

STAFF PAPER

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Background and Purpose

- 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”) includes implementation guidance about whether an entity’s promise to grant a license to intellectual property (IP) is satisfied either (a) over time (provides a right to *access* the entity’s IP as it exists at any given time throughout the license period) or (b) at a point in time (provides a right to *use* the entity’s IP as it exists at the time the license is granted). A license to “dynamic” IP (that is, IP that is expected to be *significantly* affected by the licensor’s ongoing activities or non-performance of those activities) is satisfied over time, which will result in recognition of the license fees (other than those resulting from sales- or usage-based royalties) as revenue over the contractual term of the license. A license to “static” IP (that is, IP *not* significantly affected by the licensor’s ongoing activities) is satisfied at a point in time and will result in recognition of those same license fees at the point in time the customer is first able to use and benefit from the license.

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2. Determining when (*Issue 1*) and how (*Issues 2, 2a, 2b, and 3*) to apply that implementation guidance can have a significant effect on the period or periods that an entity recognizes revenue from licenses of IP. However, the effect of determining the nature of a license will be less significant if all, or a substantial portion, of the license fees are in the form of sales- or usage-based royalties because those royalties are recognized at the later of when (a) the subsequent sales or usage occurs and (b) the performance obligation is satisfied.
3. Stakeholders have informed the staff that there may be different interpretations of the guidance about licenses of IP in the new revenue standard. Consequently, entities might reach different conclusions about the period or periods to recognize revenue for licenses of IP. For example, Entity X might conclude that the fee for a five-year license should be recognized at the beginning of the license period, while Entity Y might conclude that the fee for an identical arrangement should be recognized over the five-year license term.
4. The specific questions about licenses of IP included in this paper are:
 - (a) For a license of IP that is not a separate performance obligation, does an entity need to determine the nature of the license as a right to access the entity's IP or a right to use the entity's IP (that is, determine whether the license is satisfied over time or at a point in time)? (*Issue 1*)
 - (b) For the nature of a license to be a right to access the entity's intellectual property as it exists throughout the license period, (a) do the contractual or expected activities of the licensor have to change the form and/or functionality of the underlying IP or (b) do significant changes in the value of the IP alone constitute a change to the IP? (*Issue 2*)
 - (c) If a customer is not required to use the most recent version of the underlying IP, do the licensor's activities directly expose the customer to positive or negative effects of the IP to which the customer has rights? (*Issue 2a*)
 - (d) Are activities that transfer a good or service that is *not* separable from the license of IP considered in determining the nature of the license? (*Issue 2b*)

- (e) Can restrictions in a contract for a license of IP affect the determination of whether that contract contains one or multiple licenses when applying Step 2 (identify performance obligations) of the new revenue standard?
(Issue 3)

5. This paper includes a summary of the potential implementation issues that stakeholders have reported to the staff. The staff plans to ask the members of the FASB-IASB Joint Transition Resource Group for Revenue Recognition for their input about those potential implementation issues.

Accounting Guidance

6. The guidance in the new revenue standard that is applicable to the topics in this paper is included in Appendix A. Paragraphs referenced as “[XX]” throughout this paper are the paragraphs in IFRS 15.

Potential Implementation Issues Reported by Stakeholders

Issue 1: For a license of IP that is not a separate performance obligation, does an entity need to determine the nature of the license as a right to access the entity’s IP or a right to use the entity’s IP (that is, determine whether the license is satisfied over time or at a point in time)?

7. Licenses of IP are often sold with other goods and/or services. For example:
 - (a) Software licenses are commonly sold with post-contract customer support (PCS), other services (for example, hosting, customization or implementation services), and/or hardware
 - (b) Franchise licenses are frequently sold with consulting or training services and/or equipment
 - (c) Bio-technology and pharmaceutical licenses are often sold with research and development services and/or a promise to manufacture the drug for the customer.

8. A license of IP may, or may not, be a separate performance obligation in the contract. This is because (a) the license may, or may not, be distinct *or* (b) one or more of the other goods or services in the contract may not be distinct. Paragraph 606-10-25-22 [30] states that if a good or service is not distinct, it must be combined with other goods or services until it is combined into a distinct bundle, at which point it would be a separate performance obligation. Therefore, even if one of the goods or services in a contract with two goods or services is distinct (for example, a license of IP), it may not be a separate performance obligation if the other good or service is *not* distinct.
9. Paragraphs 606-10-55-56 [B54] through 55-58 [B56] suggest that if a license is not a separate performance obligation, an entity would not apply the licenses implementation guidance in paragraphs 606-10-55-59 [B57] through 55-64 [B62] to that license. Instead, the entity would apply the general guidance applicable to performance obligations to determine whether the combined performance obligation (that is, the license and whatever other goods or services are included in the single performance obligation) is satisfied over time or at a point in time.
10. However, the new revenue standard also includes the following guidance about this issue:
 - 606-10-25-27 [35]** An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if one of the following criteria is met:
 - a. The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs 606-10-55-5 [B3] through 55-6 [B4]).
 - b. The entity's performance creates or enhances *an asset (for example, work in process) that the customer controls as the asset is created or enhanced* (see paragraph 606-10-55-7 [B5]). [Emphasis added.]
 - c. The entity's performance does not create an asset with an alternative use to the entity (see paragraph 606-10-25-

28 [36]), and the entity has an enforceable right to payment for performance completed to date (see paragraph 606-10-25-29 [37]).

606-10-25-33 [41] Appropriate methods of measuring progress include output methods and input methods. Paragraphs 606-10-55-16 [B14] through 55-21 [B19] provide guidance for using output methods and input methods to measure an entity's progress toward complete satisfaction of a performance obligation. *In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.* [Emphasis added.]

BC407. If the customer cannot benefit from the license on its own, and/or the license cannot be separated from other promises in the contract, the license would not be distinct and, thus, would be combined with those other promises (see paragraph 606-10-25-22 [30]). The entity would then determine when the single performance obligation is satisfied on the basis of when the good or service (that is, the output) is transferred to the customer. *The Boards noted that in some cases, the combined good or service transferred to the customer may have a license as its primary or dominant component. When the output that is transferred is a license, or when the license is distinct, the entity would apply the criteria in paragraph 606-10-55-60 [B58] to determine whether the promised license provides the customer with access to the entity's intellectual property or a right to use the entity's intellectual property.* [Emphasis added.]

11. Those paragraphs appear to acknowledge that determining the nature of a license may be necessary in some cases to ensure appropriate revenue recognition for a performance obligation that includes a license of IP and at least one other good or service (hereafter referred to as a "combined performance obligation"). Therefore, determining the nature of a license should not be restricted to only those cases in

which the license is distinct from the other goods or services in the contract. For example, an entity *may* need to determine the nature of the license in order to:

- (a) Determine whether a combined performance obligation that includes a license is satisfied over time or at a point in time. This is because it may be necessary to determine whether the entity's performance creates or enhances an asset *that the customer controls* as the entity performs. Paragraph 606-10-55-63 [B61] stipulates that the customer does not obtain control of a license of IP at a point in time if that license provides access to the entity's IP over time, but the customer *does* obtain control of a license at a point in time if it transfers a right to use the entity's intellectual property. Therefore, an entity may need to determine the nature of the license in order to conclude whether the customer controls an asset as the entity performs.
- (b) Measure progress towards complete satisfaction of a combined performance obligation that is satisfied over time and includes a license. Paragraph 606-10-25-33 [41] stipulates that, in selecting the appropriate measure of progress towards complete satisfaction of a performance obligation, an entity should consider the nature of the good or service that the entity promised to transfer to the customer. If an entity does not consider the nature of the license, it might recognize revenue differently than it would if it considered the nature of the license. For example, this might be the case for:
 - (i) A license that would be recognized over time if it were distinct when it is combined with a relatively insignificant or short-duration service component (for example, a ten-year license combined with a service component that will be completed in the first year of that ten-year license term); or
 - (ii) Where the measure of progress that would be applied to the service component (for example, an input method) is different from the measure of progress that would be

applied to the license if it were satisfied over time (for example, a time-based method).

