# STAFF PAPER

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| **Project** | **FASB/IASB Joint Transition Resource Group for Revenue Recognition** |
| Paper topic | Noncash consideration |


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## Purpose

1. Some stakeholders informed the staff that there are different interpretations of the guidance in Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, and IFRS 15 *Revenue from Contracts with Customers* (collectively referred to as the "new revenue standard"), for determining the measurement date for promised consideration in a form other than cash ("noncash consideration"). Examples of noncash consideration include equity (for example, shares or share options) and advertising. Some stakeholders also informed the staff that there are multiple interpretations of how the guidance in the new revenue standard regarding the inclusion of variable consideration in the transaction price is applied when the fair value of noncash consideration varies due to both the form of the consideration (for example, a change in the price of a share to which an entity is entitled to receive from a customer) and for reasons other than the form of consideration (for example, a change in the exercise price of a share option because of the entity's performance). This paper summarizes the potential implementation issues that were reported to the staff. The staff will seek input from members of the FASB-IASB Joint Transition Resource Group for Revenue Recognition on these potential implementation issues.

## Accounting Guidance

2. The core principle of the new revenue standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

3. The new revenue standard includes five steps that are applied to achieve its core principle. Step 3 requires an entity to determine the transaction price of a contract. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price can be a fixed amount of customer consideration, but it may sometimes include variable consideration or consideration in a form other than cash.

4. If the consideration is variable, an entity must estimate the amount of consideration to which it will be entitled in exchange for the promised goods or services. The estimated amount of variable consideration is included in the transaction price only to the extent that it is probable [highly probable] [1] that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved ("the constraint").

5. Paragraph 606-10-32-21 [66] states that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the noncash consideration (or promise of noncash consideration) at fair value. Paragraph 606-10-32-22 [67] clarifies that if an entity cannot reasonably estimate the fair value of the noncash consideration, the entity shall measure the consideration indirectly by reference to the standalone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration.

6. Paragraph 606-10-32-23 [68] addresses application of the constraint when the fair value of noncash consideration varies. It states that if the fair value of noncash consideration promised by a customer varies for reasons *other than only the form of the consideration,* an entity shall apply the constraint. If the fair value of the

[1] IFRS 15 references are included in "[XX]" throughout this paper.

noncash consideration varies because of the form of the consideration, the constraint would not apply.

7. Paragraph BC252 explains that the Boards decided that it would be most appropriate to apply the constraint to the same types of variability, regardless of whether the amount that will be received from a customer will be in the form of cash or noncash consideration. Consequently, the Boards decided to constrain variability in the estimate of the fair value of noncash consideration if that variability relates to changes in the fair value for reasons other than the form of consideration.

8. Paragraph 606-10-32-24 [69] states that when a customer contributes goods or services (for example, materials, equipment, or labor) to facilitate an entity's fulfillment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as noncash consideration.

9. Paragraph BC253 states that, once recognized, any asset arising from noncash consideration is measured and accounted for in accordance with other relevant guidance (for example, Topic 320, Investments—Debt and Equity Securities or IFRS 9).

10. Paragraph BC254 explains that the noncash consideration guidance in the new revenue standard results in the removal of previous generally accepted accounting principles (GAAP) on the accounting for share-based payments received by an entity in exchange for goods and services. That previous GAAP provided guidance for the measurement and recognition of revenue when the consideration was in the form of shares or share options. The new revenue standard also results in the removal of previous GAAP on the accounting for barter advertising.

11. Paragraphs 606-10-55-248 through 55-250 [IE156–IE158] include an example to illustrate the guidance in paragraphs 606-10-32-21 through 32-24 [66–69] on noncash consideration. That example is included for reference in Appendix A of this paper.

## Potential Implementation Issues

12. Paragraphs 606-10-32-21 through 32-24 [66–69] and paragraphs 606-10-55-248 through 55-250 [IE156–IE158] are clear that noncash consideration is measured at fair value (or by reference to the standalone selling price of the goods or services promised to the customer if an entity cannot reasonably estimate fair value) and included in the transaction price. However, some stakeholders think the new revenue standard is unclear about when noncash consideration is measured.

