

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2016-10
April 2016

Revenue from Contracts with Customers (Topic 606)

Identifying Performance Obligations and Licensing

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

On May 28, 2014, the FASB and the International Accounting Standards Board (IASB) issued a converged standard on recognition of revenue from contracts with customers. In June 2014, the FASB and the IASB (collectively, the Boards) announced the formation of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG). One of the objectives of the TRG is to inform the Boards about potential implementation issues that could arise when organizations implement the new revenue guidance. The TRG also assists stakeholders in understanding specific aspects of the new revenue guidance. The TRG does not issue authoritative guidance. Instead, the Boards evaluate the feedback received from the TRG and other stakeholders to determine what action, if any, is necessary for each potential implementation issue.

Implementation questions submitted to the TRG and discussions at TRG meetings informed the Board about a few issues in the guidance on identifying performance obligations and licensing. Those issues include:

1. Identifying Performance Obligations:
 - a. When identifying performance obligations, whether it is necessary to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract
 - b. Determining whether promised goods and services are separately identifiable (that is, distinct within the context of the contract)
 - c. Determining whether shipping and handling activities are a promised service in a contract or are activities to fulfill an entity's other promises in the contract.
2. Licensing:
 - a. Determining whether the nature of an entity's promise in granting a license is to provide a right to access the entity's intellectual property, which is satisfied over time and for which revenue is recognized over time, or to provide a right to use the entity's intellectual property, which is satisfied at a point in time and for which revenue is recognized at a point in time
 - b. The scope and applicability of the guidance about when to recognize revenue for sales-based or usage-based royalties promised in exchange for a license of intellectual property
 - c. Distinguishing contractual provisions that require an entity to transfer additional licenses (that is, rights to use or access intellectual property) to a customer from contractual provisions that define the

attributes of a promised license (for example, restrictions of time, geographical region, or use).

To address those issues, the Board decided to add a project to its technical agenda to improve Topic 606, Revenue from Contracts with Customers, by reducing:

1. The potential for diversity in practice at initial application
2. The cost and complexity of applying Topic 606 both at transition and on an ongoing basis.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect entities with transactions included within the scope of Topic 606. The scope of that Topic includes entities that enter into contracts with customers to transfer goods or services (that are an output of the entity's ordinary activities) in exchange for consideration.

What Are the Main Provisions and How Are Those an Improvement?

The core principle of the guidance in Topic 606 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps:

1. Identify the contract(s) with a customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations in the contract.
5. Recognize revenue when (or as) the entity satisfies a performance obligation.

The amendments in this Update do not change the core principle of the guidance in Topic 606. Rather, the amendments in this Update clarify the following two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance, while retaining the related principles for those areas.

Identifying Performance Obligations

Before an entity can identify its performance obligations in a contract with a customer, the entity first identifies the promised goods or services in the contract. The amendments in this Update are expected to reduce the cost and complexity of applying the guidance on identifying promised goods or services by adding the following guidance:

1. An entity is not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer.
2. An entity is permitted, as an accounting policy election, to account for shipping and handling activities that occur after the customer has obtained control of a good as an activity to fulfill the promise to transfer the good rather than as an additional promised service.

To identify performance obligations in a contract, an entity evaluates whether promised goods and services are distinct. Topic 606 includes two criteria for assessing whether promises to transfer goods or services are distinct. One of those criteria is that the promises are separately identifiable. This Update will improve the guidance on assessing that criterion by:

1. Better articulating the principle for determining whether promises to transfer goods or services to a customer are separately identifiable by emphasizing that an entity determines whether the nature of its promise in the contract is to transfer each of the goods or services or whether the promise is to transfer a combined item (or items) to which the promised goods and/or services are inputs.
2. Revising the related factors and examples to align with the improved articulation of the separately identifiable principle.

Licensing Implementation Guidance

Topic 606 includes implementation guidance on determining whether an entity's promise to grant a license provides a customer with either a right to use the entity's intellectual property (which is satisfied at a point in time) or a right to access the entity's intellectual property (which is satisfied over time). The amendments in this Update are intended to improve the operability and understandability of the licensing implementation guidance by clarifying the following:

1. An entity's promise to grant a customer a license to intellectual property that has significant standalone functionality (for example, the ability to process a transaction, perform a function or task, or be played or aired) does not include supporting or maintaining that intellectual property during the license period. Rather, the nature of the entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists at the point in time the license is granted unless the entity is expected to undertake activities (that do not transfer a promised good

or service to the customer) that will change the functionality of the intellectual property to which the customer has rights. An entity's promise to provide a customer with a right to use the entity's intellectual property is satisfied at the point in time the customer is able to use and benefit from the license, because the entity's promise in granting the license is solely to make the underlying intellectual property available for the customer's use and benefit. Functional intellectual property includes software, biological compounds or drug formulas, and completed media content (for example, films, television shows, or music).

2. An entity's promise to grant a customer a license to symbolic intellectual property (that is, intellectual property that does not have significant standalone functionality) includes supporting or maintaining that intellectual property during the license period. Therefore, the nature of the entity's promise to the customer is both to (a) grant the customer rights to use and benefit from the entity's intellectual property and make that underlying intellectual property available for the customer's use and benefit and (b) support or maintain the intellectual property during the license period (or over the remaining economic life of the intellectual property, if shorter). Consequently, a license to symbolic intellectual property is satisfied over time. Symbolic intellectual property includes brands, team or trade names, logos, and franchise rights.
3. An entity considers the nature of its promise in granting a license, regardless of whether the license is distinct, in order to apply the other guidance in Topic 606 to a single performance obligation that includes a license and other goods or services (in particular, the guidance on determining whether a performance obligation is satisfied over time or at a point in time and the guidance on how best to measure progress toward the complete satisfaction of a performance obligation satisfied over time).

Topic 606 includes implementation guidance on when to recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property. The amendments in this Update clarify the scope and applicability of this guidance as follows:

1. An entity should not split a sales-based or usage-based royalty into a portion subject to the recognition guidance on sales-based and usage-based royalties and a portion that is not subject to that guidance. That requirement does not affect allocation of the transaction price to performance obligations.
2. The guidance on sales-based and usage-based royalties applies to a sales-based or usage-based royalty whenever the predominant item to which the royalty relates is a license of intellectual property.

The amendments in this Update clarify that contractual provisions that, explicitly or implicitly, require an entity to transfer control of additional goods or services to a customer (for example, by requiring the entity to transfer control of additional rights to use or rights to access intellectual property that the customer does not already

control) should be distinguished from contractual provisions that, explicitly or implicitly, define the attributes of a single promised license (for example, restrictions of time, geographical region, or use). Attributes of a promised license define the scope of a customer's right to use or right to access an entity's intellectual property and, therefore, do not define whether the entity satisfies its performance obligation at a point in time or over time and do not create an obligation for the entity to transfer any additional rights to use or access its intellectual property.

When Will the Amendments Be Effective?

The amendments in this Update affect the guidance in Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements in Topic 606 (and any other Topic amended by Update 2014-09). Accounting Standards Update 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, defers the effective date of Update 2014-09 by one year.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

Topic 606 and IFRS 15, *Revenue from Contracts with Customers*, create common revenue recognition guidance for GAAP and IFRS and are the result of a joint project of the FASB and the IASB. Although the amendments in this Update are not identical, and some are incremental, to the amendments the IASB decided to make to its standard with *Clarifications to IFRS 15* the FASB expects that the amendments generally will maintain the convergence that was achieved with the issuance of Update 2014-09 and IFRS 15 by reducing the potential for diversity arising in practice. Significant diversity in application would substantially reduce the benefits achieved by converged guidance.

The amendments in this Update do not change the core principle for revenue recognition in Topic 606. Instead, the amendments provide (1) more detailed guidance in a few areas and (2) additional implementation guidance and examples based on feedback the FASB received from its stakeholders. The amendments are expected to reduce the degree of judgment necessary to comply with Topic 606, which the FASB expects will reduce the potential for diversity arising in practice and reduce the cost and complexity of applying the guidance.

There are three principal areas of this Update that could create generally minor differences in financial reporting outcomes between GAAP and IFRS.

1. IFRS guidance does not allow an entity to make a policy election to account for shipping and handling activities that occur after the customer has obtained control of a good as an activity to fulfill the promise to transfer the good rather than as an additional promised service.
2. The IASB's amendments to the licensing application guidance in IFRS 15 are different from the amendments in this Update because, although most licenses to symbolic intellectual property will be recognized over time under the IASB's Standard, revenue may be recognized at a point in time in those cases in which the entity will undertake no activities that significantly affect the ability of the customer to obtain benefit from the intellectual property during the license period. Such cases are expected to be relatively rare. In contrast, as a result of the amendments in this Update, revenue for all licenses to symbolic intellectual property is recognized over time (over the license period or the remaining economic life of the intellectual property, if shorter).
3. The FASB's amendments to the licensing implementation guidance and illustrative examples clarify that a renewal or extension of a license is subject to the use and benefit guidance in paragraph 606-10-55-58C, which will result in revenue recognition at the beginning of the renewal period. In contrast, the IASB has decided not to amend its guidance in this area. As such, under IFRS, revenue for the same types of arrangements may be recognized either when the parties agree to the renewal or when the renewal period begins, depending on the facts and circumstances.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–10. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Section 606-10-25

2. Amend paragraphs 606-10-25-16 through 25-19 and 606-10-25-21, add paragraphs 606-10-25-16A through 25-16B and 606-10-25-18A through 25-18B and the heading preceding paragraph 606-10-25-19, and supersede the heading preceding paragraph 606-10-25-18, with a link to transition paragraph 606-10-65-1, as follows:

Revenue from Contracts with Customers—Overall

Recognition

> Identifying Performance Obligations

606-10-25-14 At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation **each promise to transfer to the customer either:**

- a. **A good or service (or a bundle of goods or services) that is distinct**
- b. **A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 606-10-25-15).**

606-10-25-15 A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- a. Each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time.
- b. In accordance with paragraphs 606-10-25-31 through 25-32, the same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

> > Promises in Contracts with Customers

606-10-25-16 A **contract** with a **customer** generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the ~~performance obligations~~ promised goods or services identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer also may include promises that are implied by an entity's customary business practices, published policies, or specific statements if, at the time of entering into the contract, those promises create a valid reasonable expectation of the customer that the entity will transfer a good or service to the customer.

606-10-25-16A An entity is not required to assess whether promised goods or services are **performance obligations** if they are immaterial in the context of the contract with the customer. If the revenue related to a performance obligation that includes goods or services that are immaterial in the context of the contract is recognized before those immaterial goods or services are transferred to the customer, then the related costs to transfer those goods or services shall be accrued.

606-10-25-16B An entity shall not apply the guidance in paragraph 606-10-25-16A to a customer option to acquire additional goods or services that provides the customer with a material right, in accordance with paragraphs 606-10-55-41 through 55-45.

606-10-25-17 ~~Performance obligations~~ Promised goods or services do not include activities that an entity must undertake to fulfill a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not promised goods or services in the contract with the customer ~~a performance obligation~~.

