FASB FINANCIAL ACCOUNTING STANDARDS BOARD

STAFF PAPER

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Project	**Transition Resource Group for Revenue Recognition**
Paper topic	April 2016 Meeting – Summary of Issues Discussed and Next Steps

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Purpose

1. The seventh meeting of the Transition Resource Group for Revenue Recognition (TRG) was held on April 18, 2016. The purpose of the meeting was for the TRG members to inform the FASB about potential issues with implementing Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (the "new revenue standard"), to help the Board determine what, if any, action may be needed to address those issues.
2. The purpose of this paper is to provide a summary of (a) the issues discussed at the April 18, 2016 meeting, (b) the views expressed at the meeting by the TRG members and FASB staff views about those issues, and (c) the planned next steps, if any, for each of those issues.

Background

3. The following topics were discussed at the April 18, 2016 meeting:
    (a) *Topic 1:* Scoping Considerations for Incentive-based Capital Allocations, Such as Carried Interest
    (b) *Topic 2:* Considering Class of Customer When Evaluating Whether a Customer Option Gives Rise to a Material Right
    (c) *Topic 3:* Scoping Considerations for Financial Institutions

(d) *Topic 4:* Evaluating How Control Transfers Over Time

(e) *Topic 5:* Contract Asset Treatment in Contract Modifications.

4. The staff papers for each of those topics were made public to all stakeholders before the TRG meeting and are available on the FASB website. A direct link to the staff papers is also included within each topic below. This summary should be read in conjunction with those staff papers, which contain a more detailed description of the issues, stakeholder views, and staff analysis.

5. A replay of the entire meeting is available on the FASB's website. The website also contains a log of questions submitted to the TRG.

Topic 1: Scoping Considerations for Incentive-based Capital Allocations, Such as Carried Interest (TRG Agenda Ref No. 50)

6. Some entities, particularly asset managers, receive incentive-based performance fees via an allocation of capital from an investment fund under management (that is, through a "carried interest"). The fees are provided to compensate the asset manager for its services and performance in managing the fund. Many stakeholders think there are two aspects to those incentive-based fee arrangements: (a) compensation for asset management services and (b) financial exposure to the fund's performance. Stakeholders have raised questions about whether those arrangements are within the scope of Topic 606 or, instead, are in the scope of other GAAP, such as Topic 323, Investments-Equity Method and Joint Ventures, which is listed as a scope exception in paragraph 606-10-15-2(c)(3).

7. All seven FASB Board members were present at the TRG meeting and each stated their views that those arrangements are within the scope of Topic 606. Board members highlighted that:

    (a) On various occasions during development of the new revenue standard, the FASB and the IASB discussed how the new revenue recognition guidance would apply to asset management contracts. The topic was discussed during public joint Board meetings on September 24, 2012, November 19, 2012, and January 30, 2013. At the January 30, 2013 joint Board meeting, the Boards confirmed their proposal in the 2011 Exposure

Draft that an asset manager's performance-based incentive fees are subject to the constraint on variable consideration.

(b) Example 25 of Update 2014-09 illustrates the application of the variable consideration constraint guidance to an asset manager contract. Although Example 25 is not explicit about whether the guidance applies to fee arrangements in which the asset manager is compensated for performance-based fees via an interest, such as a carried interest, the Board's view is that this example illustrates the intent that performance-based fees are in the scope of Topic 606.

(c) A few Board members highlighted a potential inconsistency in feedback received from some stakeholders about the nature of carried interest during the outreach phase of ASU 2015-02, *Consolidation (Topic 810)—Amendments to the Consolidation Analysis*, and during the implementation phase of the new revenue standard. In outreach for the project leading to Update 2015-02, some stakeholders asserted that carried interest is a fee for services and, therefore, it should not be considered a variable interest under the consolidation guidance. This assertion seems inconsistent with a view that carried interest is an equity interest for the purposes of determining whether the contracts are within the scope of Topic 606. Several Board members also stated their belief that if the arrangements are considered equity interests outside the scope of Topic 606, an entity would need to evaluate the effect of that conclusion on its consolidation analysis under Topic 810, Consolidation.

8. Many TRG members agreed that the arrangements are within the scope of Topic 606. A few TRG members stated that they can understand a view that carried interest could be considered an equity arrangement, because it is, in form, an interest in the entity. Some TRG members stated that if the arrangements are considered equity interests outside the scope of Topic 606, then questions could arise in practice about the effect of such a conclusion on the analysis of whether the asset managers should consolidate the funds.

9. The SEC staff observer indicated that he anticipates the SEC staff would accept an application of Topic 606 for those arrangements. However, the observer noted that

there may be a basis for following an ownership model. If an entity were to apply an ownership model, then the SEC staff would expect the full application of the ownership model, including an analysis of the consolidation model under Topic 810, the equity method of accounting under Topic 323, or other relevant guidance

10. The FASB staff does not recommend that the Board undertake standard-setting action as a result of this discussion. This is because the staff thinks Topic 606 is clear that performance based fees, such as carried interest arrangements, are within the scope of Topic 606. Several TRG members had the same view. In addition, each of the seven FASB Board members stated during the meeting that they believe that carried interests are within in the scope of Topic 606.

