STAFF PAPER

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Project	FASB-IASB Joint Transition Resource Group for Revenue Recognition
Paper topic	Licenses - Specific Application Issues About Restrictions and Renewals

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Purpose

1. Some stakeholders informed the staff that there are questions about the guidance in Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and IFRS 15 *Revenue from Contracts with Customers* (collectively referred to as the "new revenue standard"), as it relates to:

   (a) Accounting for renewals of time-based licenses that provide the customer with a right to use the entity's intellectual property (that is, licenses that are satisfied at a point in time that are separate performance obligations)

   (b) Identifying attributes of a single license versus identifying additional licenses

   (c) Accounting for a customer's option to purchase or use additional copies of software.

2. 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 (TRG) on the potential implementation issues.

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Background and Accounting Guidance

3. In order to discuss the implementation questions about (a) renewals of time-based *right-to-use* licenses and (b) identifying attributes (including restrictions) of a license versus identifying promises, the staff think context about the history of the guidance in paragraphs 606-10-55-63 [B61][1] (and 606-10-55-58C in the FASB proposed Accounting Standards Update, Revenue from Contracts with Customers (Topic 606), *Identifying Performance Obligations and Licensing*) and 606-10-55-64 [B62], is instructive.

Guidance on Timing of Revenue Recognition

4. The Boards provided the guidance below about the point in time an entity should recognize revenue from a license that provides the customer with a right to use intellectual property (that is, a point in time license). The FASB also proposed some amendments to the guidance in its recent proposed Update on identifying performance obligations and licensing. However, those proposed amendments were solely intended to clarify the Boards' intent by improving the drafting and the organization of the licensing implementation guidance in section 606-10-55 (that is, the amendments were not intended to change the guidance).[2]

> **606-10-55-63 (as issued in May 2014) [B61] …revenue cannot be recognized for a license that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the license.** For example, if a software license period begins before an entity provides (or otherwise makes available) to the customer a code that enables the customer to immediately use the software, the entity would not recognize revenue before that code has been provided (or otherwise made available).

[1] References that appear in [XX] within this paper refer to paragraph numbers in IFRS 15.

[2] Stakeholders should **not** assume the final ASU on identifying performance obligations and licensing will include the *same* drafting as the proposed Update. Changes resulting from recent Board deliberations and feedback from comment letters and other stakeholder outreach will influence the final drafting.

606-10-55-58C (FASB proposed Update)…revenue cannot be recognized from a license of intellectual property before both:

a) An entity provides (or otherwise makes available) the intellectual property to the customer.

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

BC414. **(as issued in May 2014)** The Boards also decided to specify that control of a license **could not transfer before the beginning of the period during which the customer can use and benefit from the licensed property**. If the customer cannot use and benefit from the licensed property then, by definition, it does not control the license. The Boards noted that when viewed from the entity's perspective, performance may appear to be complete when a license has been provided to the customer, even if the customer cannot yet use that license. However, the Boards observed that the definition of control in paragraph 606-10-25-25 focuses on the customer's perspective, as explained in paragraph BC121.

BC121. **(as issued in May 2014)** The Boards observed that the assessment of when control has transferred could be applied from the perspective of

> either the entity selling the good or service or the customer purchasing the good or service. Consequently, revenue could be recognized when the seller surrenders control of a good or service or when the customer obtains control of that good or service. Although in many cases both perspectives lead to the same result, **the Boards decided that control should be assessed primarily from the perspective of the customer**. That perspective minimizes the risk of an entity recognizing revenue from undertaking activities that do not coincide with the transfer of goods or services to the customer.
>
> **[Emphasis added.]**

5. The staff think the context of the Boards' deliberations leading to the issuance of the above guidance might be helpful to addressing the implementation questions. The Boards' deliberations primarily focused on a customer's *initial* license to an entity's intellectual property (for example, the first term license to a software application). The Boards considered previous U.S. GAAP that generally specified that revenue related to *initial* licenses of intellectual property cannot be recognized before the beginning of the license period (Subtopic 985-605, which is applicable to software, Subtopic 926-605, which is applicable to films and shows, and SEC SAB Topic 13.A, which addresses licenses like those for biological compounds or patents that do not have industry-specific U.S. GAAP).

6. The Boards did not specifically deliberate application of the guidance in paragraph 606-10-55-63 [B61] to *renewals* of time-based licenses (for example, a renewal of a three-year term license for an additional three years). License renewals were not a significant topic raised by stakeholders during the course of the deliberations of the revenue project.

Guidance on Contractual Restrictions in Paragraph 606-10-55-64 [B62]

7. The new revenue standard includes guidance in paragraph 606-10-55-64 [B62] on the effect of contractual restrictions on accounting for each promised license that is

identified in accordance with paragraph 606-10-25-18 [26]. The FASB recently tentatively decided to make amendments to paragraph 606-10-55-64 in its forthcoming ASU on identifying performance obligations and licensing. In its Exposure Draft *Clarifications to IFRS 15,* the IASB has not proposed to make any revisions to the guidance in paragraph B62 of IFRS 15 (however, the Basis for Conclusions to the IASB's Exposure Draft includes discussion relevant to this topic). Below are the currently *issued* guidance and the amendments that were included in the FASB's proposed update issued in May 2015, as well as the discussion in the IASB's Basis for Conclusions to its recent Exposure Draft.