>> ~~Distinct Goods or Services~~

606-10-25-18 Depending on the **contract**, promised goods or services may include, but are not limited to, the following:

- a. Sale of goods produced by an entity (for example, inventory of a manufacturer)
- b. Resale of goods purchased by an entity (for example, merchandise of a retailer)
- c. Resale of rights to goods or services purchased by an entity (for example, a ticket resold by an entity acting as a principal, as described in paragraphs 606-10-55-36 through 55-40)
- d. Performing a contractually agreed-upon task (or tasks) for a **customer**
- e. Providing a service of standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-

- and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides
- f. Providing a service of arranging for another party to transfer goods or services to a customer (for example, acting as an agent of another party, as described in paragraphs 606-10-55-36 through 55-40)
 - g. Granting rights to goods or services to be provided in the future that a customer can resell or provide to its customer (for example, an entity selling a product to a retailer promises to transfer an additional good or service to an individual who purchases the product from the retailer)
 - h. Constructing, manufacturing, or developing an asset on behalf of a customer
 - i. Granting licenses (see paragraphs 606-10-55-54 through ~~55-65~~60 and paragraphs 606-10-55-62 through 55-65B)
 - j. Granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs 606-10-55-41 through 55-45).

606-10-25-18A An entity that promises a good to a customer also might perform shipping and handling activities related to that good. If the shipping and handling activities are performed before the customer obtains control of the good (see paragraphs 606-10-25-23 through 25-30 for guidance on satisfying performance obligations), then the shipping and handling activities are not a promised service to the customer. Rather, shipping and handling are activities to fulfill the entity's promise to transfer the good.

606-10-25-18B If shipping and handling activities are performed after a customer obtains control of the good, then the entity may elect to account for shipping and handling as activities to fulfill the promise to transfer the good. The entity shall apply this accounting policy election consistently to similar types of transactions. An entity that makes this election would not evaluate whether shipping and handling activities are promised services to its customers. If revenue is recognized for the related good before the shipping and handling activities occur, the related costs of those shipping and handling activities shall be accrued. An entity that applies this accounting policy election shall comply with the accounting policy disclosure requirements in paragraphs 235-10-50-1 through 50-6.

> > Distinct Goods or Services

606-10-25-19 A good or service that is promised to a customer is distinct if both of the following criteria are met:

- a. The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct).
- b. The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (that is, the promise to transfer the good or service is distinct within the context of the contract).

606-10-25-20 A customer can benefit from a good or service in accordance with paragraph 606-10-25-19(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value, or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

606-10-25-21 In assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 606-10-25-19(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that an entity's two or more promises promise to transfer a good goods or services service to a customer is are not separately identifiable (in accordance with paragraph 606-10-25-19(b)) include, but are not limited to, the following:

- a. The entity does not provide provides a significant service of integrating the good goods or services service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is not using the good goods or services service as inputs an input to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element, or unit.
- b. One or more of the goods or services significantly modifies or customizes, or are significantly modified or customized by, one or more of the other goods or services promised in the contract. The good or service does not significantly modify or customize another good or service promised in the contract.
- c. The goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfill its promise by transferring each of the goods or services independently. The good or service is not highly dependent on, or highly interrelated with, other goods

~~or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services.~~

606-10-25-22 If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single **performance obligation**.

Amendments to Section 606-10-55

3. Amend paragraph 606-10-55-3(i), with a link to transition paragraph 606-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

606-10-55-3 This implementation guidance is organized into the following categories:

- i. Licensing (paragraphs 606-10-55-54 through 55-60 and 606-10-55-62 through 55-65B ~~55-65~~)

4. Amend paragraphs 606-10-55-54 through 55-55, 606-10-55-57 through 55-60, and 606-10-55-62 through 55-64, add paragraphs 606-10-55-58A through 55-58C, 606-10-55-63A, 606-10-55-64A, and 606-10-55-65A through 55-65B, and supersede paragraph 606-10-55-61, with a link to transition paragraph 606-10-65-1, as follows:

>> Licensing

606-10-55-54 A license establishes a customer's rights to the intellectual property of an entity. Licenses of intellectual property may include, but are not limited to, licenses of any of the following:

- a. Software (other than software subject to a hosting arrangement that does not meet the criteria in paragraph 985-20-15-5) and technology
- b. Motion pictures, music, and other forms of media and entertainment
- c. Franchises
- d. Patents, trademarks, and copyrights.

606-10-55-55 In addition to a promise to grant a license (or licenses) to a

customer, an entity may also promise to transfer other goods or services to the customer. Those promises may be explicitly stated in the **contract** or implied by an entity's customary business practices, published policies, or specific statements (see paragraph 606-10-25-16). As with other types of contracts, when a contract with a customer includes a promise to grant a license (or licenses) in addition to other promised goods or services, an entity applies paragraphs 606-10-25-14 through 25-22 to identify each of the **performance obligations** in the contract.

606-10-55-56 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 through 25-22, 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 When a single performance obligation includes a license (or licenses) of intellectual property and one or more other goods or services, the entity considers the nature of the combined good or service for which the customer has contracted (including whether the license that is part of the single performance obligation provides the customer with a right to use or a right to access intellectual property in accordance with paragraphs 606-10-55-59 through 55-60 and 606-10-55-62 through 55-64A) in determining whether that combined good or service is satisfied over time or at a point in time in accordance with paragraphs 606-10-25-23 through 25-30 and, if over time, in selecting an appropriate method for measuring progress in accordance with paragraphs 606-10-25-31 through 25-37. If the license is not distinct, an entity should apply paragraphs 606-10-25-23 through 25-30 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 In evaluating whether a license transfers to a customer at a point in time or over time 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 (or its remaining economic life, if shorter)
- b. A right to use the entity's intellectual property as it exists at the point in time at which the license is granted.

606-10-55-58A An entity should account for a promise to provide a customer with a right to access the entity's intellectual property 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)). An entity should apply paragraphs 606-10-25-31 through 25-37 to select an appropriate method to measure its progress toward complete satisfaction of that performance obligation to provide access to its intellectual property.

606-10-55-58B An entity's promise to provide a customer with the right to use its intellectual property is satisfied at a point in time. The entity should apply paragraph 606-10-25-30 to determine the point in time at which the license transfers to the customer.

606-10-55-58C Notwithstanding paragraphs 606-10-55-58A through 55-58B, revenue cannot be recognized from a license of intellectual property before both:

- a. An entity provides (or otherwise makes available) a copy of the intellectual property to the customer.
- b. The beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the intellectual property. That is, an entity would not recognize revenue before the beginning of the license period even if the entity provides (or otherwise makes available) a copy of the intellectual property before the start of the license period or the customer has a copy of the intellectual property from another transaction. For example, an entity would recognize revenue from a license renewal no earlier than the beginning of the renewal period.

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

606-10-55-59 ~~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. To determine whether the entity's promise to provide a right to access its intellectual property or a right to use its intellectual property, the entity should consider the nature of the intellectual property to which the customer will have rights. Intellectual property is either:

- a. Functional intellectual property. Intellectual property that has significant standalone functionality (for example, the ability to process a transaction, perform a function or task, or be played or aired). Functional intellectual property derives a substantial portion of its utility (that is, its ability to provide benefit or value) from its significant standalone functionality.
- b. Symbolic intellectual property. Intellectual property that is not functional intellectual property (that is, intellectual property that does not have significant standalone functionality). Because symbolic intellectual property does not have significant standalone functionality, substantially all of the utility of symbolic intellectual property is derived from its association with the entity's past or ongoing activities, including its ordinary business activities.

606-10-55-60 A customer's ability to derive benefit from a license to symbolic intellectual property depends on the entity continuing to support or maintain the intellectual property. Therefore, a license to symbolic intellectual property grants the customer a right to access the entity's intellectual property, which is satisfied over time (see paragraphs 606-10-55-58A and 606-10-55-58C) as the entity fulfills its promise to both~~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. Grant the customer rights to use and benefit from the entity's intellectual property~~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).~~
- b. Support or maintain the intellectual property. An entity generally supports or maintains symbolic intellectual property by continuing to undertake those activities from which the utility of the intellectual property is derived and/or refraining from activities or other actions that would significantly degrade the utility of the intellectual property.~~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).~~
- c. Subparagraph superseded by Accounting Standards Update No. 2016-10.~~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).~~

606-10-55-61 Paragraph superseded by Accounting Standards Update No. 2016-10.~~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 If the criteria in paragraph 606-10-55-60 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)). An entity should apply paragraphs 606-10-25-31 through 25-37 to select an appropriate method to measure its progress toward complete satisfaction of that performance obligation to provide access. A license to functional intellectual property grants a right to use the entity's intellectual property as it exists at the point in time at which the license is granted unless both of the following criteria are met:

- a. The functionality of the intellectual property to which the customer has rights is expected to substantively change during the license period as a result of activities of the entity that do not transfer a promised good or service to the customer (see paragraphs 606-10-25-16 through 25-18). Additional promised goods or services (for example, intellectual property upgrade rights or rights to use or access additional intellectual property) are not considered in assessing this criterion.
- b. The customer is contractually or practically required to use the updated intellectual property resulting from the activities in criterion (a).

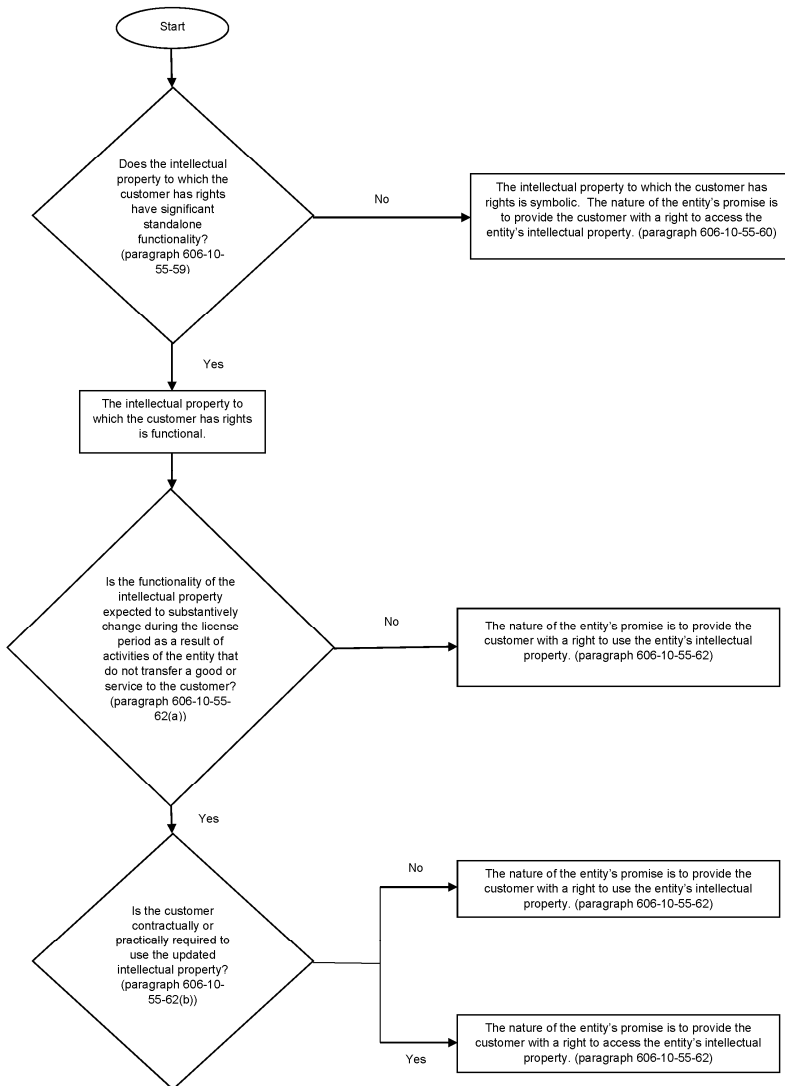
If both of those criteria are met, then the license grants a right to access the entity's intellectual property.