Issue 2: For the nature of a license to be a right to access the entity's intellectual property as it exists throughout the license period, (a) do the contractual or expected activities of the licensor have to change the form and/or functionality of the underlying IP or (b) do significant changes in the value of the IP alone constitute a change to the IP?

12. Stakeholders have communicated to the staff that there are different interpretations about how to apply the implementation guidance on licenses included in paragraphs 606-10-55-59 [B57] through 55-64 [B62]. The most significant issue about that guidance is applying the criterion in paragraph 606-10-55-60(a) [B58(a)]. That criterion is important in distinguishing between a license that represents a right to use the licensor's IP satisfied at a point in time and a license that represents a right to access the licensor's IP satisfied over time. Stakeholders have different interpretations about what it means for contractual or expected activities of the licensor to *significantly affect the intellectual property to which the customer has rights*.
13. Under the new revenue standard, if the activities significantly affect the IP, then the nature of the entity's promise in granting the license is a promise to provide a right to access the IP, assuming the other criteria in paragraph 606-10-55-60 [B58] are met. Consequently, revenue would be recognized over time in those cases.
14. The staff think that stakeholders have the following interpretations about that guidance:
 - (a) *Interpretation A*: For activities to significantly affect the IP to which the customer has rights, those activities must be expected to change the *form and/or functionality* of that IP. Changes that solely affect the *value* of the IP do not significantly affect the IP to which the customer has rights.
 - (b) *Interpretation B*: For activities to significantly affect the IP to which the customer has rights, those activities only need to significantly affect (that is, change) the value of the IP to the customer. Those activities also could significantly affect the form and/or functionality of the IP, but

changes to form and/or functionality are not required to meet the criterion.

- (c) *Interpretation C*: This interpretation is the same as Interpretation B, *except that* the notion of “significantly affects the intellectual property” is a high threshold.

15. The timing of revenue recognition may be significantly different under each of those interpretations. Some stakeholders think that Interpretation A would result in most, but not all, licenses being considered rights to use the entity’s IP (revenue recognized at a point in time) rather than rights to access the entity’s IP (recognized over the license term). This is because it may not be common that the IP itself changes with respect to its form and/or functionality. For example, there may be no reasonable expectation that the licensor will change the form and/or the functionality of a trade name, logo, or media content (for example, movie or television episode) during the license period and, therefore, Interpretation A would indicate those licenses are satisfied at a point in time.
16. Some stakeholders think that Interpretation B would result in most licenses being considered rights to access the entity’s IP (revenue recognized over time). This is because those stakeholders think that it would be uncommon that an entity would not be engaged in activities that could significantly affect the value of the IP to which its customers have rights. For example:
- (a) A software provider’s ongoing marketing activities may significantly affect the value of the licensed software to which a customer has rights, especially in scenarios where the customer integrates the licensed software in its products sold to its customers. For example, ongoing marketing of an operating system for a handheld computer device by the licensor may increase demand for the customer’s handheld computer device that includes that software.
- (b) A biotechnology entity’s continued research and development (R&D) of a particular set of IP for use in treating a particular disease (one “indication”) may significantly affect the value of the customer’s rights to that same IP because it is possible that the continued R&D will lead to

approval of the same IP for another indication. The R&D directed by the biotechnology entity at one indication may advance the prospects for approval of the IP for use in the licensed indication or may affect the perception of the IP in the marketplace, impacting the marketability of the customer's planned drug product using the IP.

- (c) A media company's continued production and related promotion of new seasons of a television show may prompt viewers to watch old seasons of the show licensed to the media company's customers, which likely would increase the value of the licensed IP (that is, the older seasons) to those customers (for example, increased viewership might result in greater advertising revenue).

17. Interpretation C may result in a many types of licenses being accounted for over time and many other types of licenses being accounted for at a point in time because it views "significantly affects" as a high threshold intended to capture those activities that effectively *define* the IP and, therefore, can significantly change or alter the character of that IP. For example, a sports team logo is effectively defined by the team's ongoing activities of playing games and by its stature as a competitive organization (that is, the image of the logo itself - for example, a character or a graphic - without association to the ongoing activities of the team often would have a much more limited value), and a brand name is similarly defined by the ongoing activities of the underlying organization. Interpretation C would generally not view promotional or other activities related to IP that has significant functionality and value separate from those activities as ones that *significantly affect* the related IP.

Interpretation A

18. Stakeholders that support Interpretation A think paragraph 606-10-55-59 [B57] is the principle of the licenses implementation guidance. The principle is that a customer obtains control over the license (that is, can direct the use of and obtain substantially all of the remaining benefits from the license) when "the intellectual property to which the customer has rights will not change." In contrast, a customer does not obtain control of a license at a point in time "if the intellectual property to which the customer has rights changes throughout the license period." The

customer does not obtain control over the promised license, and the licensor does not satisfy its performance obligation, when the IP is first made available for the customer's use and benefit because there is an expectation that the licensor will continue to change the form and/or functionality of the IP and continue to make the changed version(s) of the IP available to the customer.

19. Stakeholders that support Interpretation A also point to BC408, which states that “the license provides the customer with a right to use an entity’s intellectual property as that intellectual property exists (in the form and with the functionality) at the point in time when the license transfers to the customer.” BC408 states that the goal of the criteria in 606-10-55-60 [B58] is to determine when the IP to which the customer has rights is changing (that is, when the IP is “dynamic”), rather than when the IP to which the customer has rights is “static.”
20. Stakeholders that support Interpretation A think Examples 54 and 57 through 59 in the new revenue standard support their interpretation.
 - (a) In Examples 57 and 58, the IP to which the customer has rights is expected to change. In Example 58, new characters in a comic strip are developed and the existing characters’ images “*evolve*”, and the customer only has rights to the most recent form/version of the IP (the customer must use the latest images and characters). Therefore, the customer does not have the ability to direct the use of, or obtain substantially all the remaining benefits from, the license at the point in time at which it first obtains rights to access the licensor’s IP because the customer is not expected to have rights to access *that* IP (in its present form and/or with its current functionality) throughout the license term. That “original” IP will be replaced throughout the license term because the customer will no longer have rights to use the original IP.
 - (b) In Examples 54 and 59, the licenses are transferred at a point in time because the IP is not expected to change during the license period.
 - (i) Example 59 states the “entity does not have any contractual or implied obligations to *change the licensed recording*. Thus, the intellectual property to which the customer has

rights is static. *Consequently*, the entity concludes that the nature of its promise in transferring the license is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time it is granted."

[Emphasis added.]