> **606-10-55-64 (as issued in May 2014) [B62]** An entity should disregard the following factors when determining whether a license provides a right to access the entity's intellectual property or a right to use the entity's intellectual property:
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> a. Restrictions of time, geographical region, or use—those restrictions define the attributes of the promised license, rather than define whether the entity satisfies its performance obligation at a point in time or over time
>
> b. Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorized use—A promise to defend a patent right is not a performance obligation because the act of defending a patent protects the value of the entity's intellectual property assets and provides assurance to the customer that the license transferred meets the specifications of the license promised in the contract.
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> **606-10-55-64 (FASB proposed Update)** An entity should disregard the following factors when

determining whether a license provides a right to access the entity's intellectual property or a right to use the entity's intellectual property or when identifying the promises in the contract:

a. Restrictions of time, geographical region, or use— Those restrictions define the attributes of the promised license. ~~license, rather than~~ Therefore, they do not define whether the entity satisfies its performance obligation at a point in time or over time or affect how many goods or services are promised in the contract. A restriction defines the scope of a customer's right to use or right to access intellectual property. Therefore, an entity assesses whether a contractual provision defines the scope of the customer's right to use or right to access the intellectual property to determine whether that provision is a restriction.

b. Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorized use—A promise to defend a patent right is not a performance obligation because ~~the act of defending a patent protects the value of the entity's intellectual property assets and~~ it solely provides assurance to the customer that the license transferred meets the specifications of the license promised in the contract.

BC81 (IASB Exposure Draft) …the IASB decided that a clarification about the effect of contractual restrictions in licensing arrangements on the identification of the promised goods or services in

the contract was not necessary. This is because, in its view, there is adequate guidance in IFRS 15 and the accompanying Basis for Conclusions. Paragraph B62 states that restrictions of time, geographical region or use define the attributes of the promised licence, rather than define whether the entity satisfies its performance obligation at a point in time or over time. Paragraph BC411 of IFRS 15 explains that restrictions 'define attributes of the rights transferred rather than the nature of the underlying intellectual property and the rights provided by the licence', ie the contractual restrictions define the attributes of the licence and do not change the number of promises in the contract. Consequently, the IASB did not intend for a licence to show a movie only on a particular date in each year over a three-year period to be accounted for as three licences.

8. Paragraph 606-10-55-64 [B62], as issued, originally was developed in the context of the then-ongoing discussions of when a license is satisfied at a point in time versus over time. The Boards and staff considered, for example, the following scenarios related to the entertainment and media industry:

   (a) A scenario in which a television series is licensed to a customer, with the restriction that it must be shown in sequential order (and potentially also limited to a specified number of episodes per week). The Boards decided that contractual restrictions on use of the licensed IP should not affect the over time versus point in time evaluation and does not affect that the customer controls (that is, could direct the use of, and obtain substantially all the remaining benefits from) the license. This guidance is consistent with

previous U.S. GAAP in Subtopic 926-605 for films and shows (originally from SOP 79-4[3] and carried forward to SOP 00-2[4]).

(b) A scenario in which a television show or movie is licensed to a customer for a period of time (for example, 3 years), but the customer is limited to airing the licensed content during a particular period, at particular times of day (or after another piece of content), or a limited number of times during the license period. The discussion in BC411 of the Basis for Conclusions to the new revenue standard explicitly discusses restrictions in the entertainment and media industry of this nature. Similar to the fact pattern described in (a), the Boards decided that those restrictions are attributes of the license (that is, the specific rights conveyed by the license), and do not affect whether the customer controls the license at the point in time it obtains the media content and can begin to use and benefit from the license. This guidance is consistent with previous U.S. GAAP in Subtopic 926-605 (originally from SOP 79-4 and carried forward to SOP 00-2).

9. The staff further notes that decisions reached in the revenue project about restrictions of the nature described above were made in the context of similar decisions reached in the leases project. In the leases project, the Boards decided that restrictions similar to those described above do not affect whether a lease exists. For example, the Boards decided in the leases project that restrictions on selling products from a retail store during certain hours each day or restrictions on where a leased aircraft may fly are attributes of the customer's right to use the underlying asset and do not affect whether the customer controls that right of use.

10. The FASB's decision in February 2015 to propose clarifications to paragraph 606-10-55-64 that contractual restrictions do not affect the identification of the promises to the customer in the contract also was discussed in the context principally of the same type of example as in paragraph 8(b) above. The IASB did not propose similar revisions; however, the Basis for Conclusions to the IASB's ED, *Clarifications to IFRS 15*, states agreement with the effect of the FASB's proposed revision (the

[3] AICPA Statement of Position No. 79-4, *Accounting for Motion Picture Films*
[4] AICPA Statement of Position No. 00-2, *Accounting by Producers or Distributors of Films*

IASB's discussion is included above). The scenario raised at the October 31, 2014 TRG meeting was a customer has rights to air a specified show or movie for a number of years, but the customer is limited to showing that movie only during specified periods (for example, around a particular holiday) during those years.