606-10-55-63 Because functional intellectual property has significant standalone functionality, an entity's activities that do not substantively change that functionality do not significantly affect the utility of the intellectual property to which the customer has rights. Therefore, the entity's promise to the customer in granting a license to functional intellectual property does not include supporting or maintaining the intellectual property. Consequently, if a license to functional intellectual property is a separate **performance obligation** (see paragraph 606-10-55-55) and does not meet the criteria in paragraph 606-10-55-62, it is satisfied at a point in time (see paragraphs 606-10-55-58B through 55-58C). 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).~~

606-10-55-63A The following flowchart depicts the decision process for evaluating whether the nature of an entity's promise in granting a license is to provide the customer with a right to access the entity's intellectual property or a right to use the entity's intellectual property. The flowchart does not include all of the guidance on determining the nature of an entity's promise in granting a license of intellectual property in this Subtopic and is not intended as a substitute for the guidance in this Subtopic.

[For ease of readability, the new flowchart is not underlined.]



>>> Other Licensing Considerations

606-10-55-64 Contractual provisions that explicitly or implicitly require an entity to transfer control of additional goods or services to a customer (for example, by

~~requiring the entity to transfer control of additional rights to use or rights to access intellectual property that the customer does not already control) should be distinguished from contractual provisions that explicitly or implicitly define the attributes of a single promised license (for example, restrictions of time, geographical region, or use). Attributes of a promised license define the scope of a customer's right to use or right to access the entity's intellectual property and, therefore, do not define whether the entity satisfies its **performance obligation** at a point in time or over time and do not create an obligation for the entity to transfer any additional rights to use or access its intellectual property. 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. Subparagraph superseded by Accounting Standards Update No. 2016-10. Restrictions of time, geographical region, or use—These 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. Subparagraph superseded by Accounting Standards Update No. 2016-10. 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. [Content amended and moved to paragraph 606-10-55-64A]~~

606-10-55-64A Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorized use—~~do not affect whether a license provides a right to access the entity's intellectual property or a right to use the entity's intellectual property. Similarly, a~~ A promise to defend a patent right is not a promised good or service performance obligation because the act of defending a patent protects the value of the entity's intellectual property assets and it provides assurance to the customer that the license transferred meets the specifications of the license promised in the contract. [Content amended as shown and moved from paragraph 606-10-55-64(b)]

>>> Sales-Based or Usage-Based Royalties

606-10-55-65 Notwithstanding the guidance in paragraphs 606-10-32-11 through 32-14, an entity should recognize **revenue** for a sales-based or usage-based royalty promised in exchange for a license of intellectual property only when (or as) the later of the following events occurs:

- a. The subsequent sale or usage occurs.

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

606-10-55-65A The guidance for a sales-based or usage-based royalty in paragraph 606-10-55-65 applies when the royalty relates only to a license of intellectual property or when a license of intellectual property is the predominant item to which the royalty relates (for example, the license of intellectual property may be the predominant item to which the royalty relates when the entity has a reasonable expectation that the customer would ascribe significantly more value to the license than to the other goods or services to which the royalty relates).

606-10-55-65B When the guidance in paragraph 606-10-55-65A is met, revenue from a sales-based or usage-based royalty should be recognized wholly in accordance with the guidance in paragraph 606-10-55-65. When the guidance in paragraph 606-10-55-65A is not met, the guidance on variable consideration in paragraphs 606-10-32-5 through 32-14 applies to the sales-based or usage-based royalty.

- 5. Amend paragraph 606-10-55-93(c) and (s), with a link to transition paragraph 606-10-65-1, as follows:

> Illustrations

606-10-55-93 The Examples are organized as follows:

- c. Identifying Performance Obligations
 - Example 10—Goods and Services Are Not Distinct
 - Example 11—Determining Whether Goods or Services Are Distinct
 - Example 12—Explicit and Implicit Promises in a Contract
 - Example 12A—Series of Distinct Goods or Services
- s. Licensing
 - Example 54—Right to Use Intellectual Property
 - Example 55—License of Intellectual Property
 - Example 56—Identifying a Distinct License
 - Example 57—Franchise Rights
 - Example 58—Access to Intellectual Property
 - Example 59—Right to Use Intellectual Property
 - Example 60—Sales-Based Royalty Promised in Exchange for a License of Intellectual Property and Other Goods and Services Access to Intellectual Property
 - Example 61—Access to Intellectual Property
 - Example 61A—Right to Use Intellectual Property
 - Example 61B—Distinguishing Multiple Licenses from Attributes of a Single License

6. Amend paragraphs 606-10-55-136 through 55-137, 606-10-55-139, 606-10-55-142 through 55-143, 606-10-55-145, 606-10-55-147 through 55-150, 606-10-55-153, 606-10-55-155, and the heading preceding paragraph 606-10-55-156 and add paragraphs 606-10-55-140A through 55-140F and their related headings, 606-10-55-150A through 55-150K and their related headings, paragraph 606-10-55-153A, and 606-10-55-157A through 55-157E and the related heading, with a link to transition paragraph 606-10-65-1, as follows:

> > Identifying Performance Obligations

606-10-55-136 Examples ~~40–42~~ 10–12A illustrate the guidance in paragraphs 606-10-25-14 through 25-22 on identifying performance obligations.

> > > Example 10—Goods and Services Are Not Distinct

> > > Case A—Significant Integration Service

606-10-55-137 An entity, a contractor, enters into a contract to build a hospital for a customer. The entity is responsible for the overall management of the project and identifies various promised goods and services ~~to be provided~~, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment, and finishing.

606-10-55-138 The promised goods and services are capable of being distinct in accordance with paragraph 606-10-25-19(a). That is, the customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling, or holding those goods or services.

606-10-55-139 However, the promises to transfer the goods and services are not separately identifiable distinct within the context of the contract in accordance with paragraph 606-10-25-19(b) (on the basis of the factors in paragraph 606-10-25-21). ~~That is, the entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract.~~ This is evidenced by the fact that the entity provides a significant service of integrating the goods and services (the inputs) into the hospital (the combined output) for which the customer has contracted.

606-10-55-140 Because both criteria in paragraph 606-10-25-19 are not met, the goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

> > > Case B—Significant Integration Service

606-10-55-140A An entity enters into a contract with a customer that will result in the delivery of multiple units of a highly complex, specialized device. The terms of the contract require the entity to establish a manufacturing process in order to

produce the contracted units. The specifications are unique to the customer based on a custom design that is owned by the customer and that were developed under the terms of a separate contract that is not part of the current negotiated exchange. The entity is responsible for the overall management of the contract, which requires the performance and integration of various activities including procurement of materials; identifying and managing subcontractors; and performing manufacturing, assembly, and testing.

606-10-55-140B The entity assesses the promises in the contract and determines that each of the promised devices is capable of being distinct in accordance with paragraph 606-10-25-19(a) because the customer can benefit from each device on its own. This is because each unit can function independently of the other units.

606-10-55-140C The entity observes that the nature of its promise is to establish and provide a service of producing the full complement of devices for which the customer has contracted in accordance with the customer's specifications. The entity considers that it is responsible for overall management of the contract and for providing a significant service of integrating various goods and services (the inputs) into its overall service and the resulting devices (the combined output) and, therefore, the devices and the various promised goods and services inherent in producing those devices are not separately identifiable in accordance with paragraphs 606-10-25-19(b) and 606-10-25-21. In this Case, the manufacturing process provided by the entity is specific to its contract with the customer. In addition, the nature of the entity's performance and, in particular, the significant integration service of the various activities mean that a change in one of the entity's activities to produce the devices has a significant effect on the other activities required to produce the highly complex specialized devices such that the entity's activities are highly interdependent and highly interrelated. Because the criterion in paragraph 606-10-25-19(b) is not met, the goods and services that will be provided by the entity are not separately identifiable, and, therefore, are not distinct. The entity accounts for all of the goods and services promised in the contract as a single performance obligation.

> > > Case C—Combined Item

606-10-55-140D An entity grants a customer a three-year term license to anti-virus software and promises to provide the customer with when-and-if available updates to that software during the license period. The entity frequently provides updates that are critical to the continued utility of the software. Without the updates, the customer's ability to benefit from the software would decline significantly during the three-year arrangement.

606-10-55-140E The entity concludes that the software and the updates are each promised goods or services in the contract and are each capable of being distinct in accordance with paragraph 606-10-25-19(a). The software and the updates are capable of being distinct because the customer can derive economic benefit from the software on its own throughout the license period (that is, without the updates the software would still provide its original functionality to the customer), while the

customer can benefit from the updates together with the software license transferred at the outset of the contract.

606-10-55-140F The entity concludes that its promises to transfer the software license and to provide the updates, when-and-if available, are not separately identifiable (in accordance with paragraph 606-10-25-19(b)) because the license and the updates are, in effect, inputs to a combined item (anti-virus protection) in the contract. The updates significantly modify the functionality of the software (that is, they permit the software to protect the customer from a significant number of additional viruses that the software did not protect against previously) and are integral to maintaining the utility of the software license to the customer. Consequently, the license and updates fulfill a single promise to the customer in the contract (a promise to provide protection from computer viruses for three years). Therefore, in this Example, the entity accounts for the software license and the when-and-if available updates as a single performance obligation. In accordance with paragraph 606-10-25-33, the entity concludes that the nature of the combined good or service it promised to transfer to the customer in this Example is computer virus protection for three years. The entity considers the nature of the combined good or service (that is, to provide anti-virus protection for three years) in determining whether the performance obligation is satisfied over time or at a point in time in accordance with paragraphs 606-10-25-23 through 25-30 and in determining the appropriate method for measuring progress toward complete satisfaction of the performance obligation in accordance with paragraphs 606-10-25-31 through 25-37.

> > > Example 11—Determining Whether Goods or Services Are Distinct

> > > > Case A—Distinct Goods or Services

606-10-55-141 An entity, a software developer, enters into a contract with a customer to transfer a software license, perform an installation service, and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the license, installation service, and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management, and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support.

606-10-55-142 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. The entity observes that the software is delivered before the other goods and services and remains functional without the updates and the technical support. The customer can benefit from the updates together with the software license transferred at the outset of the contract. Thus, the entity concludes that the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available and the criterion in paragraph 606-10-25-19(a) is met.

606-10-55-143 The entity also considers the principle and the factors in paragraph 606-10-25-21 and determines that the promise to transfer each good and service to the customer is separately identifiable from each of the other promises (thus, the criterion in paragraph 606-10-25-19(b) is met). In reaching this determination the entity considers that although it integrates the software into the customer's system, the installation services do not significantly affect the customer's ability to use and benefit from the software license because the installation services are routine and can be obtained from alternate providers. The software updates do not significantly affect the customer's ability to use and benefit from the software license because, in contrast with Example 10 (Case C), the software updates in this contract are not necessary to ensure that the software maintains a high level of utility to the customer during the license period. The entity further observes that none of the promised goods or services significantly modify or customize one another and the entity is not providing a significant service of integrating the software and the services into a combined output. Lastly, the entity concludes that the software and the services do not significantly affect each other and, therefore, are not highly interdependent or highly interrelated because the entity would be able to fulfill its promise to transfer the initial software license independent from its promise to subsequently provide the installation service, software updates, or technical support. In particular, the entity observes that the installation service does not significantly modify or customize the software itself, and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output.