- (ii) Example 54 states "the entity concludes that because the software is functional when it transfers to the customer, the customer does not reasonably expect the entity to undertake activities that significantly affect the intellectual property to which the license relates. *This is because* at the point in time that the license is transferred to the customer, *the intellectual property will not change throughout the license period.*" [Emphasis added.] This example, therefore, appears to conclude that the criterion in 606-10-55-60(a) [B58(a)] is not met expressly because the IP to which the customer has rights will not change during the license term.

21. Stakeholders that support Interpretation A also point to the following excerpts from the guidance that they think are consistent with Interpretation A:

- (a) Paragraph 606-10-55-58 [B56] makes explicit reference to the entity's intellectual property *as it exists* either "throughout the license period" or "at the point in time at which the license is granted." To those stakeholders, the notion of the entity's intellectual property *as it exists* throughout the license period suggests that the IP itself, not just the value of the IP, must change or be expected to change.
- (b) Paragraphs 606-10-55-59 [B57] through 55-61 [B59] each explicitly refer to activities that significantly affect *the intellectual property* to which the customer has rights. Those holding Interpretation A think that it is important that those paragraphs refer to significantly affecting the intellectual property rather than, for example, the license or the contract. A change in the benefits that the customer can derive from its rights

would seem, to those stakeholders, to reflect a significant effect on the contract, not on the underlying IP.

- (c) Paragraph 606-10-55-63 [B61] states that a customer obtains control at a point in time over a license that grants the customer rights to use the entity's IP as it "exists (in terms of form and functionality) at the point in time at which the license is granted." This paragraph suggests that unless the form and/or functionality of the underlying IP to which the customer has rights is expected to change, then the customer obtains control over the license when rights to that unchanging IP are granted.
- (d) Paragraph 606-10-55-64 [B62] states that a "promise to defend a patent right" should not be considered in determining the nature of a license. It further states that such a promise "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." BC411 includes a similar notion that such activities should not affect the nature of the license and refers to a promise to "defend and maintain" the IP. To some stakeholders that hold Interpretation A, those paragraphs support the notion that activities intended simply to protect (or that affect) the value of an entity's IP that is being licensed (the protection of which clearly affects the customer) are not activities that should be considered in determining the nature of a license.
- (e) BC409 states that when the customer expects the licensor to undertake activities that will significantly affect the IP to which the customer has rights and, thus, expose the customer to positive or negative effects, the customer "will be using the most recent *form* of the intellectual property throughout the license period." This excerpt supports the view that what the licensor should be evaluating in the criterion in paragraph 606-10-55-60(a) [B58(a)] is whether the licensor's expected activities will change the form or functionality of the underlying IP.

22. Stakeholders that support Interpretation A think that the principle in paragraph 606-10-55-59 [B57] is an application of step 5 of the revenue model (recognize revenue when, or as, the entity satisfies a performance obligation by transferring a promised good or service to a customer). Paragraph 606-10-55-62 [B60] explains that “the customer receives and consumes the benefit from the entity’s performance of providing access to its intellectual property as the performance occurs.” Those that support Interpretation A suggest that it is only in the context of *changing* IP (in form and/or function, rather than changing *value*) that the customer obtains rights to IP (that is, a license) for which it will not have rights for the entire license term and the entity must continue to perform by making the changed IP (for example, the new code, content, or design) available to the customer. For example, if a customer is granted a ten-year license, but will only have rights to that IP until it changes, then the customer has not obtained control over the license at the start of the license period, and the vendor has not fulfilled its performance obligation (as it is expected to change the IP and must make the changed IP available to the customer for its use as changes occur throughout the license term).

Interpretation B

23. Interpretation B is a broader view of what constitutes a change to the IP to which the customer has rights. Under Interpretation B, changes to the IP include not only changes to the form or functionality of the IP, but *also* changes in the value of the IP. Under Interpretation B, if the criteria in paragraph 606-10-55-60 [B58] are met, then the IP to which the customer has rights *is* “dynamic” and, therefore, expected to change throughout the license period. This is even where the change in the IP is exclusively a change in the value of the IP to the customer arising from the entity’s activities (that is, the amount of benefits that the customer can derive from its right to use or access that IP).
24. Stakeholders that support Interpretation B point to the following excerpts from the new revenue standard that they think are consistent with Interpretation B:
- (a) BC408 states that “the Boards decided to specify criteria in paragraph 606-10-55-60 [B58] for determining if the intellectual property will change and, thus, if a license provides a customer with the right to access

the entity’s intellectual property.” Those that support Interpretation B think paragraph 606-10-55-60 [B58] *defines* what it means for IP to change, and observe that that paragraph does not state the form or functionality of the IP itself must change. Instead, the paragraph states “the entity will undertake activities that significantly affect the intellectual property” and that those activities “directly expose the customer to any positive or negative effects of the entity’s activities as those activities occur.” Those that support Interpretation B point to activities referenced in certain examples in the new revenue standard.

- (b) Example 61 states that the criteria in paragraph 606-10-55-60 [B58] have been met without any indication that the form or functionality of the IP to which the customer has rights (that is, the team name or the logo) will change during the one-year license term. Despite no indication of change in the form or functionality of the IP, the conclusion in the example is that the expected activities of the licensor (that is, to continue to play games and provide a competitive team) “in effect, change the intellectual property to which the customer has rights.”
- (c) Example 56 (Case B) states that the pharmaceutical license is satisfied at a point in time because the entity is not expected to undertake any activities “to support the drug,” and that, *consequently*, the entity is not reasonably expected to undertake activities that would significantly affect the IP to which the customer has rights. While the example is not specific as to what would constitute activities “to support the drug,” some think activities that support a drug are more frequently promotional or other similar activities than activities that would change the IP (that is, the drug compound) itself. Promotional or other similar activities generally would be viewed as affecting the *value* of the licensed IP, but not changing the underlying IP itself in terms of form or functionality.

25. Stakeholders that support Interpretation B think Examples 57 and 58 illustrate when a license is satisfied over time because the form or functionality of the IP is expected to change, while Example 61 demonstrates an instance where the expected change in the IP extends beyond a change in the form or functionality of that IP.

26. Stakeholders that support Interpretation B think that the intent of the Boards' decision with respect to licenses is that some licenses would be satisfied at a point in time and some licenses would be satisfied over time. Those stakeholders think that Interpretation A would result in most licenses being satisfied at a point in time, which they think is inconsistent with the Boards' intentions.
27. Some stakeholders think that Interpretation B does not reflect *licenses-specific* implementation guidance because they do not think the underlying premise can be isolated to licenses of IP. If the premise of Interpretation B is that the customer does not control the license in the contract because activities of the licensor are expected to significantly affect the value of the IP to the customer (that is, the benefits that can be derived from the license to that IP), then that premise would seem to apply to many tangible goods as well. For example, if a luxury car manufacturer is expected to continue to advertise and promote the car and brand or continue to produce only high-end vehicles, then one could argue the manufacturer's activities are expected to significantly affect the value of the product to the customer (for example, the resale value of the car could change significantly based on the manufacturer's activities to promote and maintain the value of the brand).
28. Some stakeholders have suggested that the premise underlying Interpretation B may be more closely linked to the separation principle (that is, Step 2 of the new revenue model) than the transfer of control principle that underlies Step 5 of the new revenue model (that is, when a customer obtains the ability to direct the use of, and obtain substantially all the remaining benefits from, an asset). The licenses implementation guidance is intended to interpret the transfer of control notion per paragraph 606-10-55-59 [B57]. Those stakeholders think that a change in value notion is more akin to concluding that while an entity's customary business practices or other ongoing activities may not comprise an additional promised good or service in the contract with the customer, those activities (that the customer generally cannot choose to have the licensor perform or not perform) may significantly affect the license. Therefore, the customer reasonably expects the licensor to continue to perform the activities throughout the license period.

