-32-17(c) (IFRS 15 paragraph 62(c)) be applied broadly (consistent with example 30 of Topic 606)?

1. Paragraph 606-10-32-17(c) (IFRS 15 paragraph 62(c)) notes that a significant financing component does not exist if the difference between the consideration and cash selling price arises for reasons "other than financing." Should the factor in paragraph 606-10-32-17(c) (IFRS 15 paragraph 62(c)) be applied broadly (consistent with example 30 of Topic 606)? That is, quite often the reason for payment terms differing from the timing of recognition of revenue is for reasons other than financing, especially in arrangements with upfront fees (e.g., perceived value by customer versus timing required by the standard, or when contingent revenue exists in an arrangement).

    (a) View A – Paragraph 606-10-32-17(c) (IFRS 15 paragraph 62(c)) should not be applied broadly. If the timing of payment differs from the timing of recognizing revenue (and the amount of interest would be significant if the difference were an actual loan or receivable) a significant financing component likely exists (that is, a presumption of such that can be overcome for a truly valid reason).

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(b) View B – Paragraph 606-10-32-17(c) (IFRS 15 paragraph 62(c)) was intended to be applied broadly (especially in arrangements that include upfront payments). Entities should determine if the payments terms were intended (or implied) to be used as financing component (i.e., it was considered in determining the amount of consideration) and if so determine if the financing component is significant. If not, entities would generally look to the intent of the payment terms (i.e., retainer fees, avoiding periodic billings, customer convenience, normal business practice, perceived value by customer, etc.) as other than financing.

2. Examples:
   - Upfront membership fees (upfront payment for a gym membership with annual renewals that represent material rights).
   - Upfront payments for licenses recognized overtime (10 year license for use of a sports franchise logo for a $10 million upfront payment).
   - Annual payments for a license recognized at a point in time (10 year software license with annual payments of $1 million per year).
   - Retainer fees (30% upfront payment in a long-term service arrangement)
   - Allowing a customer to pay for an upfront good or service as ongoing related services are provided ("free" handset provided with 2 years of wireless phone service, upfront customer owned tooling provided in a long-term supply agreement where payment for the tooling is included in the piece price).
3. Key tension point seems to be that oftentimes companies may cite business reasons or industry practice as a basis for either "up front" or "extended" payment terms. If the guidance in paragraph 606-10-32-17(c) (IFRS 15 paragraph 62(c)) were applied broadly as described in View B it would seem that many companies could concluded a significant financing component does not exist. It would also seem that the use of a broad application would lead to diversity in practice such that 2 companies in the same industry with the same product and arrangement term would account for the transaction differently as a result of describing a different business purpose for the payment terms.

4. NOTE: The question as stated above is not related to whether a financing component is “significant” or not. The question is whether a financing component exists. The significance or lack thereof can be evaluated by applying judgment in the particular facts and circumstances.

Question 2: If the implied interest rate in an arrangement is zero (i.e., interest free financing) such that the consideration to be received is equal to the cash selling price, does a financing component exist?

5. The standard states that the objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognize revenue at an “amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (that is, the cash selling price).” If the implied interest rate in an arrangements is zero (i.e., interest free financing) such that the consideration to be received is equal to the cash selling price, does a financing component exist? (Note: Whether or not it is significant is a separate judgment that is not intended to be answered by this question).
   (a) View A - There is no significant financing component because there isn't any difference between the amount of promised consideration and the cash selling price (paragraph 606-10-32-16(a)) (IFRS 15 paragraph 61(a)).
   (b) View B - The customer is receiving the benefit of being able to pay for the product/service over time and therefore, the arrangement contains a financing component.
6. Examples
   - A cell phone device/service provider sells new phones as well as monthly voice/data service. Customers who purchase a phone are not contractually obligated to use the same company for the service. Customers have the option of paying $600 upfront for a new phone, or $25 per month for 24 months; in both instances, the total cash selling price of the phone is $600. The monthly service price is the same regardless of whether the customer elects to pay for the phone over time or upfront. The customer has control of the phone on the date of the sale. If a customer elects to pay for the phone over 24 months, does the contract contain a significant financing component?

- A customer can purchase a piece of equipment for $1200 and then will be eligible to purchase service for the equipment for $100 each month under a month-to-month service contract. Instead, the customer could choose to pay $0 for the equipment on day one and have the option to sign a note to pay the $1200 over a 24 month period without interest and still pay $100 each month for service.

7. This may be common in a number of industries and considered “industry practice or common commercial terms in the industry”. If a customer chooses to pay the “cash selling price” over a period of 2 years (in this example) does a financing component exist (view B) or not (view A)?
8. Note – In these examples, since cash is fungible can an entity look to apply the 1 year practical expedient on the entire contract even though payments are specifically tied to a specific good or service (i.e., look at timing of cash for all goods or services on a rolling 12 month period such that the $1200 in the second example is collected in the first 6 months)?[1]

Question 3: How should an entity adjust for the time value of money in situations in which the consideration is received upfront and revenue is recognized over multiple years?

9. Example – Upfront payments for licenses recognized overtime (10 year license for use of a sports franchise logo for a $10 million upfront payment). Entity concludes that straight line recognition of the right is the appropriate measure of progress. The difference between timing of payment and recognition of the revenue is deemed a significant financing. The entities incremental borrowing rate is 5% and the entity would have required the customer to pay more than $1 million per year if allowed to pay annually. How should the entity adjust for the time value of money in this example and then how should revenue be recognized?
   (a) View A – Use an effective interest rate amortization method using the 5% incremental borrowing rate and allocating the “principal” such that the entity recognizes the total transaction on a straight line basis (since the measure of progress is deemed to be on a straight line basis). This would seemingly require a method to calculate the compounding interest each period (based on

[1] This issue could also arise if the payment streams are not specifically tied to a good or service.

the original principal and any additions for interest or reduction for the recognition of revenue) and also (at the same time) a method to ensure the deferred revenue balance (original $10 million plus interest each period) is recognized into revenue on a straight line basis. Such a calculation may be complex given the principal amount (the reduction to the deferred revenue balance) has to be same each period (to ensure the measure of progress remains on a straight line basis) while also ensuring the interest amount is appropriately calculated based on the remaining principal (deferred revenue) amount. If the Boards believe this method is appropriate, an example illustrating the debits and credits for this method would be helpful. A

(b) View B – Use the 5% incremental borrowing rate assuming the principal balance is decreased on a straight line basis over the 10 years and includes all of the interest expense as additional revenue each year (revenue of $1,500,000 in year 1, $1,450,000 in year 2, $1, 400,000 year 3, etc.). Deferred revenue balance would decrease $1,000,000 each year over the 10 years [This view obviously does not accomplish straight line measure of progress].

(c) View C - Use the 5% incremental borrowing rate, calculate the total interest expense assuming the principal balance is decreased on a straight line basis over the 10 years, and then straight line the total amount over the 10 years (revenue of $1,275,000 each year). Deferred revenue balance would be adjusted each year based on additions for interest expense (assumed additional cash received) and the straight line amortization.

10. Note – The example above only includes one performance obligations, how should the significant financing guidance be applied when there are multiple performance obligations? That is, does an adjustment for a significant financing component have to be applied using the allocation guidance in the ASU (as if it is a discount or premium) or can it be applied to the specific performance obligation for which it is deemed to relate (understanding that cash is fungible)?