606-10-55-144 On the basis of this assessment, the entity identifies four performance obligations in the contract for the following goods or services:

- a. The software license
- b. An installation service
- c. Software updates
- d. Technical support.

606-10-55-145 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each of the performance obligations for the installation service, software updates, and technical support are satisfied at a point in time or over time. The entity also assesses the nature of the entity's promise to transfer the software license in accordance with ~~paragraph 606-10-55-60~~ paragraphs 606-10-55-59 through 55-60 and 606-10-55-62 through 55-64A (see Example 54 in paragraphs 606-10-55-362 through ~~55-363~~55-363).

>>> **Case B—Significant Customization**

606-10-55-146 The promised goods and services are the same as in Case A, except that the contract specifies that, as part of the installation service, the software is to be substantially customized to add significant new functionality to enable the software to interface with other customized software applications used by the customer. The customized installation service can be provided by other entities.

606-10-55-147 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. The entity first assesses whether the criterion in paragraph 606-10-25-19(a) has been met. For the same reasons as in Case A, the entity determines that the software license, installation, software updates, and technical support each meet that criterion. The entity next assesses whether the criterion in paragraph 606-10-25-19(b) has been met by evaluating the principle and the factors in paragraph 606-10-25-21. The entity observes that the terms of the contract result in a promise to provide a significant service of integrating the licensed software into the existing software system by performing a customized installation service as specified in the contract. In other words, the entity is using the license and the customized installation service as inputs to produce the combined output (that is, a functional and integrated software system) specified in the contract (see paragraph 606-10-25-21(a)). ~~In addition, the~~ The software is significantly modified and customized by the service (see paragraph 606-10-25-21(b)). ~~Although the customized installation service can be provided by other entities, Consequently,~~ the entity determines that within the context of the contract, the promise to transfer the license is not separately identifiable from the customized installation service and, therefore, the criterion in paragraph 606-10-25-19(b) ~~(on the basis of the factors in paragraph 606-10-25-21)~~ is not met. Thus, the software license and the customized installation service are not distinct.

606-10-55-148 ~~As in Case A, On the basis of the same analysis as in Case A,~~ the entity concludes that the software updates and technical support are distinct from the other promises in the contract. ~~This is because the customer can benefit from the updates and technical support either on their own or together with the other goods and services that are readily available and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises.~~

606-10-55-149 On the basis of this assessment, the entity identifies three performance obligations in the contract for the following goods or services:

- a. Customized Software customization installation service (that which is comprised of the license to the software and the customized installation service includes the software license)
- b. Software updates
- c. Technical support.

606-10-55-150 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each performance obligation is satisfied at a point in time or over time and paragraphs 606-10-25-31 through 25-37 to measure progress toward complete satisfaction of those performance obligations determined to be satisfied over time. In applying those paragraphs to the software customization, the entity considers that the customized software to which the customer will have rights is functional intellectual property and that the functionality of that software will not change during the license period as a result of activities that do not transfer

a good or service to the customer. Therefore, the entity is providing a right to use the customized software. Consequently, the software customization performance obligation is completely satisfied upon completion of the customized installation service. The entity considers the other specific facts and circumstances of the contract in the context of the guidance in paragraphs 606-10-25-23 through 25-30 in determining whether it should recognize revenue related to the single software customization performance obligation as it performs the customized installation service or at the point in time the customized software is transferred to the customer.

> > > Case C—Promises Are Separately Identifiable (Installation)

606-10-55-150A An entity contracts with a customer to sell a piece of equipment and installation services. The equipment is operational without any customization or modification. The installation required is not complex and is capable of being performed by several alternative service providers.

606-10-55-150B The entity identifies two promised goods and services in the contract: (a) equipment and (b) installation. The entity assesses the criteria in paragraph 606-10-25-19 to determine whether each promised good or service is distinct. The entity determines that the equipment and the installation each meet the criterion in paragraph 606-10-25-19(a). The customer can benefit from the equipment on its own, by using it or reselling it for an amount greater than scrap value, or together with other readily available resources (for example, installation services available from alternative providers). The customer also can benefit from the installation services together with other resources that the customer will already have obtained from the entity (that is, the equipment).

606-10-55-150C The entity further determines that its promises to transfer the equipment and to provide the installation services are each separately identifiable (in accordance with paragraph 606-10-25-19(b)). The entity considers the principle and the factors in paragraph 606-10-25-21 in determining that the equipment and the installation services are not inputs to a combined item in this contract. In this Case, each of the factors in paragraph 606-10-25-21 contributes to, but is not individually determinative of, the conclusion that the equipment and the installation services are separately identifiable as follows:

- a. The entity is not providing a significant integration service. That is, the entity has promised to deliver the equipment and then install it; the entity would be able to fulfill its promise to transfer the equipment separately from its promise to subsequently install it. The entity has not promised to combine the equipment and the installation services in a way that would transform them into a combined output.
- b. The entity's installation services will not significantly customize or significantly modify the equipment.
- c. Although the customer can benefit from the installation services only after it has obtained control of the equipment, the installation services do not significantly affect the equipment because the entity would be able to fulfill

its promise to transfer the equipment independently of its promise to provide the installation services. Because the equipment and the installation services do not each significantly affect the other, they are not highly interdependent or highly interrelated.

On the basis of this assessment, the entity identifies two performance obligations (the equipment and installation services) in the contract.

606-10-55-150D The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each performance obligation is satisfied at a point in time or over time.

> > > Case D—Promises Are Separately Identifiable (Contractual Restrictions)

606-10-55-150E Assume the same facts as in Case C, except that the customer is contractually required to use the entity's installation services.

606-10-55-150F The contractual requirement to use the entity's installation services does not change the evaluation of whether the promised goods and services are distinct in this Case. This is because the contractual requirement to use the entity's installation services does not change the characteristics of the goods or services themselves, nor does it change the entity's promises to the customer. Although the customer is required to use the entity's installation services, the equipment and the installation services are capable of being distinct (that is, they each meet the criterion in paragraph 606-10-25-19(a)), and the entity's promises to provide the equipment and to provide the installation services are each separately identifiable (that is, they each meet the criterion in paragraph 606-10-25-19(b)). The entity's analysis in this regard is consistent with Case C.

> > > Case E—Promises Are Separately Identifiable (Consumables)

606-10-55-150G An entity enters into a contract with a customer to provide a piece of off-the-shelf equipment (that is, it is operational without any significant customization or modification) and to provide specialized consumables for use in the equipment at predetermined intervals over the next three years. The consumables are produced only by the entity, but are sold separately by the entity.

606-10-55-150H The entity determines that the customer can benefit from the equipment together with the readily available consumables. The consumables are readily available in accordance with paragraph 606-10-25-20 because they are regularly sold separately by the entity (that is, through refill orders to customers that previously purchased the equipment). The customer can benefit from the consumables that will be delivered under the contract together with the delivered equipment that is transferred to the customer initially under the contract. Therefore, the equipment and the consumables are each capable of being distinct in accordance with paragraph 606-10-25-19(a).

606-10-55-150I The entity determines that its promises to transfer the equipment and to provide consumables over a three-year period are each separately identifiable in accordance with paragraph 606-10-25-19(b). In determining that the equipment and the consumables are not inputs to a combined item in this contract, the entity considers that it is not providing a significant integration service that transforms the equipment and consumables into a combined output. Additionally, neither the equipment nor the consumables are significantly customized or modified by the other. Lastly, the entity concludes that the equipment and the consumables are not highly interdependent or highly interrelated because they do not significantly affect each other. Although the customer can benefit from the consumables in this contract only after it has obtained control of the equipment (that is, the consumables would have no use without the equipment) and the consumables are required for the equipment to function, the equipment and the consumables do not each significantly affect the other. This is because the entity would be able to fulfill each of its promises in the contract independently of the other. That is, the entity would be able to fulfill its promise to transfer the equipment even if the customer did not purchase any consumables and would be able to fulfill its promise to provide the consumables even if the customer acquired the equipment separately.

606-10-55-150J On the basis of this assessment, the entity identifies two performance obligations in the contract for the following goods or services:

- a. The equipment
- b. The consumables.

606-10-55-150K The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each performance obligation is satisfied at a point in time or over time.

> > > **Example 12—Explicit and Implicit Promises in a Contract**

606-10-55-151 An entity, a manufacturer, sells a product to a distributor (that is, its customer), who will then resell it to an end customer.

> > > > **Case A—Explicit Promise of Service**

606-10-55-152 In the contract with the distributor, the entity promises to provide maintenance services for no additional consideration (that is, “free”) to any party (that is, the end customer) that purchases the product from the distributor. The entity outsources the performance of the maintenance services to the distributor and pays the distributor an agreed-upon amount for providing those services on the entity’s behalf. If the end customer does not use the maintenance services, the entity is not obliged to pay the distributor.

606-10-55-153 The contract with the customer includes two promised goods or services—(a) the product and (b) the maintenance services (because ~~Because~~ the promise of maintenance services is a promise to transfer goods or services in the future and is part of the negotiated exchange between the entity and the

~~distributor). distributor, the entity determines that the promise to provide maintenance services is a performance obligation (see paragraph 606-10-25-18(g)). The entity concludes that the promise would represent a performance obligation regardless of whether the entity, the distributor, or a third party provides the service. Consequently, the entity allocates a portion of the transaction price to the promise to provide maintenance services. The entity assesses whether each good or service is distinct in accordance with paragraph 606-10-25-19. The entity determines that both the product and the maintenance services meet the criterion in paragraph 606-10-25-19(a). The entity regularly sells the product on a standalone basis, which indicates that the customer can benefit from the product on its own. The customer can benefit from the maintenance services together with a resource the customer already has obtained from the entity (that is, the product).~~

606-10-55-153A ~~The entity further determines that its promises to transfer the product and to provide the maintenance services are separately identifiable (in accordance with paragraph 606-10-25-19(b)) on the basis of the principle and the factors in paragraph 606-10-25-21. The product and the maintenance services are not inputs to a combined item in this contract. The entity is not providing a significant integration service because the presence of the product and the services together in this contract do not result in any additional or combined functionality. In addition, neither the product nor the services modify or customize the other. Lastly, the product and the maintenance services are not highly interdependent or highly interrelated because the entity would be able to satisfy each of the promises in the contract independent of its efforts to satisfy the other (that is, the entity would be able to transfer the product even if the customer declined maintenance services and would be able to provide maintenance services in relation to products sold previously through other distributors). The entity also observes, in applying the principle in paragraph 606-10-25-21, that the entity's promise to provide maintenance is not necessary for the product to continue to provide significant benefit to the customer. Consequently, the entity allocates a portion of the transaction price to each of the two performance obligations (that is, the product and the maintenance services) in the contract.~~

>>> **Case B—Implicit Promise of Service**

606-10-55-154 The entity has historically provided maintenance services for no additional consideration (that is, “free”) to end customers that purchase the entity's product from the distributor. The entity does not explicitly promise maintenance services during negotiations with the distributor, and the final contract between the entity and the distributor does not specify terms or conditions for those services.

606-10-55-155 However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity's past practices of providing these services create ~~valid~~ reasonable expectations of the entity's customers (that is, the distributor and end customers) in accordance with paragraph 606-10-25-16. Consequently, the entity ~~identifies~~

assesses whether the promise of maintenance services as is a performance obligation. For the same reasons as in Case A, the entity determines that the product and maintenance services are separate performance obligations to which it allocates a portion of the transaction price.