Interpretation C

29. Similar to Interpretation B, Interpretation C is based on the view that:
- (a) Changes to the IP include not only changes to the form and/or functionality of the IP, but also changes in the value of the IP; and
 - (b) If the criteria in paragraph 606-10-55-60 [B58] are met, then the IP to which the customer has rights is “dynamic” and, therefore, expected to change throughout the license period.
30. However, Interpretation C differs from Interpretation B because Interpretation C focuses on the notion that the criterion in paragraph 606-10-55-60(a) [B58(a)] was intended to identify only those activities that effectively *give* value to the IP (for example, when the performance, or non-performance, of the expected activities will have a fundamental effect on the value of the IP). The criterion was not intended to capture activities that affect the IP only in a “more-than-insignificant” manner. Put another way, Interpretation C views IP as “dynamic” (that is, changing) when the entity’s ongoing activities will, or have the potential to, substantially change the character of the IP. “Significant” is a high threshold under Interpretation C.
31. Those that support Interpretation C think Example 61 demonstrates this interpretation. The sports team’s logo and team name derive their value from the sports team’s ongoing activities of being a competitive team that plays games each season. The logo or team name may have little, if any, value separate from the team’s activities, and those activities *significantly* affect the value of the IP. If the team were to stop playing games, move to a small sports market, or substantially change its approach from one of providing a top-level team to one that was no longer competitive, the value of that IP likely would change significantly.
32. In contrast, stakeholders supporting Interpretation B have suggested that promotional or other similar types of activities would often meet the criterion in paragraph 606-10-55-60(a) [B58(a)]. This is despite the fact that the underlying IP may have significant functionality and value to the customer separate from the entity’s performance or non-performance of expected activities. Interpretation C would suggest that such activities typically would not have a significant effect on the IP because the effect of such activities would be weighed against the overall

value of the IP (for example, the effect of promotional activities would be weighed against the value a customer can derive from the functionality of the IP that is unaffected by the promotional activities). If the core functionality of the IP (for example, its ability to process transactions or be aired on television) will be unchanged by the entity's activities and holds a significant portion of the value of that IP, the IP would typically not be viewed as "dynamic."

33. Supporters of Interpretation C think that this interpretation would most accurately reflect the intent of the Boards' decision on licenses of IP both with respect to:
- (a) What types of IP should result in over time recognition for licenses of that IP – supporters of Interpretation C think that the notion of "dynamic" IP was intended to capture those types of IP for which their value is derived from and, therefore, dependent upon and heavily influenced by, the entity's ongoing activities (for example, logos, trade names, or brands); and
 - (b) Unlike the way many stakeholders view either of the other two interpretations, this interpretation would result in many licenses being recognized over time, but many others being recognized at a point in time, which some stakeholders view as the essence of the Boards' decision.
34. Supporters of Interpretation C also think that some of the concerns about Interpretation B (for example, how far the concept could be applied, perhaps beyond its intent) are not concerns under Interpretation C.
35. Others that do not support Interpretation C see no basis in the guidance for this interpretation. "Significantly" is not defined in the manner expressed under this interpretation. In addition, Example 56 could be seen as suggesting promotional and other "support" activities are activities that the Boards think significantly affect the related IP.

Issue 2a: If a customer is not required to use the most recent version of the underlying IP, do the licensor's activities directly expose the customer to positive or negative effects of the IP to which the customer has rights?

36. The second criterion in paragraph 606-10-55-60 [B58] requires that, in order for a license to represent a right to access the entity's IP (revenue recognized over time), the license must directly expose the customer to the positive or negative effects of the licensor's activities that significantly affect the IP to which the customer has rights. If the customer has the continuing right and ability to use prior versions of the licensed IP, then the licensor's activities would not appear to directly expose the customer to positive or negative effects. This is because the customer can effectively *avoid* positive or negative effects of the change if it can use prior versions of the IP.
37. For example, if the customer can choose whether or not to (a) implement new menu items or other product improvements in a franchise scenario such as Example 57 in the new revenue standard, or (b) use changed character images in a comic strip example such as Example 58, then it appears the customer would not be directly exposed to the positive or negative effects of those changes to the underlying IP.
38. However, a stakeholder's interpretation of Issue 2 (what it means to "change" the IP) might affect how often the second criterion in paragraph 606-10-55-60 [B58] is met. If one subscribes to Interpretation A in Issue 2, then the customer's contractual and practical ability to continue to use prior versions of the licensed IP will often dictate the evaluation of this criterion. If one subscribes to Interpretation B or Interpretation C in Issue 2, then there likely is no instance in which the customer will have the ability to continue to use prior versions of the IP (that is, a prior version that reflects a previous value). Even if the IP is unchanged in its form or functionality, a customer cannot choose to be associated with a prior value of that IP. For example, even if a team logo is unchanged in appearance from the prior year to the current year, an apparel maker cannot choose to be associated with the value of that logo in the prior year when the team won a championship if that team lost the championship in the current year. As a result, it would appear that a licensor's activities that significantly affect the value of the IP to which the customer has rights will directly expose the customer to the positive or negative

effects of that change in value under Interpretations B or C in Issue 2. Some stakeholders suggest that the *presence* of this second criterion is supportive of Interpretation A in Issue 2 since it would appear to nearly always be met under either other interpretation; and therefore, calls into question why it would be included if it is never really in question.

Issue 2b: Are activities that transfer a good or service that is not separable from the license of IP considered in determining the nature of the license (606-10-55-60(c) [B58(c)]?

39. The third criterion that must be met in order for a license to represent a right of access (and therefore, be recognized over time) is that the expected activities of the licensor do not result in the transfer of a good or service to the customer as those activities occur. Some stakeholders have raised questions about whether activities of the licensor that are expected to significantly affect the IP to which the customer has rights could include activities that transfer a good or service that is not distinct from the license (that is, the good or service and the license are part of the same performance obligation).
40. Issue 1 should clarify that, in some cases, an entity may be required to determine the nature of a license that is combined with another promised good or service into a single performance obligation. This may occur when an entity concludes the license is the primary or dominant component of the combined performance obligation. It might also occur when an entity is determining (a) whether the combined performance obligation is satisfied over time or at a point in time and/or (b) the best measure of progress for that performance obligation (if it is satisfied over time). The determination of the nature of the license in those circumstances may materially affect the accounting and, therefore, appropriately applying all of the criteria in paragraph 606-10-55-60 [B58] will be important.
41. The third criterion in paragraph 606-10-55-60 [B58] explicitly states that expected activities of the licensor (that are expected to significantly affect the IP to which the customer has rights) are considered in determining the nature of a license only if those activities “do not result in the transfer of a good or service to the customer as those activities occur (see paragraph 606-10-25-17 [25]).” This criterion does not

refer to whether those activities are an *additional performance obligation* (that is, separate and distinct from the license of IP). Further, paragraph 606-10-25-17 [25], referred to in this criterion, is about identifying promised goods or services in the contract (separate from administrative and other tasks that do not transfer a promised good or service to the customer) and does not address whether those goods or services are distinct. Paragraph 606-10-25-17 [25] is about identifying the promises to the customer in the contract, which are then assessed as to whether or not they are distinct only *after* being identified.