Accounting for a Customer's Option to Purchase or Use Additional Copies of Software

11. The new revenue standard includes the following guidance on customer options for additional goods or services:

> **606-10-55-42 [B40]** If, in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services, and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

12. The new revenue standard includes the following guidance on sales-based or usage-based royalties:

> **606-10-55-65 [B63]** Notwithstanding the guidance in paragraph 606-10-32-11 through 32-14 [56 through 59], an entity should recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property only when (or as) the later of the following events occurs:
>
> (a) The subsequent sale or usage occurs.

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

13. While this topic relates to the issue of accounting for a customer option, as well as the guidance on accounting for sales- and usage-based royalties, a more fundamental question is whether the promise to the customer is a single license or multiple licenses.

14. Previous software revenue recognition guidance in U.S. GAAP (Subtopic 985-605) included the following guidance on multiple copies of software products versus multiple licenses:

> **985-605-25-22** Arrangements to use multiple copies of a software product under site licenses with users and to market multiple copies of a software product under similar arrangements with resellers shall be distinguished from arrangements to use or market multiple single licenses of the same software.
>
> **985-605-25-23** In a multiple copy arrangement, duplication is incidental to the arrangement and the delivery criterion is met upon the delivery of the first copy or product master. The vendor may be obligated to furnish up to a specified number of copies of the software, but only if the copies are requested by the user. The licensing fee is payable even if no additional copies are requested by the user or reseller. If the other criteria in this Subtopic for revenue recognition are met, revenue shall be recognized upon delivery of the first copy or product master. The estimated costs of duplication shall be accrued at that time.
>
> **985-605-25-24** In a multiple license arrangement, the licensing fee is a function of the number of copies delivered to, made by, or deployed by the user or

> reseller. Delivery occurs and revenue shall be recognized as the copies are made by the user or sold by the reseller if the other criteria in this Subtopic for revenue recognition are met.

15. Subtopic 985-605 included the following implementation guidance about arrangements that include usage-based versus user-based fees:

> **985-605-55-5** Software vendors may enter into arrangements for licensing rights and postcontract customer support that include contingent usage-based fees. Usage-based fees are determined based on applying a constant multiplier to the frequency that the licensee uses the software. For example, a vendor may license customer call center software whereby a fee of $.01 is charged for each call handled. That fee structure is different from fees that are determined based on the number of individuals or workstations that use or employ the software (that is, user-based fees). If usage-based fees are not paid timely, the licensee's perpetual license to use the software is vacated and the vendor has no continuing obligation to provide postcontract customer support.

16. Subtopic 985-605 also included the following implementation guidance about customer options to purchase additional copies of software products licensed by and delivered to the customer:

> **985-605-55-87** However, the provisions of paragraph 985-605-15-3(d) [**guidance on more-than-insignificant discounts**] should not be applied to an option within a software arrangement that allows the customer to purchase additional copies of products licensed by and delivered to the customer under the same arrangement. In that case, revenue should be recognized as the rights to additional

> copies are purchased, based on the price per copy as stated in the arrangement. Additional copies of delivered software are not considered an undelivered element. In accordance with paragraphs 985-605-25-22 through 25-24, duplication of software is considered incidental to an arrangement, and the delivery criterion is met upon the delivery of the first copy or product master.

17. In addition, there is widely-available interpretive guidance from many of the accounting firms that discusses identifying a single license (multiple *copy*) arrangement from a multiple license arrangement under the previous U.S. GAAP on software revenue recognition in Subtopic 985-605. In general, those publications acknowledge that judgment is required to determine the substance of the arrangement as one conveying a single license or one conveying multiple licenses; that facts and circumstances particular to the given arrangement must be considered. Determining the substance of the arrangement as one conveying a single license or one conveying multiple licenses is vital to the revenue recognition because, in general, if the entity determines that the arrangement is for a single license, the delivery criterion is met when the product master is delivered and delivery of additional copies is considered incidental to the arrangement (costs are accrued for expected costs to deliver additional copies) under the previous U.S. GAAP. In contrast, multiple-license arrangements link the total amount and payment of the arrangement consideration to delivery of each copy of the software. In such arrangements, license fees are recognized under previous U.S. GAAP only as each copy is delivered to or made by the customer, and the provision of additional copies is not considered solely incidental to the arrangement.

Implementation Questions

18. This section of the paper includes questions that have been brought to the staff's attention regarding (a) license renewals, (b) identifying attributes of a single promised license versus multiple promised licenses, and (c) accounting for a customer's option

to purchase or use additional copies of software. Examples have been included to facilitate discussion among members of the TRG.

Issue 1 – Renewals of Time-Based Right-to-Use (Point in Time) Licenses

19. Paragraph 606-10-55-63 [B61] states that "…**revenue** cannot be recognized for a license that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the license." Similarly, paragraph 606-10-55-58C in the FASB proposed Update states "…revenue cannot be recognized from a license of intellectual property before both…the beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the intellectual property." BC414 (included earlier in this paper) explains the guidance in paragraph 606-10-55-63 [B61] (and, by extension, the guidance in paragraph 606-10-55-58C of the FASB proposed Update).