13. Some stakeholders also have questioned how the guidance in paragraph 606-10-32-23 [68] regarding the constraint is applied in scenarios in which the fair value of noncash consideration varies due to both the form of the consideration and for reasons other than the form of consideration.

***Issue 1: What is the measurement date[2] for noncash consideration received (or receivable)[3] from a customer?***

14. The staff is aware of the following views:

    (a) *View A* – Noncash consideration is measured at contract inception

    (b) *View B* – Noncash consideration is measured when the noncash consideration is received (or is receivable)

    (c) *View C* – Noncash consideration is measured at the earlier of (i) when the noncash consideration is received (or is receivable) and (ii) when the related performance obligation is satisfied (or as the performance obligation is satisfied, if satisfied over time).

15. To illustrate the views, consider the following example. On January 1, 20X0, Company A is engaged to develop a website for Customer X. Company A concludes that the service is a single performance obligation satisfied ratably over time in accordance with paragraphs 606-10-25-14 [22] and 606-10-25-27 through 25-28 [35–37].

[2] The term *measurement date* in this paper refers to the date at which the fair value of the noncash consideration is fixed. Before the measurement date, the fair value of the noncash consideration is remeasured at each reporting period.

[3] Paragraph 606-10-45-4 [108] states that a receivable is an entity's right to consideration that is unconditional. Noncash consideration in the form of equity instruments is generally considered as *received* (*or receivable*) at the date on which an entity (or individual) vests in the equity instruments.

16. As consideration for developing the website, Company A will be permitted to display an advertisement for its business on Customer X's website for one month following the completion of the website. Company A is contractually entitled to an unconditional right to display the advertisement only upon completion of the website. Company A completes development of the website on September 1, 20X0.

17. Proponents of *View A* think the noncash consideration should be measured on January 1, 20X0, consistent with when other components of the transaction price are initially determined. Proponents of *View A* think that timing of payment should not affect the amount of revenue recognized unless the arrangement contains a financing component.

18. Proponents of *View A* also think the fair value of noncash consideration at contract inception best reflects the value that a customer is willing to exchange for promised goods or services.

19. Proponents of *View B* think the noncash consideration should be measured on September 1, 20X0, the date at which the website is completed and the asset arising from the noncash consideration is recognized (that is, the noncash consideration is received (or is receivable)).

20. Proponents of *View B* think paragraphs BC253 and 606-10-55-250 [IE158] indicate that changes in the fair value of noncash consideration after it is received (or is receivable) should not affect revenue. Proponents of *View B* think that, absent any explicit guidance to the contrary, the new revenue standard implies that changes in the fair value of noncash consideration before it is received (or is receivable) on September 1 should affect revenue. That is, the measurement date for the noncash consideration is September 1, and therefore, changes in the fair value of the noncash consideration from January 1 through September 1 should affect revenue.

21. Proponents of *View C* think the noncash consideration should be measured using the fair value of the advertising space on each day as the performance obligation is satisfied (that is, from January 1, 20X0, to September 1, 20X0).[4]

[4] Some stakeholders think a practical expedient to *View C* is to use the average fair value of the advertising space during the period over which the performance obligation is satisfied (that is, from January 1, 20X0, to September 1, 20X0).

22. Proponents of *View C* think that a requirement to remeasure the fair value of noncash consideration when the related performance obligation is satisfied (or as the performance obligation is satisfied, if satisfied over time) is similar (although not identical) to the measurement guidance in existing GAAP (paragraph 505-50-30-11) and IFRS 2 for the issuance of equity instruments to nonemployees.

23. Proponents of *View C* also think the intent of the example in paragraph 606-10-55-250 [IE158] is to illustrate that noncash consideration is measured as the performance obligation is satisfied (that is, "upon completion of each weekly service" in the example).