42. Therefore, many think the guidance is clear that an activity is not relevant to determining the nature of a license when that activity results in the transfer of a good or service, regardless of whether the license or the good or service that results from the activity is distinct. To these stakeholders, the criterion is clear in its language and reflects, appropriately, the view that in determining the nature of one good or service (in this case, a license), an entity would make that determination based solely on the characteristics of *that* good or service. The licenses implementation guidance is intended to capture the effect of activities that do not, themselves, transfer a good or service on a promised license of IP.
43. Other stakeholders note that the wording in BC410 in the Basis for Conclusions speaks to this criterion only in the context of the activities being additional, separate performance obligations, including distinct automobile maintenance and the distinct service of providing software updates as examples. In addition, BC409 states:

In developing the criteria, the Boards observed that the main factor that results in the intellectual property changing is when the contract requires, or the customer reasonably expects, that the entity undertakes activities that do not directly transfer goods or services to a customer (that is, *they do not meet the definition of a performance obligation*). (Emphasis added.)

The discussion in those two paragraphs in the Basis for Conclusions appears to have raised the question for some stakeholders.

44. With respect to the effect of this issue on an entity's accounting, the staff think that how this criterion is interpreted *could* have a significant effect on some types of

contracts, in particular those in which it may be necessary to determine whether the customer controls a license as it is being enhanced or modified (in accordance with paragraph 606-10-25-27b [35b]). By way of example, assume a biotech company licenses its early-stage IP to a customer and agrees to provide R&D services to develop that IP into a commercial drug product. In some contracts of this nature, the biotech company will conclude that the license and the R&D services are not separate performance obligations. The activities involved in providing the R&D services will significantly change (that is, modify and enhance) the underlying IP to which the customer has rights and directly expose the customer to the positive or negative effects of those changes (either as a contractual requirement or because of economic imperative). However, based on the criterion in paragraph 606-10-55-60(c) [B58(c)], those activities will not affect the nature of the license because they are a promised service to the customer. As a result, the biotech company concludes that the combined performance obligation is satisfied over time because the customer controls the initial license as it is being enhanced (that is, further developed) in accordance with paragraph 606-10-25-27(b) [35(b)].

45. Conversely, if one reads paragraph 606-10-55-60(c) [B58(c)] as referring only to activities that transfer a performance obligation *separate from the license*, the activities in providing the R&D services *would* be considered in evaluating the other criteria in paragraph 606-10-55-60 [B58], potentially resulting in a conclusion that the license is satisfied over time (and therefore, that the customer does not control a license). If the customer does not control the license at contract inception, the combined license/R&D services performance obligation may not qualify for over time revenue recognition (depending on the entity's evaluation of the first and third criteria in paragraph 606-10-25-27 [35]).

Issue 3: Can restrictions in a contract for a license of IP affect the determination of whether that contract contains one or multiple licenses when applying Step 2 (identify performance obligations) of the new revenue standard?

46. Some licenses, particularly those in the entertainment and media industry, contain substantive restrictions on how the customer may employ the license. A customer may license a well-known television program or movie for a period of time (for example, three years), but be restricted to showing that licensed content only on a

specified day (for example, Christmas Eve or New Year's Eve) during each of those three years.

47. Paragraph 606-10-55-64 [B62] explicitly states that restrictions of time, geography, or use do *not* affect the licensor's determination as to whether the license is satisfied over time or at a point in time. However, some stakeholders have suggested that the new revenue standard is unclear about whether, in the example above, the contract includes a promise to deliver a single license or to deliver multiple licenses. Assuming the customer in the example above can benefit from its right to air the licensed content at each date, independent from its right to air the licensed content on either of the other agreed-upon dates, the determination as to whether the contract provides for a single license or for three distinct licenses will significantly affect revenue recognition for the contract. If the nature of the license is a right to use the licensor's IP (rather than a right of access), then revenue from a single license would be recognized at the point in time the customer is first able to use and benefit from the content. However, if the contract contains three distinct licenses, then the total transaction price would be allocated among those licenses, with each allocation recognized at the point in time the customer is able to use and benefit from the content under the applicable license.
48. Some stakeholders have expressed the view that the scenario described above represents a single license. Those stakeholders think that the guidance in paragraph 606-10-55-64 [B62] with respect to contractual restrictions supports this view, despite the context of that paragraph being about determining the nature of a license. This is because paragraph 606-10-55-64 [B62] defines contractual restrictions (such as those in the example above) as attributes of the license. Those stakeholders, therefore, think that the inclusion, or the exclusion, of various attributes with *any* good or service should not affect the determination about what the promised goods or services are in the contract. Consequently, they think there should be no difference with respect to this evaluation as to the number of licenses promised in the contract between a license with unlimited airing rights for a three-year period and the example above.
49. Other stakeholders that have raised this issue point to the guidance in paragraph 606-10-55-63 [B61] that states "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.”

Those stakeholders have questioned whether a contract like the example above, in effect, grants three licenses because after the first airing date, the customer can no longer use and benefit from its rights to air the licensed content until the next airing date.

50. Those stakeholders question whether those that think the example above constitutes a single license would reach the same conclusion if the contract grants rights to air content in the same manner as the example above, but the content to which the customer has rights is three *different* movies (that is, Movie 1 will be shown in Year 1, Movie 2 in Year 2, Movie 3 in Year 3). They think that it would appear reasonable under the new revenue standard to conclude that there are three licenses in that contract. This is because the customer obtains the right to use and benefit from three different movies at different dates (that is, Movie 1 on its airing date, Movie 2 on its airing date, and Movie 3 on its airing date). Those stakeholders question whether there is a substantive economic difference between the example above (with one movie or show) and this scenario (with three different movies or shows), especially if one considers that all of the content in either scenario may be transferred to the customer at a single point in time (for example, prior to the first airing date or at contract inception) and the licensor's costs and effort to transfer the content to the customer are minimal.

Questions for TRG Members

1. Do you think the guidance about licenses of intellectual property can be applied consistently?
2. If not, which issue(s) in this paper do you think might significantly affect an entity's ability to implement the new revenue standard?
3. Are there other implementation issues about licenses of which the Boards should be made aware?

Appendix A – Applicable Guidance

A1. The following paragraphs from the new revenue standard are referred to in the discussion of the implementation issues in this paper:

> > > **Methods for Measuring Progress**

606-10-25-33 [41] Appropriate methods of measuring progress include output methods and input methods. Paragraphs 606-10-55-16 [B14] through 55-21 [B19] provide guidance for using output methods and input methods to measure an entity's progress toward complete satisfaction of a performance obligation. In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.

> > **Licensing**

606-10-55-56 [B54] If the promise to grant a license is not distinct from other promised goods or services in the contract in accordance with paragraphs 606-10-25-18 [26] through 25-22 [30], an entity should account for the promise to grant a license and those other promised goods or services together as a single performance obligation. Examples of licenses that are not distinct from other goods or services promised in the contract include the following:

- a. A license that forms a component of a tangible good and that is integral to the functionality of the good
- b. A license that the customer can benefit from only in conjunction with a related service (such as an online service provided by the entity that enables, by granting a license, the customer to access content).