20. The first implementation question pertains to renewals of licenses that provide a right to use the entity's intellectual property. Consider the following example:

    (a) ***Example A***—Licensor and Customer enter into a three-year license of software, executed on 8/1/X0, which extends from 1/1/X1 through 12/31/X3. On 6/30/X3, Licensor and Customer enter into an amendment that renews the license for the period from 1/1/X4 through 12/31/X6. Assume the license provides a right to use Licensor's intellectual property and is a separate performance obligation (that is, the license is satisfied at a point in time).

21. While it is clear that Licensor would not recognize revenue from the initial license until 1/1/X1, some stakeholders think that it is unclear whether the guidance in paragraph 606-10-55-63 [B61] (or paragraph 606-10-55-58C of the FASB proposed Update) requires Licensor to recognize the fee for the license renewal on 6/30/X3 when the renewal is agreed to by the parties or on 1/1/X4 when the renewal period begins.

View A

22. Some stakeholders think that license revenue, whether from an initial license or a renewal of an existing license, cannot be recognized until the beginning of the license

period to which the revenue relates. In their view, the guidance in paragraph 606-10-55-63 [B61], which states "… revenue cannot be recognized for license that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the license," supports view A. Therefore, if a renewal is separately negotiated (that is, it is not combined with the initial license contract in accordance with contract combinations guidance in the new revenue standard), the renewal fee is recognized only at the start of the renewal period (1/1/X4 in Example A).

View B

23. Other stakeholders think the transaction price for the renewal would be recognized when the parties agree upon the extension (6/30/X3 in Example A). The staff note that this is consistent with the accounting for license renewals under previous U.S. GAAP. The revenue recognition guidance for the software and film industry in Subtopics 985-605 and 926-605 included specific guidance to this effect and those two pieces of industry-specific U.S. GAAP were analogized to for licenses accounted for in accordance with the general revenue recognition guidance in Topic 605 and SEC SAB Topic 13.A.

24. Stakeholders supportive of View B think that an extension or renewal of a customer's existing rights to use the licensor's intellectual property merely changes an attribute of the license the customer already controls and no additional performance on the part of the licensor (that is, in the form of granting new rights from which the customer can begin to use and benefit) is required. Because no new rights are being transferred to the customer, the renewal (or extension) is a *change* to an attribute of the rights the customer already controls, rather than the granting of a second, distinct license. Stakeholders that support View B assert that time increments (that is, each month or year of the license period) in a *right-to-use* license are not distinct from the license any more than the specifications of a product (for example, the color, the top speed, or mileage per gallon of a car) are distinct from the product. It is important to consider that, under the licensing model in the new revenue standard, in granting a right-to-use license, the licensor transfers what is, in effect, a *good.* The duration of the license is merely an attribute of that "good," which is why a licensor recognizes revenue upfront regardless of whether the license is 2, 5, or 10 years in duration. This is in

contrast to a right to access (over time) license in which the entity performs throughout the license period (like a service), such that the licensor provides a distinct and discreet act of performance (that of providing access) each period of the license term (including any renewal or extension periods). Consequently, those stakeholders think a renewal or extension of a right-of-use license is not adding a distinct good or service, but rather is a modification to a *completed* performance obligation. Therefore, the modifications guidance in paragraph 606-10-25-13(b) [21(b)], applicable to modifications that are not distinct from the goods or services in the original contract, applies and the additional consideration resulting from the renewal will be recognized, in Example A, on 6/30/X3.

25. Those stakeholders that support View B also assert that, if the parties were to cancel the initial license and enter into a new license agreement for the remainder of the initial term plus the renewal period that commences upon execution of the new contract, then the licensing guidance would require revenue to be recognized at the point in time the contract is executed. This is because the customer would have the intellectual property and the license period would begin at that point in time. Those stakeholders think the different accounting outcome that would result from View A (that is, recognizing the renewal revenue on 1/1/X4 rather than 6/30/X3) would not make sense because the economics of both transactions would appear to be the same.

Staff Analysis

26. In the staff's view, the revenue for the license renewal in Example A should be recognized on 6/30/X3, the date the renewal is agreed to by Licensor and Customer. The staff concurs with the views of those stakeholders in support of this accounting result (View B). That is, the staff think that when the customer already controls, and is benefitting from, the rights that will be renewed or extended, it already controls that license and that extending the term of (or renewing) a license is merely changing an attribute of that license, which already was transferred to the customer.

Issue 2 – Distinct Rights within a Contract

27. Questions have arisen about license contracts in which the customer's rights accrue over time (referred to herein as "staggered rights") - that is, the customer obtains additional rights during the contract period. Consider the following examples (in

both examples, the license(s) provide the customer with a right to *use* the entity's intellectual property – that is, the license(s) is (are) satisfied at a point in time):

(a) ***Example B***—Licensor grants Customer the right to use its patent to manufacture a product for sale for 7 years beginning on 1/1/X1. In the first 2 years, Customer may only sell product produced using the patent in Europe. Beginning in Year 3 (on 1/1/X3), Customer also is permitted to sell product produced using the patent in Japan.