> > > Case C—Services Are Not a Promised Service Performance Obligation

606-10-55-156 In the contract with the distributor, the entity does not promise to provide any maintenance services. In addition, the entity typically does not provide maintenance services, and, therefore, the entity's customary business practices, published policies, and specific statements at the time of entering into the contract have not created an implicit promise to provide goods or services to its customers. The entity transfers control of the product to the distributor and, therefore, the contract is completed. However, before the sale to the end customer, the entity makes an offer to provide maintenance services to any party that purchases the product from the distributor for no additional promised consideration.

606-10-55-157 The promise of maintenance is not included in the contract between the entity and the distributor at contract inception. That is, in accordance with paragraph 606-10-25-16, the entity does not explicitly or implicitly promise to provide maintenance services to the distributor or the end customers. Consequently, the entity does not identify the promise to provide maintenance services as a performance obligation. Instead, the obligation to provide maintenance services is accounted for in accordance with Topic 450 on contingencies.

606-10-55-157A Although the maintenance services are not a promised service in the current contract, in future contracts with customers the entity would assess whether it has created a business practice resulting in an implied promise to provide maintenance services.

> > > Example 12A—Series of Distinct Goods or Services

606-10-55-157B An entity, a hotel manager, enters into a contract with a customer to manage a customer-owned property for 20 years. The entity receives consideration monthly that is equal to 1 percent of the revenue from the customer-owned property.

606-10-55-157C The entity evaluates the nature of its promise to the customer in this contract and determines that its promise is to provide a hotel management service. The service comprises various activities that may vary each day (for example, cleaning services, reservation services, and property maintenance). However, those tasks are activities to fulfill the hotel management service and are not separate promises in the contract. The entity determines that each increment of the promised service (for example, each day of the management service) is distinct in accordance with paragraph 606-10-25-19. This is because the customer can benefit from each increment of service on its own (that is, it is capable of being

distinct) and each increment of service is separately identifiable because no day of service significantly modifies or customizes another and no day of service significantly affects either the entity's ability to fulfill another day of service or the benefit to the customer of another day of service.

606-10-55-157D The entity also evaluates whether it is providing a series of distinct goods or services in accordance with paragraphs 606-10-25-14 through 25-15. First, the entity determines that the services provided each day are substantially the same. This is because the nature of the entity's promise is the same each day and the entity is providing the same overall management service each day (although the underlying tasks or activities the entity performs to provide that service may vary from day to day). The entity then determines that the services have the same pattern of transfer to the customer because both criteria in paragraph 606-10-25-15 are met. The entity determines that the criterion in paragraph 606-10-25-15(a) is met because each distinct service meets the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time. The customer simultaneously receives and consumes the benefits provided by the entity as it performs. The entity determines that the criterion in paragraph 606-10-25-15(b) also is met because the same measure of progress (in this case, a time-based output method) would be used to measure the entity's progress toward satisfying its promise to provide the hotel management service each day.

606-10-55-157E After determining that the entity is providing a series of distinct daily hotel management services over the 20-year management period, the entity next determines the transaction price. The entity determines that the entire amount of the consideration is variable consideration. The entity considers whether the variable consideration may be allocated to one or more, but not all, of the distinct days of service in the series in accordance with paragraph 606-10-32-39(b). The entity evaluates the criteria in paragraph 606-10-32-40 and determines that the terms of the variable consideration relate specifically to the entity's efforts to transfer each distinct daily service and that allocation of the variable consideration earned based on the activities performed by the entity each day to the distinct day in which those activities are performed is consistent with the overall allocation objective. Therefore, as each distinct daily service is completed, the variable consideration allocated to that period may be recognized, subject to the constraint on variable consideration.

7. Amend paragraphs 606-10-55-309 and 606-10-55-311 through 55-313, with a link to transition paragraph 606-10-65-1, as follows:

>>> Example 44—Warranties

606-10-55-309 An entity, a manufacturer, provides its customer with a warranty with the purchase of a product. The warranty provides assurance that the product complies with agreed-upon specifications and will operate as promised for one year from the date of purchase. The contract also provides the customer with the right to receive up to 20 hours of training services on how to operate the product

at no additional cost. The training services will help the customer optimize its use of the product in a short time frame. Therefore, although the training services are only for 20 hours and are not essential to the customer's ability to use the product, the entity determines that the training services are material in the context of the contract on the basis of the facts and circumstances of the arrangement.

606-10-55-310 The entity assesses the goods and services in the contract to determine whether they are distinct and therefore give rise to separate performance obligations.

~~**606-10-55-311** The product is distinct because it meets both criteria in paragraph 606-10-25-19. The product and training services are each capable of being distinct in accordance with paragraphs 606-10-25-19(a) and 606-10-25-20 because the customer can benefit from the product on its own without the training services and can benefit from the training services together with the product that already has been transferred by the entity. The entity regularly sells the product separately without the training services. In addition, the product is distinct within the context of the contract in accordance with paragraphs 606-10-25-19(b) and 606-10-25-21 because the entity's promise to transfer the product is separately identifiable from other promises in the contract.~~

~~**606-10-55-312** In addition, the training services are distinct because they meet both criteria in paragraph 606-10-25-19. The training services are capable of being distinct in accordance with paragraphs 606-10-25-19(a) and 606-10-25-20 because the customer can benefit from the training services together with the product that has already been provided by the entity. In addition, the training services are distinct within the context of the contract in accordance with The entity next assesses whether its promises to transfer the product and to provide the training services are separately identifiable in accordance with paragraphs 606-10-25-19(b) and 606-10-25-21 because the entity's promise to transfer the training services are separately identifiable from other promises in the contract. The entity does not provide a significant service of integrating the training services with the product (see paragraph 606-10-25-21(a)). The training services and product are not do not significantly modify or customize each other modified or customized by the product (see paragraph 606-10-25-21(b)). The product and the training services are not highly interdependent dependent on, or highly interrelated with, the product as described in paragraph 606-10-25-21(c). The entity would be able to fulfill its promise to transfer the product independent of its efforts to subsequently provide the training services and would be able to provide training services to any customer that previously acquired its product. Consequently, the entity concludes that its promise to transfer the product and its promise to provide training services are not inputs to a combined item and, therefore, are each separately identifiable.~~

606-10-55-313 The product and training services are each distinct in accordance with paragraph 606-10-25-19 and therefore give rise to two separate performance obligations.

606-10-55-314 Finally, the entity assesses the promise to provide a warranty and observes that the warranty provides the customer with the assurance that the product will function as intended for one year. The entity concludes, in accordance with paragraphs 606-10-55-30 through 55-35, that the warranty does not provide the customer with a good or service in addition to that assurance and, therefore, the entity does not account for it as a performance obligation. The entity accounts for the assurance-type warranty in accordance with the requirements on product warranties in Subtopic 460-10.

606-10-55-315 As a result, the entity allocates the transaction price to the two performance obligations (the product and the training services) and recognizes revenue when (or as) those performance obligations are satisfied.

8. Amend paragraphs 606-10-55-361, 606-10-55-363 through 55-368, 606-10-55-370 through 55-383, 606-10-55-385 through 55-389, 606-10-55-391 through 55-394, and 606-10-55-396 through 55-399 and add paragraphs 606-10-55-363A through 55-363B, 606-10-55-365A, 606-10-55-372A, 606-10-55-392A through 55-392D and their related heading, and 606-10-55-399A through 55-399O and their related headings, with a link to transition paragraph 606-10-65-1, as follows:

> > Licensing

606-10-55-361 Examples 54–~~61B~~⁶⁴ illustrate the guidance in paragraphs 606-10-25-14 through 25-22 on identifying performance obligations and paragraphs 606-10-55-54 through 55-60 and ~~606-10-55-62 through 55-65B~~⁶⁵ on licensing. These Examples also illustrate other guidance as follows:

- a. Paragraphs 606-10-25-31 through 25-37 on measuring progress toward complete satisfaction of a performance obligation (~~Example~~^{Examples 57 and 58})
- b. Paragraphs 606-10-32-39 through 32-41 on allocating variable consideration to performance obligations (Example 57)
- c. ~~Paragraph~~^{Paragraphs 606-10-55-65 through 55-65B} on consideration in the form of sales-based or usage-based royalties on licenses of intellectual property (Examples 57 and 61).

> > > 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 through 55-145), 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. The entity first concludes that the software to which the customer

obtains rights as a result of the license is functional intellectual property. This is because the software has significant standalone functionality from which the customer can derive substantial benefit regardless of the entity's ongoing business activities, in accordance with paragraph 606-10-55-60. 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 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 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.

606-10-55-363A The entity further concludes that while the functionality of the underlying software is expected to change during the license period as a result of the entity's continued development efforts, the functionality of the software to which the customer has rights (that is, the customer's instance of the software) will change only as a result of the entity's promise to provide when-and-if available software updates. Because the entity's promise to provide software updates represents an additional promised service in the contract, the entity's activities to fulfill that promised service are not considered in evaluating the criteria in paragraph 606-10-55-62. The entity further notes that the customer has the right to install, or not install, software updates when they are provided such that the criterion in 606-10-55-62(b) would not be met even if the entity's activities to develop and provide software updates had met the criterion in paragraph 606-10-55-62(a).

606-10-55-363B Therefore, the entity concludes that it has provided the customer with a right to use its software as it exists at the point in time the license is granted and the entity accounts for the software license performance obligation as a performance obligation satisfied at a point in time. The entity recognizes revenue on the software license performance obligation in accordance with paragraphs 606-10-55-58B through 55-58C.

>>> **Example 55—License of Intellectual Property**

606-10-55-364 An entity enters into a contract with a customer to license (for a period of three years) intellectual property related to the design and production processes for a good. The contract also specifies that the customer will obtain any

updates to that intellectual property for new designs or production processes that may be developed by the entity. The updates are ~~essential-integral~~ to the customer's ability to derive benefit from ~~use~~ the license during the license period because the ~~customer operates~~ intellectual property is used in an industry in which technologies change rapidly. The entity does not sell the updates separately, and the customer does not have the option to purchase the license without the updates.

606-10-55-365 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. The entity determines that the customer can benefit from (a) the license on its own without the updates and (b) the updates together with the initial license. Although the benefit the customer can derive from the license on its own (that is, without the updates) is limited because the updates are integral to the customer's ability to continue to use the intellectual property in an industry in which technologies change rapidly, the license can be used in a way that generates some economic benefits. Therefore, the criterion in paragraph 606-10-25-19(a) is met for the license and the updates. The entity determines that although the entity can conclude that the customer can obtain benefit from the license on its own without the updates (see paragraph 606-10-25-19(a)), that benefit would be limited because the updates are critical to the customer's ability to continue to make use of the license in the rapidly changing technological environment in which the customer operates. In assessing whether the criterion in paragraph 606-10-25-19(b) is met, the entity observes that the customer does not have the option to purchase the license without the updates and the customer obtains limited benefit from the license without the updates. Therefore, the entity concludes that the license and the updates are highly interrelated and the promise to grant the license is not distinct within the context of the contract because the license is not separately identifiable from the promise to provide the updates (in accordance with the criterion in paragraph 606-10-25-19(b) and the factors in paragraph 606-10-25-21).