606-10-55-57 [B55] If the license is not distinct, an entity should apply paragraphs 606-10-25-23 [31] through 25-30 [38] to determine whether the performance obligation (which includes the promised license) is a performance obligation that is satisfied over time or satisfied at a point in time.

606-10-55-58 [B56] If the promise to grant the license is distinct from the other promised goods or services in the contract and, therefore, the promise to grant the license is a separate performance obligation, an entity should determine whether the license transfers to a customer either at a point in time or over time. In making this determination, an entity should consider whether the nature of the entity's promise in granting the license to a customer is to provide the customer with either:

a. A right to access the entity's intellectual property as it exists throughout the license period

b. A right to use the entity's intellectual property as it exists at the point in time at which the license is granted.

> > > Determining the Nature of the Entity's Promise

606-10-55-59 [B57] To determine whether an entity's promise to grant a license provides a customer with either a right to access an entity's intellectual property or a right to use an entity's intellectual property, an entity should consider whether a customer can direct the use of, and obtain substantially all of the remaining benefits from, a license at the point in time at which the license is granted. A customer cannot direct the use of, and obtain substantially all of the remaining benefits from, a license at the point in time at which the license is granted if the intellectual property to which the customer has rights changes throughout the license period. The intellectual property will change (and thus affect the entity's assessment of when the customer controls the license) when the entity continues to be involved with its intellectual property and the entity undertakes activities that significantly affect the intellectual property to which the customer has rights. In these cases, the license provides the customer with a right to access the entity's intellectual property (see paragraph 606-10-55-60). In contrast, a customer can direct the use of, and obtain substantially all of the remaining benefits from, the license at the point in time at which the license is granted if the intellectual property to which the customer has

rights will not change (see paragraph 606-10-55-63). In those cases, any activities undertaken by the entity merely change its own asset (that is, the underlying intellectual property), which may affect the entity's ability to provide future licenses; however, those activities would not affect the determination of what the license provides or what the customer controls.

606-10-55-60 [B58] The nature of an entity's promise in granting a license is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:

- a. The contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights (see paragraph 606-10-55-61 [B59]).
- b. The rights granted by the license directly expose the customer to any positive or negative effects of the entity's activities identified in paragraph 606-10-55-60(a) [B58(a)].
- c. Those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 606-10-25-17 [25]).

606-10-55-61 [B59] Factors that may indicate that a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property include the entity's customary business practices, published policies, or specific statements. Although not determinative, the existence of a shared economic interest (for example, a sales-based royalty) between the entity and the customer related to the intellectual property to which the customer has rights may also indicate that the customer could reasonably expect that the entity will undertake such activities.

606-10-55-62 [B60] If the criteria in paragraph 606-10-55-60 [B58] are met, an entity should account for the promise to grant a license as a performance obligation satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access to

its intellectual property as the performance occurs (see paragraph 606-10-25-27(a) [35(a)]). An entity should apply paragraphs 606-10-25-31 [39] through 25-37 [45] to select an appropriate method to measure its progress toward complete satisfaction of that performance obligation to provide access.

606-10-55-63 [B61] If the criteria in paragraph 606-10-55-60 are not met, the nature of an entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the license is granted to the customer. This means that the customer can direct the use of, and obtain substantially all of the remaining benefits from, the license at the point in time at which the license transfers. An entity should account for the promise to provide a right to use the entity's intellectual property as a performance obligation satisfied at a point in time. An entity should apply paragraph 606-10-25-30 to determine the point in time at which the license transfers to the customer. However, 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).

606-10-55-64 [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:

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.

A2. The following paragraphs from the Basis for Conclusions to ASU 2014-09/IFRS 15 are also relevant to the discussion in this paper:

BC407. If the customer cannot benefit from the license on its own, and/or the license cannot be separated from other promises in the contract, the license would not be distinct and, thus, would be combined with those other promises (see paragraph 606-10-25-22 [30]). The entity would then determine when the single performance obligation is satisfied on the basis of when the good or service (that is, the output) is transferred to the customer. The Boards noted that in some cases, the combined good or service transferred to the customer may have a license as its primary or dominant component. When the output that is transferred is a license, or when the license is distinct, the entity would apply the criteria in paragraph 606-10-55-60 [B58] to determine whether the promised license provides the customer with access to the entity's intellectual property or a right to use the entity's intellectual property. Developing the Criteria for Licenses That Provide a Right to Access

BC408. As noted in paragraph BC404, the Boards decided to specify criteria in paragraph 606-10-55-60 [B58] for determining if the intellectual property will change and, thus, if a license provides a customer with a right to access the entity's intellectual property. If those criteria are not met, the license provides the customer with a right to use an entity's intellectual property as that intellectual property exists (in the form and with the functionality) at the point in time when the license transfers to the customer. To ensure that all licenses are accounted for as

either a right of access or a right to use, the Boards decided to specify criteria for only one type of license. In determining for which type of license they should develop criteria, the Boards observed that it was easier to determine when the intellectual property to which the customer has rights was changing (that is, was dynamic), rather than when it was static.

BC409. In developing the criteria, the Boards observed that the main factor that results in the intellectual property changing is when the contract requires, or the customer reasonably expects, that the entity undertakes activities that do not directly transfer goods or services to a customer (that is, they do not meet the definition of a performance obligation). The activities may be part of an entity's ongoing and ordinary activities and customary business practices. However, the Boards noted that it was not enough that the entity undertook activities, but also that those activities affected the intellectual property to which the customer has rights and, thus, exposes the customer to positive or negative effects. In those cases, the customer essentially will be using the most recent form of the intellectual property throughout the license period. The Boards observed that when the activities do not affect the customer, the entity is merely changing its own asset, which, although it may affect the entity's ability to provide future licenses, would not affect the determination of what the license provides or what the customer controls.

BC410. The Boards noted that the assessment of the criteria would not be affected by other promises in the contract to transfer goods or services (that is, performance obligations) that are separate from the license. This is because the nature and pattern of transfer of each (separate) performance obligation in a contract would not affect the timing of other promised goods or services in the contract and, thus, would not affect the identification of the rights provided by the license. This is because, by definition, a performance obligation is separate from the other promises in the contract. Consider a contract to provide a car and ongoing maintenance services—that is, two

distinct goods or services (and thus two separate performance obligations). In this case, it seems counterintuitive to include the promise to provide a (separate) maintenance service when determining the nature and timing of the entity's performance related to the transfer of the car. A similar example can be drawn from a contract that includes a software license and a promise to provide a service of updating the customer's software (sometimes included in a contract as post-contract support), in which the post-contract support is identified as a distinct good or service. This is because the entity would not consider the post-contract support when determining when control of the software transfers to the customer. In other words, a promise to transfer separate updates to the license would not be considered in the assessment of the criteria in paragraph 606-10-55-60 [B58] and, furthermore, would be specifically excluded by criterion (c) in that paragraph.

BC411. The Boards also noted that an entity would exclude the factors specified in paragraph 606-10-55-64 [B62] for the following reasons:

a. Restrictions of time, geographical region, or use that define the attributes of the asset conveyed in a license—An entity would not consider restrictions of time, geographical region, or use because they define attributes of the rights transferred rather than the nature of the underlying intellectual property and the rights provided by the license. Consider, for example, a term license that permits the customer to show a movie in its theatre six times over the next two years. The restrictions in that example determine the nature of the asset that the entity has obtained (that is, six showings of the movie), rather than the nature of the underlying intellectual property (that is, the underlying movie).

b. Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend and maintain that patent—Guarantees that the entity has a valid patent would not

be included in the assessment of the criteria for determining the rights provided in a license because those promises are part of the entity's representation that the intellectual property is legal and valid (this notion was previously included in the 2011 Exposure Draft).