24. However, proponents of *View C* think that, in certain fact patterns (for example, when the noncash consideration is received (or is receivable) in advance of the performance obligation being satisfied), the guidance in paragraphs BC253 and 606-10-55-250 [IE158] require measurement of the noncash consideration before the related performance obligation is satisfied because that guidance states that changes in the fair value of noncash consideration after it is received (or is receivable) should not affect revenue.

***Issue 2: How is the constraint applied to transactions in which the fair value of noncash consideration might vary due to <u>both</u> the form of the consideration and for reasons other than the form of the consideration?***

25. The staff is aware of the following views:

    (a) *View A* – The constraint applies to variability resulting from both the form of the consideration and for reasons other than the form of consideration.

    (b) *View B* – The constraint applies only to variability resulting from other than the form of the consideration.

26. To illustrate the views, consider the following example. On January 1, 20X0, Company A is engaged to develop a website for Customer X. Company A concludes that the service is a single performance obligation satisfied ratably over time in accordance with paragraphs 606-10-25-14 [22] and 606-10-25-27 through 25-28 [35-37].

27. As consideration for developing the website, Company A will vest in 100 options to purchase shares of Customer X. Company A will not receive any share options if development of the website is not completed.

28. The terms of the arrangement are such that the exercise price of the share options is affected by Company A's performance. The exercise price of the share options is $1 if Company A develops the website within one month, $2 if the website is developed within two months, and $3 if the website is developed in three or more months.

29. Proponents of *View A* think that paragraph 606-10-32-23 [68] indicates that if the fair value of noncash consideration promised by a customer varies for reasons other than *only* (emphasis added) the form of the consideration, an entity shall apply the constraint. Proponents of *View A* think the constraint should be applied to all changes in the fair value of the noncash consideration when *one* of the conditions that results in variability is for reasons other than the form of consideration. Accordingly, proponents of *View A* think the constraint should be applied to changes in the fair value of the share options resulting from variability of Customer X's share price (that is, variability due to the form of the consideration) and to changes in the fair value of the share options resulting from variability of the exercise price (that is, variability due to Company A's performance). Proponents of *View A* think that Company A must evaluate the factors in paragraph 606-10-32-12 [57] to determine whether any of the noncash consideration that varies should be included in the transaction price.

30. Proponents of *View B* think paragraph BC252 indicates that the constraint should be applied to the same types of variability, regardless of the form of consideration. Proponents of *View B* think that application of *View A* is inconsistent with the Boards' intent. That is, proponents of *View B* observe that application of *View A* could result in differences in the timing of revenue recognition for similar fact patterns that are settled in different forms of consideration (for example, cash and noncash consideration). Accordingly, proponents of *View B* think the constraint should be applied only to changes in the fair value of the share options resulting from variability of the exercise price (that is, variability due to Company A's performance).

31. Opponents of *View B*, however, think that separately identifying changes in the fair value of noncash consideration resulting from the form of the consideration and changes resulting for reasons other than the form of consideration could be complex and costly and it might decrease the usefulness of information provided to financial statement users compared with *View A*.

| **Questions for the TRG Members** |
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| 1. What are your views about the potential implementation issues discussed in this paper?<br><br>2. Are you aware of other interpretations for these issues?<br><br>3. Are there any related potential interpretation issues not included in this paper? |

# Appendix A

**> > > Example 31—Entitlement to Noncash Consideration**

**606-10-55-248** An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on January 1, 20X1, and work begins immediately. The entity concludes that the service is a single performance obligation in accordance with paragraph 606-10-25-14(b). This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

**606-10-55-249** In exchange for the service, the customer promises 100 shares of its common stock per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.

**606-10-55-250** The entity measures its progress toward complete satisfaction of the performance obligation as each week of service is complete. To determine the transaction price (and the amount of revenue to be recognized), the entity measures the fair value of 100 shares that are received upon completion of each weekly service. The entity does not reflect any subsequent changes in the fair value of the shares received (or receivable) in revenue.