606-10-55-365A The fact that the benefit the customer can derive from the license on its own (that is, without the updates) is limited (because the updates are integral to the customer's ability to continue to use the license in the rapidly changing technological environment) also is considered in assessing whether the criterion in paragraph 606-10-25-19(b) is met. Because the benefit that the customer could obtain from the license over the three-year term without the updates would be significantly limited, the entity's promises to grant the license and to provide the expected updates are, in effect, inputs that, together fulfill a single promise to deliver a combined item to the customer. That is, the nature of the entity's promise in the contract is to provide ongoing access to the entity's intellectual property related to the design and production processes for a good for the three-year term of the contract. The promises within that combined item (that is, to grant the license and to provide when-and-if available updates) are therefore not separately identifiable in accordance with the criterion in paragraph 606-10-25-19(b).

606-10-55-366 The nature of the combined good or service that the entity promised to transfer to the customer is ongoing access to the entity's intellectual property related to the design and production processes for a good for the three-year term of the contract. Based on this conclusion, the entity applies paragraphs 606-10-25-23 through 25-30 to determine whether the single performance obligation (which includes the license and the updates) is satisfied at a point in time or over time and paragraphs 606-10-25-31 through 25-37 to determine the appropriate method for measuring progress toward complete satisfaction of the performance obligation. The entity concludes that because the customer simultaneously receives and consumes the benefits of the entity's performance as it occurs, the performance obligation is satisfied over time in accordance with paragraph 606-10-25-27(a) and that a time-based input measure of progress is appropriate because the entity expects, on the basis of its relevant history with similar contracts, to expend efforts to develop and transfer updates to the customer on a generally even basis throughout the three-year term.

> > > Example 56—Identifying a Distinct License

606-10-55-367 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 for 5 years, while the customer develops its own manufacturing capability. The drug is a mature product; therefore, there is no expectation that the entity will not undertake any activities to change support the drug (for example, to alter its chemical composition), which is consistent with its customary business practices. There are no other promised goods or services in the contract.

> > > Case A—License Is Not Distinct

606-10-55-368 In this case, no other entity can manufacture this drug while the customer learns the manufacturing process and builds its own manufacturing capability because of the highly specialized nature of the manufacturing process. As a result, the license cannot be purchased separately from the manufacturing service services.

606-10-55-369 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. 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) 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 The nature of the combined good or service for which the customer contracted is a sole sourced supply of the drug for the first five years; the customer benefits from the license only as a result of having access to a supply of the drug. After the first five years, the customer retains solely the right to use the entity's functional intellectual property (see Case B, paragraph 606-10-55-373), and no

further performance is required of the entity during Years 6–10. The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether the single performance obligation (that is, the bundle of the license and the manufacturing service services) is a performance obligation satisfied at a point in time or over time. Regardless of the determination reached in accordance with paragraphs 606-10-25-23 through 25-30, the entity's performance under the contract will be complete at the end of Year 5.

> > > Case B—License Is Distinct

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

606-10-55-372 ~~The entity assesses the goods and services promised to the customer to determine which goods and services are distinct, and it concludes that the criteria in paragraph 606-10-25-19 are met for each of the license and the manufacturing service. The entity concludes that the criterion in paragraph 606-10-25-19(a) is met because the customer can benefit from the license together with readily available resources other than the entity's manufacturing service (that is, because there are other entities that can provide the manufacturing service) and can benefit from the manufacturing service together with the license transferred to the customer at the start of the contract in accordance with paragraph 606-10-25-19. 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.~~

606-10-55-372A The entity also concludes that its promises to grant the license and to provide the manufacturing service are separately identifiable (that is, the criterion in paragraph 606-10-25-19(b) is met). The entity concludes that the license and the manufacturing service are not inputs to a combined item in this contract on the basis of the principle and the factors in paragraph 606-10-25-21. In reaching this conclusion, the entity considers that the customer could separately purchase the license without significantly affecting its ability to benefit from the license. Neither the license nor the manufacturing service is significantly modified or customized by the other, and the entity is not providing a significant service of integrating those items into a combined output. The entity further considers that the license and the manufacturing service are not highly interdependent or highly interrelated because the entity would be able to fulfill its promise to transfer the license independent of fulfilling its promise to subsequently manufacture the drug for the customer. Similarly, the entity would be able to manufacture the drug for

the customer even if the customer had previously obtained the license and initially utilized a different manufacturer. Thus, although the manufacturing service necessarily depends on the license in this contract (that is, the entity would not contract for the manufacturing service without the customer having obtained the license), the license and the manufacturing service do not significantly affect each other. Consequently, the entity concludes that its promises to grant the license and to provide the manufacturing service are distinct and that there are two performance obligations:

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

~~**606-10-55-373** The entity assesses, in accordance with paragraph 606-10-55-60, the nature of the entity's promise to grant the license. The entity concludes that the patented drug formula is functional intellectual property (that is, it has significant standalone functionality in the form of its ability to treat a disease or condition). There is no expectation that the entity will undertake activities to change the functionality of the drug formula during the license period. Because the intellectual property has significant standalone functionality, any other activities the entity might undertake (for example, promotional activities like advertising or activities to develop other drug products) would not significantly affect the utility of the licensed intellectual property. Consequently, the nature of the entity's promise in transferring the license is to provide a right to use the entity's functional intellectual property, and it accounts for the license as a performance obligation satisfied at a point in time. The entity recognizes revenue for the license performance obligation in accordance with paragraphs 606-10-55-58B through 55-58C. 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 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, 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 In its assessment of the nature of the license, the entity does not consider the manufacturing service because it is an additional promised service in the contract. The entity applies paragraphs 606-10-25-23 through 25-30 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 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 fixed fee of \$1 million, as well as a sales-based royalty of 5 percent of the customer's monthly sales for the term of the license. The fixed consideration for the equipment is \$150,000 payable when the equipment is delivered.

> > > Identifying Performance Obligations

606-10-55-376 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. The entity observes that the entity, as a franchisor, has developed a customary business practice to undertake activities such as analyzing the ~~customer's consumers'~~ 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 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 each distinct. This is because the customer can benefit from each good or service promise (that is, the ~~promise of the license and the promise of the equipment~~) on its ~~their~~ own or together with other resources that are readily available (see paragraph 606-10-25-19(a)). ~~(That is, the~~ 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. ~~value.)~~ The entity also determines that the promises to grant the franchise license and to transfer the equipment are separately identifiable in accordance with the criterion in paragraph 606-10-25-19(b). ~~606-10-25-19(b), because none of the factors in paragraph 606-10-25-21 are present.~~ The entity concludes that the license and the equipment are not inputs to a combined item (that is, they are not fulfilling what is, in effect, a single promise to the customer). In reaching this conclusion, the entity considers that it is not providing a significant service of integrating the license and the equipment into a combined item (that is, the licensed intellectual property is not a component of, and does not significantly modify, the equipment). Additionally, the license and the equipment are not highly interdependent or highly interrelated because the entity would be able to fulfill each promise (that is, to license the franchise or to transfer the equipment) independently of the other. Consequently, the entity has two performance obligations:

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

> > > Allocating the Transaction Price

606-10-55-378 The entity determines that the transaction price includes fixed consideration of ~~\$1,150,000~~\$150,000 and variable consideration (5 percent of ~~customer~~ the customer's sales from the franchise store). The standalone selling price of the equipment is \$150,000 and the entity regularly licenses franchises in exchange for 5 percent of customer sales and a similar upfront fee.

606-10-55-379 The entity applies paragraph 606-10-32-40 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 allocating the sales-based royalty (as well as the additional \$1 million in fixed consideration) 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 The entity assesses, ~~in accordance with paragraph 606-10-55-60,~~ the nature of the entity's promise to grant the franchise license. The entity concludes that the nature of its promise is to provide a right to access the entity's symbolic intellectual property. The trade name and logo have limited standalone functionality; the utility of the products developed by the entity is derived largely from the products' association with the franchise brand. Substantially all of the utility inherent in the trade name, logo, and product rights granted under the license stems from the entity's past and ongoing activities of establishing, building, and maintaining the franchise brand. The utility of the license is its association with the franchise brand and the related demand for its products. ~~the criteria in paragraph 606-10-55-60 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. Subparagraph superseded by Accounting Standards Update No. 2016-10. 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. ~~Subparagraph superseded by Accounting Standards Update No. 2016-10. 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. ~~Subparagraph superseded by Accounting Standards Update No. 2016-10. 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 The entity is granting a license to symbolic intellectual property. Consequently, the license provides the customer with a right to access the entity's intellectual property and the entity's performance obligation to transfer the license is satisfied over time in accordance with paragraph 606-10-55-58A. The entity recognizes the fixed consideration allocable to the license performance obligation in accordance with paragraph 606-10-55-58A and paragraph 606-10-55-58C. This includes applying paragraphs 606-10-25-31 through 25-37 to identify the method that best depicts the entity's performance in satisfying the license (see paragraph 606-10-55-382). Because the criteria in paragraph 606-10-55-60 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).

606-10-55-382 The entity also concludes that because ~~Because~~ the consideration that is in the form of a sales-based royalty relates specifically to the franchise license (see paragraph 606-10-55-379), the entity applies paragraph 606-10-55-65 in recognizing that consideration as revenue and, after the transfer of the franchise license, the entity recognizes revenue as and when those sales occur. Consequently, the entity recognizes revenue from the sales-based royalty as and when the sales occur. The entity concludes that recognizing revenue resulting from the sales-based royalty when the customer's subsequent sales occur is consistent with the guidance in paragraph 606-10-55-65(b). That is, the entity concludes that ratable recognition of the fixed \$1 million franchise fee plus recognition of the periodic royalty fees as the customer's subsequent sales occur reasonably depict the entity's performance toward complete satisfaction of the franchise license performance obligation to which the sales-based royalty has been allocated.

>>> Example 58—Access to Intellectual Property

606-10-55-383 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 and disappear 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 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 ~~In accordance with paragraph 606-10-25-19, 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 made no other performance obligations promises to the customer 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. Therefore, the entity concludes that its only performance obligation is to transfer the license.~~

606-10-55-386 ~~The entity assesses the nature of the entity's promise to transfer the license and concludes that the nature of its promise is to grant the customer the right to access the entity's symbolic intellectual property. The entity determines that the licensed intellectual property (that is, the character names and images) is symbolic because it has no standalone functionality (the names and images cannot process a transaction, perform a function or task, or be played or aired separate from significant additional production that would, for example, use the images to create a movie or a show) and the utility of those names and images is derived from the entity's past and ongoing activities such as producing the weekly comic strip that includes the characters. In accordance with paragraph 606-10-55-60. In assessing the criteria the entity considers the following:~~

- a. ~~Subparagraph superseded by Accounting Standards Update No. 2016-10. 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. ~~Subparagraph superseded by Accounting Standards Update No. 2016-10. 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. ~~Subparagraph superseded by Accounting Standards Update No. 2016-10. 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 ~~Consequently, the entity concludes that the criteria in paragraph 606-10-55-60 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, Because the nature of the entity's promise in granting the license is to provide the customer with a right to access the entity's intellectual property, in accordance with paragraph 606-10-55-58A, 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) is met).~~

606-10-55-388 The entity recognizes the fixed consideration allocable to the license performance obligation in accordance with paragraphs 606-10-55-58A and 606-10-55-58C. The entity applies considers paragraphs 606-10-25-31 through 25-37 to identify in identifying 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**

> > > **Case A—Initial License**

606-10-55-389 An entity, a music record label, licenses to a customer a ~~4975~~ 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 starting on January 1, 20X1. 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 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. The entity concludes that its only performance obligation is to grant the license. The term of the license (two years), the geographical scope of the license (that is, the customer's right to use the symphony only in Country A), and the defined permitted uses for the recording (that is, use in commercials) are all attributes of the promised license in this contract.