(b) ***Example C***—Licensor grants Customer the right to use its intellectual property in its two classes of consumer products for 5 years beginning on 1/1/X1. However, in Year 1, the license only permits Customer to embed the technology in one of the two classes of products. Only in Year 2 of the 5-year license (that is, beginning on 1/1/X2) is Customer permitted to embed the technology in the second class of consumer product.

View A

28. Some stakeholders think that in Examples B and C the contract grants a single license that includes geographical or use restrictions that are merely attributes of that single license. That is, in Example B, the license is for the right to manufacture product and distribute that product in Europe *and* Japan, but there is a restriction that is an attribute of the license in terms of restricting sales within Japan for Years 1 and 2. Those stakeholders think paragraph 606-10-55-64 [B62] (and paragraph 606-10-55-64 as amended in the FASB proposed Update and along with the IASB's Basis for Conclusions to its Exposure Draft) establishes that restrictions of time, geographical region, or use in a license are attributes of the license that do not affect the identification of the promises in the contract. Those stakeholders also think the arrangement includes only a single license because, in their view, the contract requires only a single act of "performance" by the licensor – that is, the licensor only has to make the intellectual property available to the customer once (prior to the start of the license period on 1/1/X1). Even though the customer cannot begin to use and benefit from its rights to sell the product in Japan until 1/1/X3, no further performance of the licensor is required because Customer already has access to the intellectual property at that point; Licensor does not have to make the intellectual property

available for the Customer's use a second time. In Example B, that would mean Licensor has a single license to manufacture and sell product in Europe and Japan, but with a geographical restriction that is merely an attribute of the license. That restriction affects the pricing of the license, but does not create an additional license. Customer begins to use and benefit from the single license on 1/1/X1; therefore, all of the revenue related to the license is recognized on that date.

View B

29. Other stakeholders think that in Examples B and C the Customer is granted two distinct licenses because the rights that accrue subsequently (for example, to sell product in Japan or embed Licensor's technology in the second class of Customer's products) are distinct (as defined in paragraphs 606-10-25-19 [27] through 25-22 [30]) from the rights that accrue to Customer initially (that is, to sell product in Europe or embed Licensor's technology in the first class of Customer's products). Consequently, Licensor has two performance obligations in each of the examples. The entity would, therefore, allocate the transaction price to each of those two performance obligations (the two licenses) and recognize each separate license (each set of distinct rights) independently. This would result in a portion of the total transaction price in each example being recognized only at the point in time Customer can begin to use and benefit from the second of the two licenses in each example (that is, on 1/1/X3 for Example B, and 1/1/X2 for Example C). Supporters of View B generally disagree with the assertion underlying View A that the licensor has no further obligation to perform once it has made the intellectual property available for the customer's use on 1/1/X1 in Examples B and C. View B supporters think that the Boards' intent in paragraph 606-10-55-63 [B61] is that performance with respect to licensing includes not only making available a copy of the intellectual property, but also the act of granting the rights that the customer will control.

30. To supporters of View B, examples such as B and C differ from a license renewal scenario (Example A) because, in Examples B and C, the entity obtains *new* rights that it does not already control (by virtue of being able to use and benefit from) at a later date. Those stakeholders also do not think the discussion of restrictions in paragraph 606-10-55-64 [B62] was created (or amended in the FASB proposed Update or discussed in the IASB Exposure Draft's Basis for Conclusions) to permit

circumvention of the licensing recognition guidance in paragraph 606-10-55-63 [B61] (as issued) or paragraph 606-10-55-58C (as proposed) or the identifying performance obligations guidance in paragraphs 606-10-25-14 [22] through 25-22 [30].

Staff Analysis

31. The guidance in the new revenue standard about contractual restrictions in a license does not alter or override an entity's requirement to identify the promises to the customer in the contract (in accordance with Step 2 of the revenue model – identify the performance obligations in the contract). Those promises may include granting multiple licenses, each with different attributes (including their own restrictions). Distinguishing between attributes of a single promised good or service and multiple goods or services promised to the customer is not a requirement solely applicable to licensing arrangements, even though additional judgment may be required to do so in some licensing arrangements as compared to other types of arrangements (for example, the sale of tangible products).

32. The guidance in paragraph 606-10-55-64 [B62] was not included in the new revenue standard to permit circumvention of the recognition guidance in paragraph 606-10-55-63 [B61] (as issued) or paragraph 606-10-55-58C (as proposed) or the identifying performance obligations guidance in paragraphs 606-10-25-14 [22] through 25-22 [30]. Rather, paragraph 606-10-55-64 [B62] is intended to explain that a license is, by nature, a bundle of rights and that, therefore, scoping those rights as something less than unlimited or unrestricted use of the underlying intellectual property (that is, something less than perpetual, worldwide, "all-you-can-eat") does not preclude the customer from controlling a promised license. A license for a limited (defined) period of time (for example, three year license term), restricted to use in a particular country or region (for example, the license permits broadcast of a movie within the U.S. only), and with limitations of use (for example, once per week or year, only in a certain class of product, etc.) could still be controlled by the customer because those restrictions merely define attributes of the asset the customer obtains.