A3. The following illustrative examples are provided in Topic 606/IFRS 15 with respect to determining the nature of a license to IP:

> > > Example 54—Right to Use Intellectual Property

606-10-55-362 Using the same facts as in Case A in Example 11 (see paragraphs 606-10-55-141 [IE49] through 55-145 [IE53]), the entity identifies four performance obligations in a contract:

- a. The software license
- b. Installation services
- c. Software updates
- d. Technical support.

606-10-55-363 The entity assesses the nature of its promise to transfer the software license in accordance with paragraph 606-10-55-60 [B58]. The entity observes that the software is functional at the time that the license transfers to the customer, and the customer can direct the use of, and obtain substantially all of the remaining benefits from, the software when the license transfers to the customer. Furthermore, the entity concludes that because the software is functional when it transfers to the customer, the customer does not reasonably expect the entity to undertake activities that significantly affect the intellectual property to which the license relates. This is because at the point in time that the license is transferred to the customer, the intellectual property will not change throughout the license period. The entity does not consider in its assessment of the criteria in paragraph 606-10-55-60 [B58] the promise to provide software updates because they represent a separate performance obligation. Therefore, the entity concludes that

none of the criteria in paragraph 606-10-55-60 [B58] are met and that the nature of the entity's promise in transferring the license is to provide a right to use the entity's intellectual property as it exists at a point in time—that is, the intellectual property to which the customer has rights is static. Consequently, the entity accounts for the license as a performance obligation satisfied at a point in time.

> > > Example 56—Identifying a Distinct License

606-10-55-367 [IE281] An entity, a pharmaceutical company, licenses to a customer its patent rights to an approved drug compound for 10 years and also promises to manufacture the drug for the customer. The drug is a mature product; therefore, the entity will not undertake any activities to support the drug, which is consistent with its customary business practices.

> > > > Case A—License Is Not Distinct

606-10-55-368 [IE282] In this case, no other entity can manufacture this drug because of the highly specialized nature of the manufacturing process. As a result, the license cannot be purchased separately from the manufacturing services.

606-10-55-369 [IE283] The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19 [27]. The entity determines that the customer cannot benefit from the license without the manufacturing service; therefore, the criterion in paragraph 606-10-25-19(a) [27(a)] is not met. Consequently, the license and the manufacturing service are not distinct, and the entity accounts for the license and the manufacturing service as a single performance obligation.

606-10-55-370 [IE284] The entity applies paragraphs 606-10-25-23 [31] through 25-30 [38] to determine whether the performance obligation (that is, the bundle of the license and the manufacturing services) is a performance obligation satisfied at a point in time or over time.

> > > Case B—License Is Distinct

606-10-55-371 [IE285] In this case, the manufacturing process used to produce the drug is not unique or specialized, and several other entities can also manufacture the drug for the customer.

606-10-55-372 [IE286] The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19 [27]. Because the manufacturing process can be provided by other entities, the entity concludes that the customer can benefit from the license on its own (that is, without the manufacturing service) and that the license is separately identifiable from the manufacturing process (that is, the criteria in paragraph 606-10-25-19 are met). Consequently, the entity concludes that the license and the manufacturing service are distinct and the entity has two performance obligations:

- a. License of patent rights
- b. Manufacturing service.

606-10-55-373 [IE287] The entity assesses, in accordance with paragraph 606-10-55-60 [B58], the nature of the entity's promise to grant the license. The drug is a mature product (that is, it has been approved, is currently being manufactured, and has been sold commercially for the last several years). For these types of mature products, the entity's customary business practices are not to undertake any activities to support the drug. Consequently, the entity concludes that the criteria in paragraph 606-10-55-60 [B58] are not met because the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the intellectual property to which the customer has rights. In its assessment of the criteria in paragraph 606-10-55-60 [B58], the entity does not take into consideration the separate performance obligation of promising to provide a manufacturing service. Consequently, the nature of the entity's promise in transferring the license is to

provide a right to use the entity's intellectual property in the form and the functionality with which it exists at the point in time that it is granted to the customer. Consequently, the entity accounts for the license as a performance obligation satisfied at a point in time.

606-10-55-374 [IE288] The entity applies paragraphs 606-10-25-23 [31] through 25-30 [38] to determine whether the manufacturing service is a performance obligation satisfied at a point in time or over time.

> > > Example 57—Franchise Rights

606-10-55-375 [IE289] An entity enters into a contract with a customer and promises to grant a franchise license that provides the customer with the right to use the entity's trade name and sell the entity's products for 10 years. In addition to the license, the entity also promises to provide the equipment necessary to operate a franchise store. In exchange for granting the license, the entity receives a sales-based royalty of 5 percent of the customer's monthly sales. The fixed consideration for the equipment is \$150,000 payable when the equipment is delivered.

> > > Identifying Performance Obligations

606-10-55-376 [IE290] The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19 [27]. The entity observes that the entity, as a franchisor, has developed a customary business practice to undertake activities such as analyzing the customer's changing preferences and implementing product improvements, pricing strategies, marketing campaigns, and operational efficiencies to support the franchise name. However, the entity concludes that these activities do not directly transfer goods or services to the customer because they are part of the entity's promise to grant a license and, in effect, change the intellectual property to which the customer has rights.

606-10-55-377 [IE291] The entity determines that it has two promises to transfer goods or services: a promise to grant a license and a promise to transfer equipment. In addition, the entity concludes that the promise to grant the license and the promise to transfer the equipment are distinct. This is because the customer can benefit from each promise (that is, the promise of the license and the promise of the equipment) on their own or together with other resources that are readily available (see paragraph 606-10-25-19(a)) [27(a)]. (That is, the customer can benefit from the license together with the equipment that is delivered before the opening of the franchise, and the equipment can be used in the franchise or sold for an amount other than scrap value.) The entity also determines that the franchise license and equipment are separately identifiable in accordance with the criterion in paragraph 606-10-25-19(b) [27(b)], because none of the factors in paragraph 606-10-25-21 [29] are present. Consequently, the entity has two performance obligations:

- a. The franchise license
- b. The equipment.

> > > **Allocating the Transaction Price**

606-10-55-378 [IE292] The entity determines that the transaction price includes fixed consideration of \$150,000 and variable consideration (5 percent of customer sales).

606-10-55-379 [IE293] The entity applies paragraph 606-10-32-40 [85] to determine whether the variable consideration should be allocated entirely to the performance obligation to transfer the franchise license. The entity concludes that the variable consideration (that is, the sales-based royalty) should be allocated entirely to the franchise license because the variable consideration relates entirely to the entity's promise to grant the franchise license. In addition, the entity observes that allocating \$150,000 to the equipment and the sales-based royalty to the franchise license would be consistent with an allocation based on the entity's relative standalone selling prices in similar

contracts. That is, the standalone selling price of the equipment is \$150,000 and the entity regularly licenses franchises in exchange for 5 percent of customer sales. Consequently, the entity concludes that the variable consideration (that is, the sales-based royalty) should be allocated entirely to the performance obligation to grant the franchise license.