606-10-55-391 In determining that the promised license provides the customer with a right to use its intellectual property as it exists at the point in time at which the license is granted, the entity considers the following:

- a. The classical symphony recording has significant standalone functionality because the recording can be played in its present, completed form without the entity's further involvement. The customer can derive substantial benefit from that functionality regardless of the entity's further activities or actions. Therefore, the nature of the licensed intellectual property is functional.

- b. The contract does not require, and the customer does not reasonably expect, that the entity will undertake activities to change the licensed recording.

Therefore, the criteria in paragraph 606-10-55-62 are not met. In accordance with paragraph 606-10-55-60, 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 In accordance with paragraph 606-10-55-58B, the promised license, which provides the customer with a right to use the entity's intellectual property, is a performance obligation satisfied at a point in time. The entity recognizes revenue from the satisfaction of that performance obligation in accordance with paragraphs 606-10-55-58B through 55-58C. Additionally, because 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 through 32-20 to determine whether a significant financing component exists.

> > > Case B—Renewal of the License

606-10-55-392A At the end of the first year of the license period, on December 31, 20X1, the entity and the customer agree to renew the license to the recorded symphony for two additional years, subject to the same terms and conditions as the original license. The entity will continue to receive fixed consideration of \$10,000 per month during the 2-year renewal period.

606-10-55-392B The entity considers the contract combination guidance in paragraph 606-10-25-9 and assesses that the renewal was not entered into at or near the same time as the original license and, therefore, is not combined with the initial contract. The entity evaluates whether the renewal should be treated as a new license or the modification of an existing license. Assume that in this scenario, the renewal is distinct. If the price for the renewal reflects its standalone selling price, the entity will, in accordance with paragraph 606-10-25-12, account for the renewal as a separate contract with the customer. Alternatively, if the price for the renewal does not reflect the standalone selling price of the renewal, the entity will account for the renewal as a modification of the original license contract.

606-10-55-392C In determining when to recognize revenue attributable to the license renewal, the entity considers the guidance in paragraph 606-10-55-58C

and determines that the customer cannot use and benefit from the license before the beginning of the two-year renewal period on January 1, 20X3. Therefore, revenue for the renewal cannot be recognized before that date.

606-10-55-392D Consistent with Case A, because the customer's additional monthly payments for the modification to the license will be made over two years from the date the customer obtains control of the second license, the entity considers the guidance in paragraphs 606-10-32-15 through 32-20 to determine whether a significant financing component exists.

> > > Example 60—Sales-Based Royalty Promised in Exchange for a License of Intellectual Property and Other Goods and ServicesAccess to Intellectual Property

606-10-55-393 An entity, a movie distribution company, licenses Movie XYZ to a customer. The customer, an operator of cinemas, has the right to show the movie in its cinemas for six weeks. Additionally, the entity has agreed to provide memorabilia from the filming to the customer for display at the customer's cinemas before the beginning of the six-week airing period and to sponsor radio advertisements for Movie XYZ on popular radio stations in the customer's geographical area throughout the six-week airing period. In exchange for providing the license and the additional promotional goods and services, the entity will receive a portion of the operator's ticket sales for Movie XYZ (that is, variable consideration in the form of a sales-based royalty). In exchange for providing the license, the entity will receive a portion of the operator's ticket sales for Movie XYZ (that is, variable consideration in the form of a sales-based royalty). The entity concludes that its only performance obligation is the promise to grant the license.

606-10-55-394 The entity concludes that the license to show Movie XYZ is the predominant item to which the sales-based royalty relates because the entity has a reasonable expectation that the customer would ascribe significantly more value to the license than to the related promotional goods or services. The entity will recognize revenue from the sales-based royalty, the only fees to which the entity is entitled under the contract, wholly in accordance with paragraph 606-10-55-65. If the license, the memorabilia, and the advertising activities were separate performance obligations, the entity would allocate the sales-based royalties to each performance obligation. The entity observes that regardless of whether the promise to grant the license represents a right to access the entity's intellectual property or a right to use the entity's intellectual property, the entity applies paragraph 606-10-55-65 and recognizes revenue as and when the ticket sales occur. This is because the consideration for its license of intellectual property is a sales-based royalty and the entity has already transferred the license to the movie to which the sales-based royalty relates.

> > > Example 61—Access to Intellectual Property

606-10-55-395 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 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. The entity concludes that the only good or service promised to the customer in the contract is the license. The additional activities associated with the license (that is, continuing to play games and provide a competitive team) do not directly transfer a good or service to the customer. Therefore, there is one performance obligation in the contract. 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 To determine whether the entity's promise in granting the license provides the customer with a right to access the entity's intellectual property or a right to use the entity's intellectual property, the entity assesses the nature of the intellectual property to which the customer obtains rights. The entity concludes that the intellectual property to which the customer obtains rights is symbolic intellectual property. The utility of the team name and logo to the customer is derived from the entity's past and ongoing activities of playing games and providing a competitive team (that is, those activities effectively give value to the intellectual property). Absent those activities, the team name and logo would have little or no utility to the customer because they have no standalone functionality (that is, no ability to perform or fulfill a task separate from their role as symbols of the entity's past and ongoing activities). The entity assesses the nature of the entity's promise to transfer the license in accordance with paragraph 606-10-55-60. In assessing the criteria, the entity considers the following:

- a. Subparagraph superseded by Accounting Standards Update No. 2016-10. 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. ~~Subparagraph superseded by Accounting Standards Update No. 2016-10. 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. ~~Subparagraph superseded by Accounting Standards Update No. 2016-10. 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** Consequently, the entity's promise in granting the license provides the customer with the right to access the entity's intellectual property throughout the license period and, in accordance with paragraph 606-10-55-58A, the entity accounts for the promised license as a performance obligation satisfied over time. The entity concludes that the criteria in paragraph 606-10-55-60 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) is met).~~

~~**606-10-55-399** The entity recognizes the fixed consideration allocable to the license performance obligation in accordance with paragraphs 606-10-55-58A and 606-10-55-58C. This includes applying paragraphs 606-10-25-31 through 25-37 to identify the method that best depicts the entity's performance in satisfying the license. The entity then applies paragraphs 606-10-25-31 through 25-37 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 applies because the sales-based royalty relates solely to the license that is the only performance obligation in the contract. The entity concludes that recognizing revenue from the sales-based royalty when the customer's subsequent sales of items using the team name or logo occur is consistent with the guidance in paragraph 606-10-55-65(b). That is, the entity concludes that ratable recognition of the fixed consideration of \$2 million plus recognition of the royalty fees as the customer's subsequent sales occur reasonably depict the entity's progress toward complete satisfaction of the license performance obligation. applies; therefore, the entity recognizes revenue as and when the sales of items using the team name or logo occur.~~

> > > Example 61A—Right to Use Intellectual Property

~~**606-10-55-399A** An entity, a television production company, licenses all of the existing episodes of a television show (which consists of the first four seasons) to a customer. The show is presently in its fifth season, and the television production company is producing episodes for that fifth season at the time the contract is~~

entered into, as well as promoting the show to attract further viewership. The Season 5 episodes in production are still subject to change before airing.

> > > Case A—License Is the Only Promise in the Contract

606-10-55-399B The customer obtains the right to broadcast the existing episodes, in sequential order, for a period of two years. The show has been successful through the first four seasons, and the customer is both aware that Season 5 already is in production and aware of the entity's continued promotion of the show. The customer will make fixed monthly payments of an equal amount throughout the two-year license period.

606-10-55-399C The entity assesses the goods and services promised to the customer. The entity's activities to produce Season 5 and its continued promotion of the show do not transfer a promised good or service to the customer. Therefore, the entity concludes that there are no other promised goods or services in the contract other than the license to broadcast the existing episodes in the television series. The contractual requirement to broadcast the episodes in sequential order is an attribute of the license (that is, a restriction on how the customer may use the license); therefore, the only performance obligation in this contract is the single license to the completed Seasons 1–4.

606-10-55-399D To determine whether the promised license provides the customer with a right to use its intellectual property or a right to access its intellectual property, the entity evaluates the intellectual property that is the subject of the license. The existing episodes have substantial standalone functionality at the point in time they are transferred to the customer because the episodes can be aired, in the form transferred, without any further participation by the entity. Therefore, the customer can derive substantial benefit from the completed episodes, which have significant utility to the customer without any further activities of the entity. The entity further observes that the existing episodes are complete and not subject to change. Thus, there is no expectation that the functionality of the intellectual property to which the customer has rights will change (that is, the criteria in paragraph 606-10-55-62 are not met). Therefore, the entity concludes that the license provides the customer with a right to use its functional intellectual property.

606-10-55-399E Consequently, in accordance with paragraph 606-10-55-58B, the license is a performance obligation satisfied at a point in time. In accordance with paragraphs 606-10-55-58B through 55-58C, the entity recognizes revenue for the license on the date that the customer is first permitted to air the licensed content, assuming the content is made available to the customer on or before that date. The date the customer is first permitted to air the licensed content is the beginning of the period during which the customer is able to use and benefit from its right to use the intellectual property. Because of the length of time between the entity's performance (at the beginning of the period) and the customer's annual payments over two years (which are noncancellable), the entity considers the guidance in

paragraphs 606-10-32-15 through 32-20 to determine whether a significant financing component exists.

> > > Case B—Contract Includes Two Promises

606-10-55-399F Consistent with Case A, the contract provides the customer with the right to broadcast the existing episodes, in sequential order, over a period of two years. The contract also grants the customer the right to broadcast the episodes being produced for Season 5 once all of those episodes are completed.

606-10-55-399G The entity assesses the goods and services promised to the customer. The entity concludes that there are two promised goods or services in the contract:

- a. The license to the existing episodes (see paragraph 606-10-55-399C)
- b. The license to the episodes comprising Season 5, when all of those episodes are completed.

606-10-55-399H The entity then evaluates whether the license to the existing content is distinct from the license to the Season 5 episodes when they are completed. The entity concludes that the two licenses are distinct from each other and, therefore, separate performance obligations. This conclusion is based on the following analysis:

- a. Each license is capable of being distinct because the customer can benefit from its right to air the existing completed episodes on their own and can benefit from the right to air the episodes comprising Season 5, when they are all completed, on their own and together with the right to air the existing completed content.
- b. Each of the two promises to transfer a license in the contract also is separately identifiable; they do not, together, constitute a single overall promise to the customer. The existing episodes do not modify or customize the Season 5 episodes in production, and the existing episodes do not, together with the pending Season 5 episodes, result in a combined functionality or changed content. The right to air the existing content and the right to air the Season 5 content, when available, are not highly interdependent or highly interrelated because the entity's ability to fulfill its promise to transfer either license is unaffected by its promise to transfer the other. In addition, whether the customer or another licensee had rights to air the future episodes would not be expected to significantly affect the customer's license to air the existing, completed episodes (for example, viewers' desire to watch existing episodes from Seasons 1–4 on the customer's network generally would not be significantly affected by whether the customer, or another network, had the right to broadcast the episodes that will comprise Season 5).