33. Because paragraph 606-10-55-64 [B62] (either as drafted or as proposed for revision) does not permit an entity to avoid the recognition or identification requirements of

the new revenue standard, there is a judgment to be made in distinguishing attributes of a single license (that is, those things that define the promised license) from multiple licenses (separately identifiable rights that, in general, could be sold separately). Facts and circumstances affect those determinations, just as they do under existing U.S. GAAP and IFRS, under which there is very limited guidance today to deal with arrangements similar to those in Examples B and C.

34. The staff think incremental rights that are distinct in accordance with paragraphs 606-10-25-19 [27] through 25-22 [30] generally are separate performance obligations (separate licenses) and recognition of revenue related to those rights before the customer can begin to use and benefit from them would be inconsistent with the new revenue standard. The argument that the licensor has no further requirement to perform once it has made the intellectual property available for the customer's use on 1/1/X1 in Examples B and C above does not appear to take account of the fact that the Boards have decided that performance includes not only making a copy of the intellectual property available to the customer, but also the act of granting those rights. This is because the customer does not control the intellectual property, but rather only its right to use (or access) the licensor's intellectual property. As a result, the staff think View B is more consistent with the Boards' intent and the remainder of the revenue model in the new revenue standard (for example, the guidance on identifying performance obligations) given the facts and circumstances in the examples presented.

35. The staff think it is important to note that, in most contracts, there are not staggered rights that accrue over time. Consistent with the discussion in BC116 to the new revenue standard, an entity would not be required to identify each set of distinct rights if those rights are transferred concurrently. For example, the licensor would not be precluded from accounting for the European and the Japanese rights in Example B as a single performance obligation if those rights all were conveyed on 1/1/X1 (rather than Europe on 1/1/X1 and Japan on 1/1/X3). This would be the case even if the rights were not coterminous because the pattern of transfer to the customer is concurrent (that is, the customer can begin to use and benefit from the distinct rights at the same *point in time*) even if the time attribute of those two sets of distinct rights

were not the same (for example, 7 years for one license and 5 years for the other license).

> BC116. In their redeliberations, the Boards observed that paragraph 606-10-25-14(b) [22(b)] applies to goods or services that are delivered consecutively, rather than concurrently. The Boards noted that Topic 606 would not need to specify the accounting for concurrently delivered distinct goods or services that have the same pattern of transfer. This is because, in those cases, an entity is not precluded from accounting for the goods or services as if they were a single performance obligation, if the outcome is the same as accounting for the goods and services as individual performance obligations.

Issue 3 – Distinct Rights Added Through a Modification

36. For Issue 3, assume the same two fact patterns as Examples B and C in Issue 2, *except that* the rights to Japan (in Example B) and to embed Licensor's technology in Customer's second class of consumer products (in Example C) are granted to Customer by modifying the original license agreement. In addition, assume the modification in each example is not combined with the original contract in accordance with the contract combinations guidance. The question that has been raised is similar to that in Issue 2 (that is, are distinct rights added through a modification an additional license or a modification of the original license granted to the customer), but also includes whether an entity's consideration of that question should differ depending on whether the original contract includes "staggered rights" or distinct rights are added through a contract modification.

View A

37. Some stakeholders that support View A in Issue 2 (that is, those stakeholders that think Examples B and C in Issue 2 each include only a single license with a geographical and/or use restriction), think that if the modification to add rights to the

contract (i) occurs after Customer has begun to use and benefit from the original rights granted, and (ii) does not require Licensor to make any additional intellectual property available to Customer (for example, no additional patents, formulas, or software will be made available), then the incremental rights should be viewed as a modification to the single, original license. Any fee for the incremental rights should be recognized when the modification is agreed between the parties. Even if the new rights do not commence until a subsequent date, consistent with those stakeholders' view of the staggered rights situation in Issue 2, the delay in the commencement of those incremental rights is solely an attribute of the modified license and, therefore, revenue should be recognized when the modification is agreed. This is because Licensor has no further performance obligation. Customer already has the intellectual property (made available to the customer in satisfying the original license agreement) and is already using and benefitting from the license, subject to a restriction on use of the incremental rights.

View B

38. Other stakeholders view a modification scenario as different from an initial license scenario. Those stakeholders think there is a difference between the effect of a geographical or use restriction *within* a contract and incremental, distinct rights negotiated separately. Under this view, if the incremental rights are priced commensurate with their standalone selling price (under the circumstances), then the incremental rights are part of a separate contract and, therefore, represent a separate performance obligation. However, even if the incremental rights are not priced at their standalone selling price, those rights, if distinct and negotiated separately, constitute a separate performance obligation from the license already transferred to the customer. Consequently, the revenue allocable to the incremental rights is recognized (or begins to be recognized) only when the customer is able to use and benefit from those rights.

39. Stakeholders of this view think that restrictions of geography or use that arise in the examples for Issue 2 in a single contract represent a single negotiated exchange and, therefore, differ from a separate and distinct negotiation that results in a separate contract (even if a modification, both parties have to agree to an amendment to the contract). The new revenue standard establishes the contract as the unit of account

for the revenue guidance; therefore, those stakeholders think there is no basis for a separate contract to be treated differently just because the contract is with an existing customer versus a new customer (that is, the entity should account for incremental rights granted in a separate contract without regard for whether the customer in the contract is already a customer).