Topic 2: Considering Class of Customer When Evaluating Whether a Customer Option Gives Rise to a Material Right (TRG Agenda Ref No. 54)

11. Customer options to acquire additional goods or services for free or at a discount come in many forms, such as sales incentives, customer award credits (or points), contract renewal options, or other discounts on future goods or services. The new revenue standard requires an entity to evaluate whether a customer option to acquire goods or services gives rise to a material right and, thus, a performance obligation. Some stakeholders informed the staff that there are differing views about how the class of customer is considered when evaluating whether a customer option gives rise to a material right.

12. TRG members generally agreed with the framework in the staff memo for analyzing whether a material rights exists. Specifically, the TRG memo highlighted that the guidance in paragraphs 606-10-55-42 through 55-43 is intended to make clear that customer options that would exist independently of an existing contract with a customer do not constitute performance obligations in that existing contract. The staff memo on this topic included several examples illustrating how the class of customer is considered when evaluating whether a customer option gives rise to a material right.

13. Although TRG members generally agreed with the framework, TRG members did not agree about what financial reporting outcome would result from applying that framework to tier status programs (for example, whether a program would be

considered a marketing offer or a material right). In the staff's view, part of the disagreement in the financial reporting outcomes resulted from differences in TRG members' views about the facts and circumstances of the programs (for example, whether or not an airline would provide a new customer that is part of a certain class with status without first earning status).

14. Because the different views primarily were about tier status programs and because none of the TRG members' organizations have tier status programs, the staff suggested that the FASB perform separate outreach with representatives from several industries in which tier status programs are common (for example, airlines, hospitality, and gaming). The purpose of the outreach is for the companies in those industries to inform the FASB about the specific facts and circumstances of their tier status programs and to discuss the application of the framework for customer options in the new revenue standard to those programs.

15. Because TRG members generally agreed that the framework for evaluating customer options is clear, the staff does not recommend that the Board undertake standard-setting action. Instead, the staff and the Board members will participate in outreach with organizations that have tier status programs and their auditors to assist with implementation in that specific area. [That outreach meeting occurred on May 23, 2016.]

Topic 3: Scoping Considerations for Financial Institutions (TRG Agenda Ref No. 52)

16. In developing the scope of Topic 606, the Board acknowledged that some arrangements may have unique considerations that are specifically addressed in other areas of GAAP. The Board excluded those arrangements with customers (in paragraph 606-10-15-2) because Topic 606 might not be appropriate in addressing unique accounting issues for those arrangements.

17. Financial institutions perform a variety of activities for their customers and earn a variety of fees. Stakeholders submitted questions to the TRG about whether a few specific activities and fees are included within or excluded from the scope of Topic 606. The TRG discussed the following three questions:

(a) Question 1: Is income from servicing and sub-servicing activities within the scope of Topic 606?

(b) Question 2: Are deposit-related fees within the scope of Topic 606?

(c) Question 3: Are fees from guarantees within the scope of Topic 606?

18. On Question 1, TRG members generally agreed with the staff view that fees related to arrangements that are within the scope of Topic 860, Transfers and Servicing, are not within the scope of Topic 606. Paragraph 606-10-15-2(c) contains a scope exception for financial instruments and other contractual rights or obligations within the scope of Topic 860. Subtopic 860-50 requires that an intangible asset or liability be recognized and initially measured at fair value when the expected future servicing cash flows (that is, the benefits of servicing) are in excess of, or below, the going market rate for those services (defined as adequate compensation in Topic 860).

19. While Topic 860 includes detailed guidance on the initial recognition and subsequent measurement of servicing assets and liabilities, it does not include explicit guidance describing the revenue recognition of contractually specified servicing fees. However, based on the subsequent measurement guidance in Topic 860 that requires either (a) fair value measurement, which reflects the remaining expected cash flows or (b) amortization of the servicing asset or liability in proportion to, and over the period of, estimated net servicing income or loss (with an evaluation of impairment of the asset/liability at each reporting date), the staff view is that the subsequent measurement guidance in Topic 860 provides implicit guidance on accounting for the servicing cash flows. That is, the subsequent measurement of the asset/liability and the servicing fees cash flows are inextricably linked.

20. On Question 2, TRG members agreed with the staff view that deposit-related fees are within the scope of Topic 606. Stakeholders had raised this question because they were unclear about whether those fees would be excluded from Topic 606 due to the scope exception in paragraph 606-10-15-2(c)(5). That subparagraph states that Topic 405, Liabilities, is excluded from the scope of Topic 606. However, the staff notes that Topic 405 only addresses the accounting for the deposit liability and does not have an accounting framework for recognizing revenue from deposit-

related transactions. Accordingly, TRG members agreed that the fees are within the scope of Topic 606.