> > > Licensing

606-10-55-380 [IE294] The entity assesses, in accordance with paragraph 606-10-55-60 [B58], the nature of the entity's promise to grant the franchise license. The entity concludes that the criteria in paragraph 606-10-55-60 [B58] are met and the nature of the entity's promise is to provide access to the entity's intellectual property in its current form throughout the license period. This is because:

- a. The entity concludes that the customer would reasonably expect that the entity will undertake activities that will affect the intellectual property to which the customer has rights. This is on the basis of the entity's customary business practice to undertake activities such as analyzing the customer's changing preferences and implementing product improvements, pricing strategies, marketing campaigns, and operational efficiencies. In addition, the entity observes that because part of its compensation is dependent on the success of the franchisee (as evidenced through the sales-based royalty), the entity has a shared economic interest with the customer that indicates that the customer will expect the entity to undertake those activities to maximize earnings.
- b. The entity also observes that the franchise license requires the customer to implement any changes that result from those activities and thus exposes the customer to any positive or negative effects of those activities.
- c. The entity also observes that even though the customer may benefit from the activities through the rights granted by the

license, they do not transfer a good or service to the customer as those activities occur.

606-10-55-381 [IE295] Because the criteria in paragraph 606-10-55-60 [B58] are met, the entity concludes that the promise to transfer the license is a performance obligation satisfied over time in accordance with paragraph 606-10-25-27(a) [35(a)].

606-10-55-382 [IE296] The entity also concludes that because the consideration is in the form of a sales-based royalty, the entity applies paragraph 606-10-55-65 [B63] and, after the transfer of the franchise license, the entity recognizes revenue as and when those sales occur.

> > > **Example 58—Access to Intellectual Property**

606-10-55-383 [IE297] An entity, a creator of comic strips, licenses the use of the images and names of its comic strip characters in three of its comic strips to a customer for a four-year term. There are main characters involved in each of the comic strips. However, newly created characters appear regularly and the images of the characters evolve over time. The customer, an operator of cruise ships, can use the entity's characters in various ways, such as in shows or parades, within reasonable guidelines. The contract requires the customer to use the latest images of the characters.

606-10-55-384 [IE298] In exchange for granting the license, the entity receives a fixed payment of \$1 million in each year of the 4-year term.

606-10-55-385 [IE299] In accordance with paragraph 606-10-25-19 [27], the entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity concludes that it has no other performance obligations other than the promise to grant a license. That is, the additional activities associated with the license do not directly transfer a good or service to the customer because they are part of the entity's promise to grant a license and, in effect, change the intellectual property to which the customer has rights.

606-10-55-386 [IE300] The entity assesses the nature of the entity's promise to transfer the license in accordance with paragraph 606-10-55-60 [B58]. In assessing the criteria the entity considers the following:

a. The customer reasonably expects (arising from the entity's customary business practices) that the entity will undertake activities that will affect the intellectual property to which the customer has rights (that is, the characters). Those activities include development of the characters and the publishing of a weekly comic strip that includes the characters.

b. The rights granted by the license directly expose the customer to any positive or negative effects of the entity's activities because the contract requires the customer to use the latest characters.

c. Even though the customer may benefit from those activities through the rights granted by the license, they do not transfer a good or service to the customer as those activities occur.

606-10-55-387 [IE301] Consequently, the entity concludes that the criteria in paragraph 606-10-55-60 [B58] are met and that the nature of the entity's promise to transfer the license is to provide the customer with access to the entity's intellectual property as it exists throughout the license period. Consequently, the entity accounts for the promised license as a performance obligation satisfied over time (that is, the criterion in paragraph 606-10-25-27(a) [35(a)] is met).

606-10-55-388 [IE302] The entity applies paragraphs 606-10-25-31[39] through 25-37 [45] to identify the method that best depicts its performance in the license. Because the contract provides the customer with unlimited use of the licensed characters for a fixed term, the entity determines that a time-based method would be the most appropriate measure of progress toward complete satisfaction of the performance obligation.

> > > **Example 59—Right to Use Intellectual Property**

606-10-55-389 [IE303] An entity, a music record label, licenses to a customer a 1975 recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio, and online advertisements for two years in Country A. In exchange for providing the license, the entity receives fixed consideration of \$10,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is noncancellable.

606-10-55-390 [IE304] The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19 [27]. The entity concludes that its only performance obligation is to grant the license.

606-10-55-391 [IE305] In accordance with paragraph 606-10-55-60 [B58], the entity assesses the nature of the entity's promise to grant the license. The entity does not have any contractual or implied obligations to change the licensed recording. Thus, the intellectual property to which the customer has rights is static. Consequently, the entity concludes that the nature of its promise in transferring the license is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the license is a performance obligation satisfied at a point in time. The entity recognizes all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

606-10-55-392 [IE306] Because of the length of time between the entity's performance (at the beginning of the period) and the customer's monthly payments over two years (which are noncancellable), the entity considers the guidance in paragraphs 606-10-32-15 [60] through 32-20 [65] to determine whether a significant financing component exists.

> > > Example 61—Access to Intellectual Property

606-10-55-395 [IE309] An entity, a well-known sports team, licenses the use of its name and logo to a customer. The customer, an apparel designer, has the right to use the sports team's name and logo on items including t-shirts, caps, mugs, and towels for one year. In exchange for providing the license, the entity will receive fixed consideration of \$2 million and a royalty of 5 percent of the sales price of any items using the team name or logo. The customer expects that the entity will continue to play games and provide a competitive team.

606-10-55-396 [IE310] The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19 [27]. The entity concludes that its only performance obligation is to transfer the license. That is, the additional activities associated with the license do not directly transfer a good or service to the customer because they are part of the entity's promise to grant the license and, in effect, change the intellectual property to which the customer has rights.

606-10-55-397 [IE311] The entity assesses the nature of the entity's promise to transfer the license in accordance with paragraph 606-10-55-60 [B58]. In assessing the criteria, the entity considers the following:

a. The entity concludes that the customer would reasonably expect that the entity will undertake activities that will affect the intellectual property (that is, the team name and logo) to which the customer has rights. This is on the basis of the entity's customary business practice to undertake activities such as continuing to play and providing a competitive team. In addition, the entity observes that because some of its consideration is dependent on the success of the customer (through the sales-based royalty), the entity has a shared economic interest with the customer, which indicates that the customer will expect the entity to undertake those activities to maximize earnings.

b. The entity observes that the rights granted by the license (that is, the use of the team's name and logo) directly expose the customer to any positive or negative effects of the entity's activities.

c. The entity also observes that even though the customer may benefit from the activities through the rights granted by the license, they do not transfer a good or service to the customer as those activities occur.

606-10-55-398 [IE312] The entity concludes that the criteria in paragraph 606-10-55-60 [B58] are met and the nature of the entity's promise to grant the license is to provide the customer with access to the entity's intellectual property as it exists throughout the license period. Consequently, the entity accounts for the promised license as a performance obligation satisfied over time (that is, the criterion in paragraph 606-10-25-27(a) [35(a)] is met).

606-10-55-399 [IE313] The entity then applies paragraphs 606-10-25-31 [39] through 25-37 [45] to determine a measure of progress that will depict the entity's performance for the fixed consideration. For the consideration that is in the form of a sales-based royalty, paragraph 606-10-55-65 [B63] applies; therefore, the entity recognizes revenue as and when the sales of items using the team name or logo occur.