View C

40. The last group of stakeholders are those that agree with View B for Issue 2. In this case, the modifications to Example B and Example C would be accounted for like any other contract modification that adds a distinct good or service to an existing contract. That is, if the incremental, distinct rights are priced at their standalone selling price, then the entity applies the "new contract" modification guidance in paragraph 606-10-25-12. If the incremental, distinct rights are *not* priced commensurate with their standalone selling price, then the entity applies the modification guidance in paragraph 606-10-25-13(a).

Staff Analysis

41. Consistent with the staff view with respect to distinct rights (Issue 2), the staff think View C is the view that is most consistent with the new revenue standard. View C is the logical extension of the staff view (and View B in Issue 2) with respect to distinct rights. View C merely applies the contract modifications guidance in the new revenue standard to modifications that grant additional, distinct licenses in the same manner that one would apply that guidance to any other modification that adds additional, distinct goods or services.

Issue 4 – Accounting for a Customer's Option to Purchase or Use Additional Copies of Software

42. Some stakeholders in the software industry have questioned how the interaction of paragraphs 606-10-55-42 [B40] and 606-10-55-65 [B63] (see background section) affects the accounting for a customer's option to purchase or use additional copies of software. To illustrate stakeholders' views on this question, consider the following examples that were provided by the submitter.

Example D: A vendor enters into a 3 year software arrangement with a customer. As part of that arrangement, the software vendor delivers a master copy of the software to the customer. The customer pays a fixed fee of $300,000 for up to 500 users of the software. The customer pays an additional $400 per user for each additional user of the software above 500. The customer has been given the technical capability and has the legal right to replicate the software and add users without any assistance from the vendor. The customer will measure the number of users and pay for any additional users each quarter. The vendor has the right to audit the customer's measurement of users.

Example E: A vendor enters into a 3 year software arrangement with a customer. As part of that arrangement, the software vendor provides access to download copies of its software to the customer. The customer pays a fixed-fee of $300,000 for up to 500 downloads of the software. Each downloaded copy can only have a single user. The customer pays an additional $400 per copy downloaded above 500. The customer has been given the technical capability and legal right to download an unlimited number of copies without any assistance from the vendor. The number of downloads is measured and any additional users are paid for each quarter. The vendor has the right to audit the number of copies/users in the customer's environment.

Example F: A vendor enters into a 3 year software arrangement with a customer. As part of that arrangement, the software vendor provides access to download copies of its software to the customer. The customer pays a fixed-fee of $300,000 for up to 500 downloads of the software. Each downloaded copy can only have a single user. The customer pays an additional $400 per copy downloaded above 500. The customer has been given access codes for 500 downloads. The customer must request and the vendor will provide access codes for any additional downloads. The number of downloads is measured and any additional users are paid for each quarter. The vendor has the right to audit the number of copies/users in the customer's environment.

43. Stakeholders have reported different views about whether Examples D through F include an "option to acquire additional goods or services," as referenced in paragraph 606-10-55-42 [B40]. The staff are aware of the following three views reported by stakeholders.

View A

44. In each of the three examples (D through F), the customer has the option to acquire additional software rights (the incremental users or copies above 500), which are akin to additional goods. Proponents of this view would, therefore, apply the option to

acquire additional goods or services guidance to all three examples. Accordingly, the vendor must determine whether the option represents a material right. If the option does not represent a material right, then there would be no accounting for the additional purchases until the purchases occur. If the option does represent a material right in accordance with paragraph 606-10-55-42 [B40], then the company would allocate a portion of the transaction price for the initial licenses to the material right. In situations in which a material right exists, because the customer is in effect paying the vendor in advance for future licenses, the vendor would recognize revenue related to the material right when those future licenses are transferred or when the option expires.

View B

45. In each of the three examples (D through F), additional users or copies represent incremental usage of the software license, rather than an option acquire additional software licenses (additional rights). The customer's ability to access or download additional copies of the software for additional users do not change the nature, characteristics, or functionality of the software; they only affect the amount of usage of the rights the customer already controls. As such, additional usage of the software license the customer already controls (for which the customer will pay an incremental fee) is not an option to receive additional goods; instead the fees for additional usage are variable consideration for the license (that is, the rights) already transferred to the customer.
46. Proponents of this view would, therefore, apply the variable consideration guidance in the new revenue standard to all three examples. The variable consideration in those examples would be considered a usage-based or sales-based royalty for software (that is, additional users equal additional usage). Accordingly, revenue would be recognized in accordance with paragraph 606-10-55-65 [B63].

View C

47. Proponents of this view would apply the guidance applicable to sales-based and usage-based royalties in paragraph 606-10-55-65 [B63] to Examples D and E and the option to acquire additional goods or services guidance to Example F. Accordingly, revenue for Examples D and E would be recognized in accordance with paragraph

606-10-55-65 [B63]. In Example F, the vendor would determine whether the option to acquire additional licenses represents a material right. If the option does not represent a material right, then there would be no accounting for the additional purchases until the purchases occur. If the option does represent a material right in accordance with paragraph 606-10-55-42 [B40], then the company would allocate consideration to the material right. Because the customer is, in effect, paying the vendor in advance for future licenses, the vendor would recognize revenue related to the material right when those future licenses are transferred or when the option expires.