21. On Question 3, TRG members agreed with the staff view that guarantee fees (other than fees for product or service warranties) that are within the scope of Topic 460, Guarantees, are not within the scope of Topic 606. TRG members observed that some of the consequential amendments that were made in Update 2014-09 are potentially inconsistent with the scoping guidance in paragraph 606-10-15-2 and agreed with the staff view that the Board should consider a technical correction to the consequential amendments to further clarify that guarantee fees within the scope of Topic 460 are not within the scope of Topic 606.

22. Because the discussion indicated that stakeholders can understand and apply the applicable guidance in the new revenue standard in a manner that the staff believes is consistent with the standard, the staff recommends that the Board take no further action on Questions 1 and 2. For Question 3 on guarantees, the staff will compile issues such as this and ask the Board to decide at a later date whether to make a technical correction or minor improvement to the guidance.

Topic 4: Evaluating How Control Transfers Over Time (TRG Agenda Ref No. 53)

23. Under the new revenue standard, an entity determines whether it satisfies a performance obligation over time or at a point in time. When an entity determines that a performance obligation is satisfied over time, revenue is recognized by measuring the progress toward complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity's performance in transferring control of goods or services promised to a customer (paragraph 606-10-25-31).

24. Some stakeholders informed the staff that there is a question on evaluating how control transfers when a performance obligation is satisfied over time. Specifically, some stakeholders have questioned whether an entity that is performing over time can transfer control of the good or service underlying a performance obligation at discrete points in time.

25. TRG members agreed with the staff view that meeting the over time criteria in paragraph 606-10-25-27 implies that control cannot transfer at discrete points in time. Accordingly, an appropriate measure of progress should not result in the recognition of work in process (or a similar asset) from an entity's performance under a specific contract with a customer.
26. Because the discussion indicated that stakeholders can understand and apply the applicable guidance in the new revenue standard in a manner that the staff believes is consistent with the standard, the staff recommends that the Board take no further action.

Topic 5: Contract Asset Treatment in Contract Modifications (TRG Agenda Ref No. 51)

27. A contract modification is a change to the scope or price (or both) of a contract that is approved by the parties to the contract. Paragraphs 606-10-25-10 through 25-13 provide a framework for accounting for contract modifications. The framework is intended to faithfully depict the rights and obligations arising from a modified contract by accounting for some modifications prospectively and accounting for others on a cumulative catch-up basis. Contract modifications that are treated as a termination of the existing contract and the creation of a new contract (that is, arrangements falling under paragraph 606-10-25-13(a)) are accounted for prospectively.
28. Because paragraph 606-10-25-13(a) does not explicitly describe the accounting for any contract asset that exists immediately before a contract modification, some stakeholders questioned whether the contract asset would be written off at the termination of the existing contract (that is, debited to revenue), or rather, if the asset should be carried forward into the new contract.
29. TRG members agreed with the staff view that a contract asset should be carried forward into the new, modified contract under Topic 606 when that modified contract is accounted for in accordance with paragraph 606-10-25-13(a). Several TRG members noted that contracts modifications can vary widely and highlighted that the views in the staff paper should only be applied to those situations in which the modification is accounted for in accordance with paragraph 606-10-25-13(a).

30. Because the discussion indicated that stakeholders can understand and apply the applicable guidance in the new revenue standard in a manner that the staff believes is consistent with the standard, the staff recommends that the Board take no further action.

Other Technical Matter Discussed

31. The staff stated that it received a question from a preparer group about the point in time at which an asset resulting from a contract with a customer under Topic 606 should be presented on the balance sheet as a receivable. The question is not about when revenue or an asset should be recognized; the question is limited to whether an asset should be presented as a receivable or some other asset (for example, a contract asset). The question arises because of some confusion about the meaning of certain words in paragraph 606-10-55-286 in Example 38B of the new revenue standard.
32. The staff stated that paragraph 606-10-45-4 provides guidance about the presentation of an asset as a receivable. That guidance states:

    > A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due.

33. The staff thinks the guidance in that paragraph is sufficient to enable organizations to decide whether an asset should be presented as a receivable. In the staff's view, this guidance should not result in a significant change in practice from current U.S. GAAP. However, the staff also noted that there is some diversity in practice today in this area and the new revenue standard does not resolve that diversity.
34. The staff plans to recommend that the Board make a technical correction to Example 38B to establish a clearer connection between the guidance in paragraph 606-10-45-4 and the example. The staff will compile issues such as this and ask the Board to decide at a later date whether to make a technical correction or minor improvement to the guidance.

Project Update

35. At the TRG meeting, the staff provided an update on issues raised at previous TRG meetings. The majority of the implementation questions discussed at the first six TRG meetings have been resolved at those meetings without any further action needed. However, standard setting has been required on a few of the issues. The staff provided the following update on the status of those issues.

    (a) On March 17, 2016, the FASB issued Accounting Standards Update 2016-08—Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)

    (b) On April 14, 2016, the FASB issued Accounting Standards Update 2016-10—Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing

    (c) The FASB expects to issue its Accounting Standards Update on Narrow-Scope Improvements and Practical Expedients in the second quarter of 2016. [The final ASU was issued after the TRG meeting on May 9, 2016.]

36. An IASB staff observer noted that the IASB issued its Standard, Clarifications to IFRS 15, on April 12, 2016.