48. Proponents of View C see a distinction between Examples D and E on the one hand and Example F on the other. In the first two examples, the customer is in control of the number of additional users/copies (that is, the customer can add users/copies without the vendor's involvement), which suggests that those examples are not consistent with having an option to purchase additional goods or services from the vendor and, instead, reflect the customer's usage of the rights it already controls. However in the third example, the customer does not have control over additional users/copies. Access to the additional copies of the software can only be provided by the vendor at the customer's request. To proponents of View C, the required vendor involvement makes Example F more consistent with having an option to acquire additional goods.

Staff Analysis

49. The staff do not think View C is consistent with the new revenue standard. The staff struggle with the distinction that is drawn in View C based on whether or not the licensor has to provide the additional copies to the customer because the customer can create duplicate copies without the involvement of the licensor. Consistent with the discussion in Issue 2, under the new revenue standard, the fact that the licensor may not have to make anything additional available to the customer (provide copies or access codes) does not necessarily mean the customer controls the additional licenses (and therefore, that the licensor has satisfied its performance obligation) because a licensor's performance includes not only making the intellectual property available to the customer, but also the act of granting those rights. Put another way, the staff think that Examples D and E *do* require vendor involvement because the

vendor must grant those additional rights, regardless of the fact the vendor does not have to deliver additional copies of the software or additional access codes. Consequently, the staff do not think the accounting should vary based on which party produces copies of the intellectual property.

50. The staff understand the fine-line distinction between treating additional users or seats as additional licenses (*View A*) or as usage of the software (*View B*). Naturally, increased user or seat rights reflect increased usage of software. The staff also understand why View B might be considered a preferable interpretation to some software entities. This is because the specific software exception in previous U.S. GAAP from having to consider whether a right to additional licenses of previously delivered software is a more-than-insignificant discount has been superseded. Consequently, entities would, under View A, have to undertake an evaluation of whether the right to additional licenses provides the customer with a material right and, if so, have to allocate consideration to, and account for, that material right. This effort would be incremental to what those same entities have to do today if they determine the arrangement is one for multiple licenses.

51. However, the staff think the fundamental question in those types of examples is similar to the same question that arises in previous U.S. GAAP. Is the contract for a single license or for multiple licenses (that is, are additional users/seats/copies additional rights to use software)? The staff think it should be clear that, if the contract includes an optional right to purchase additional software licenses, then there is no basis for not considering whether the customer's right to do so is a material right. If that right is a material right, then the entity must account for that material right in the same manner as any other material right to purchase other optional goods. Under the new revenue standard, there is not separate guidance for different types of material rights. Consider other licensing scenarios, such as those discussed earlier in this paper. If Examples B and C to Issue 2 had been for *options* to acquire additional rights to manufacture and sell the licensor's products in Japan or to embed the licensor's technology in a second class of the customer's consumer products, then the staff think it would be clear that, if those additional rights were offered at a significant incremental discount to the range of discounts typically given for those rights to similar customers, the licensor would account for the initial license in the contract

and a material right offered to the customer (that is, there would be two performance obligations). The staff do not think the nature of the additional rights in Examples D through F (in this case, additional capacity) rather than additional geographic or use rights as in Examples B and C should affect the accounting conclusion reached by the licensor, and also do not think an option to obtain additional geographic or use rights (such as those in Examples B and C) represent additional *usage* of a single license.

52. As outlined in the background section, judgment, based on the specific facts and circumstances of a contract, is required to determine whether an arrangement is for a single license or for multiple licenses under the previous accounting guidance in U.S. GAAP and IFRS. Similarly, other topics discussed in this TRG agenda paper acknowledge that determining the substance of a licensing arrangement as one for a single license or for multiple licenses frequently will require judgment under the new revenue standard. The staff are unsure what in the new revenue standard would lead an entity to reach a different conclusion than it reaches under previous U.S. GAAP [IFRS] about whether Examples D through F include a single license or multiple licenses (with the option to acquire additional licenses) given (a) the judgment that is required today under previous U.S. GAAP [IFRS]; (b) the fact that recent TRG meetings have clarified that it was not the Boards' intent to substantively change the identification of the promised goods or services (that is, deliverables, elements, etc.) in a contract; and (c) the discussion of Issue 1 in this paper (which describes that the new revenue standard generally has a consistent notion of what it means to deliver a license to software as compared to previous U.S. GAAP [IFRS]). It seems to the staff that very similar considerations and judgments would apply under the new revenue standard as under previous U.S. GAAP [IFRS], such as to what extent the provision or availability of additional copies of software is effectively a convenience to the customer versus correlated to the benefit the customer can derive from the arrangement (for example, when the number of seats or users grants additional rights to the customer that directly affect the number of clients the customer can service using the software), and that judgment would continue to be necessary to determine whether rights to additional copies/seats/users represent additional licenses based on the facts and circumstances of the arrangement.

Question for the TRG Members
1. What are the TRG members' views about the issues and the staff analysis in this paper?