606-10-55-399I The entity assesses the nature of the two separate performance obligations (that is, the license to the existing, completed episodes of the series

and the license to episodes that will comprise Season 5 when completed). To determine whether the licenses provide the customer with rights to use the entity's intellectual property or rights to access the entity's intellectual property, the entity considers the following:

- a. The licensed intellectual property (that is, the completed episodes in Seasons 1–4 and the episodes in Season 5, when completed) has significant standalone functionality separate from the entity's ongoing business activities, such as in producing additional intellectual property (for example, future seasons) or in promoting the show, and completed episodes can be aired without the entity's further involvement.
- b. There is no expectation that the entity will substantively change any of the content once it is made available to the customer for broadcast (that is, the criteria in paragraph 606-10-55-62 are not met).
- c. The activities expected to be undertaken by the entity to produce Season 5 and transfer the right to air those episodes constitute an additional promised good (license) in the contract and, therefore, do not affect the nature of the entity's promise in granting the license to Seasons 1–4.

606-10-55-399J Therefore, the entity concludes that both the license to the existing episodes in the series and the license to the episodes that will comprise Season 5 provide the customer with the right to use its functional intellectual property as it exists at the point in time the license is granted. As a result, the entity recognizes the portion of the transaction price allocated to each license at a point in time in accordance with paragraphs 606-10-55-58B through 55-58C. That is, the entity recognizes the revenue attributable to each license on the date that the customer is first permitted to first air the content included in each performance obligation. That date is the beginning of the period during which the customer is able to use and benefit from its right to use the licensed intellectual property.

> > > Example 61B—Distinguishing Multiple Licenses from Attributes of a Single License

606-10-55-399K On December 15, 20X0, an entity enters into a contract with a customer that permits the customer to embed the entity's functional intellectual property in two classes of the customer's consumer products (Class 1 and Class 2) for five years beginning on January 1, 20X1. During the first year of the license period, the customer is permitted to embed the entity's intellectual property only in Class 1. Beginning in Year 2 (that is, beginning on January 1, 20X2), the customer is permitted to embed the entity's intellectual property in Class 2. There is no expectation that the entity will undertake activities to change the functionality of the intellectual property during the license period. There are no other promised goods or services in the contract. The entity provides (or otherwise makes available—for example, makes available for download) a copy of the intellectual property to the customer on December 20, 20X0.

606-10-55-399L In identifying the goods and services promised to the customer in the contract (in accordance with guidance in paragraphs 606-10-25-14 through 25-

18), the entity considers whether the contract grants the customer a single promise, for which an attribute of the promised license is that during Year 1 of the contract the customer is restricted from embedding the intellectual property in the Class 2 consumer products), or two promises (that is, a license for a right to embed the entity's intellectual property in Class 1 for a five-year period beginning on January 1, 20X1, and a right to embed the entity's intellectual property in Class 2 for a four-year period beginning on January 1, 20X2).

606-10-55-399M In making this assessment, the entity determines that the provision in the contract stipulating that the right for the customer to embed the entity's intellectual property in Class 2 only commences one year after the right for the customer to embed the entity's intellectual property in Class 1 means that after the customer can begin to use and benefit from its right to embed the entity's intellectual property in Class 1 on January 1, 20X1, the entity must still fulfill a second promise to transfer an additional right to use the licensed intellectual property (that is, the entity must still fulfill its promise to grant the customer the right to embed the entity's intellectual property in Class 2). The entity does not transfer control of the right to embed the entity's intellectual property in Class 2 before the customer can begin to use and benefit from that right on January 1, 20X2.

606-10-55-399N The entity then concludes that the first promise (the right to embed the entity's intellectual property in Class 1) and the second promise (the right to embed the entity's intellectual property in Class 2) are distinct from each other. The customer can benefit from each right on its own and independently of the other. Therefore, each right is capable of being distinct in accordance with paragraph 606-10-25-19(a)). In addition, the entity concludes that the promise to transfer each license is separately identifiable (that is, each right meets the criterion in paragraph 606-10-25-19(b)) on the basis of an evaluation of the principle and the factors in paragraph 606-10-25-21. The entity concludes that it is not providing any integration service with respect to the two rights (that is, the two rights are not inputs to a combined output with functionality that is different from the functionality provided by the licenses independently), neither right significantly modifies or customizes the other, and the entity can fulfill its promise to transfer each right to the customer independently of the other (that is, the entity could transfer either right to the customer without transferring the other). In addition, neither the Class 1 license nor the Class 2 license is integral to the customer's ability to use or benefit from the other.

606-10-55-399O Because each right is distinct, they constitute separate performance obligations. On the basis of the nature of the licensed intellectual property and the fact that there is no expectation that the entity will undertake activities to change the functionality of the intellectual property during the license period, each promise to transfer one of the two licenses in this contract provides the customer with a right to use the entity's intellectual property and the entity's promise to transfer each license is, therefore, satisfied at a point in time. The entity determines at what point in time to recognize the revenue allocable to each

performance obligation in accordance with paragraphs 606-10-55-58B through 55-58C. Because a customer does not control a license until it can begin to use and benefit from the rights conveyed, the entity recognizes revenue allocated to the Class 1 license no earlier than January 1, 20X1, and the revenue on the Class 2 license no earlier than January 1, 20X2.

Amendments to Section 606-10-65

9. Amend paragraph 606-10-65-1, and its related heading, as follows:

> Transition Related to Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), and Accounting Standards Update No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), and No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing:

606-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and Accounting Standards Update No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, and No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*:

[The remainder of this paragraph is not shown here because it is unchanged.]

Amendments to the Status Section

10. Amend paragraph 606-10-00-1, by adding the following items to the table, as follows:

606-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
606-10-25-16	Amended	2016-10	04/14/2016
606-10-25-16A	Added	2016-10	04/14/2016
606-10-25-16B	Added	2016-10	04/14/2016
606-10-25-17	Amended	2016-10	04/14/2016
606-10-25-18	Amended	2016-10	04/14/2016

Paragraph	Action	Accounting Standards Update	Date
606-10-25-18A	Added	2016-10	04/14/2016
606-10-25-18B	Added	2016-10	04/14/2016
606-10-25-19	Amended	2016-10	04/14/2016
606-10-25-21	Amended	2016-10	04/14/2016
606-10-55-3	Amended	2016-10	04/14/2016
606-10-55-54	Amended	2016-10	04/14/2016
606-10-55-55	Amended	2016-10	04/14/2016
606-10-55-57	Amended	2016-10	04/14/2016
606-10-55-58	Amended	2016-10	04/14/2016
606-10-55-58A through 55-58C	Added	2016-10	04/14/2016
606-10-55-59	Amended	2016-10	04/14/2016
606-10-55-60	Amended	2016-10	04/14/2016
606-10-55-61	Superseded	2016-10	04/14/2016
606-10-55-62	Amended	2016-10	04/14/2016
606-10-55-63	Amended	2016-10	04/14/2016
606-10-55-63A	Added	2016-10	04/14/2016
606-10-55-64	Amended	2016-10	04/14/2016
606-10-55-64A	Added	2016-10	04/14/2016
606-10-55-65A	Added	2016-10	04/14/2016
606-10-55-65B	Added	2016-10	04/14/2016
606-10-55-93	Amended	2016-10	04/14/2016
606-10-55-136	Amended	2016-10	04/14/2016
606-10-55-137	Amended	2016-10	04/14/2016
606-10-55-139	Amended	2016-10	04/14/2016
606-10-55-140A through 55-140F	Added	2016-10	04/14/2016
606-10-55-142	Amended	2016-10	04/14/2016
606-10-55-143	Amended	2016-10	04/14/2016
606-10-55-145	Amended	2016-10	04/14/2016
606-10-55-147 through 55-150	Amended	2016-10	04/14/2016
606-10-55-150A through 55-150K	Added	2016-10	04/14/2016
606-10-55-153	Amended	2016-10	04/14/2016
606-10-55-153A	Added	2016-10	04/14/2016
606-10-55-155	Amended	2016-10	04/14/2016
606-10-55-156	Amended	2016-10	04/14/2016
606-10-55-157A through 55-157E	Added	2016-10	04/14/2016
606-10-55-309	Amended	2016-10	04/14/2016

Paragraph	Action	Accounting Standards Update	Date
606-10-55-311 through 55-313	Amended	2016-10	04/14/2016
606-10-55-361	Amended	2016-10	04/14/2016
606-10-55-363	Amended	2016-10	04/14/2016
606-10-55-363A	Added	2016-10	04/14/2016
606-10-55-363B	Added	2016-10	04/14/2016
606-10-55-364	Amended	2016-10	04/14/2016
606-10-55-365	Amended	2016-10	04/14/2016
606-10-55-365A	Added	2016-10	04/14/2016
606-10-55-366 through 55-368	Amended	2016-10	04/14/2016
606-10-55-370 through 55-372	Amended	2016-10	04/14/2016
606-10-55-372A	Added	2016-10	04/14/2016
606-10-55-373 through 55-383	Amended	2016-10	04/14/2016
606-10-55-385 through 55-392	Amended	2016-10	04/14/2016
606-10-55-392A through 55-392D	Added	2016-10	04/14/2016
606-10-55-393	Amended	2016-10	04/14/2016
606-10-55-394	Amended	2016-10	04/14/2016
606-10-55-396 through 55-399	Amended	2016-10	04/14/2016
606-10-55-399A through 55-399O	Added	2016-10	04/14/2016
606-10-65-1	Amended	2016-10	04/14/2016

The amendments in this Update were adopted by the affirmative vote of five members of the Financial Accounting Standards Board. Messrs. Linsmeier and Siegel dissented.

Messrs. Linsmeier and Siegel dissent from the issuance of this Accounting Standards Update for three primary reasons. First, they believe that the amendment that permits an entity not to identify goods or services promised to the customer that are immaterial in the context of the contract is a potentially broad-reaching precedent. They are concerned that this amendment may be the first step in effectively redefining an accounting error and see no reason why the Board will not consider whether to apply this decision more broadly to disclosures, leases, capitalization policies, and other accounting matters. Second, Messrs. Linsmeier and Siegel are concerned that the amendment that will permit an entity, as an accounting policy election, to account for shipping and handling that occur after

the customer has obtained control of a good as a fulfillment activity will introduce potential noncomparability, hindering the comparison of financial information across entities. Third, they believe that the amendments relating to licenses override the core principle of the licensing implementation guidance in Topic 606 that an entity's promise to grant a license provides a customer with either a right to access or a right to use an entity's intellectual property on the basis of whether the entity is expected to undertake activities that significantly affect the intellectual property to which the customer has rights and whether those activities expose the customer to positive or negative effects that do not result in the transfer of a good or service to the customer. In particular, they are concerned that the amendments change the focus away from whether the entity undertakes activities that significantly affect the intellectual property to a focus primarily on whether the underlying intellectual property has the ability to process a transaction, perform a function or task, or be played or aired, which to Messrs. Linsmeier and Siegel represents a substantive change in the guidance. They also note that each of these decisions will result in further divergence (and with regards to licenses significant divergence) in the articulation of the revenue recognition guidance in GAAP versus IFRS.

Messrs. Linsmeier and Siegel believe that many of the issues that stakeholders raised about immaterial performance obligations are not entirely caused by the guidance in the core standard but may be arising as a result of paragraphs BC89 and BC90 of the basis for conclusions for Update 2014-09. Their understanding is that some stakeholders believe that those paragraphs essentially require them to assess each and every possible good or service in the contract no matter how insignificant. Messrs. Linsmeier and Siegel believe that preparers' and auditors' concerns are heightened in this area as a result of audit requirements about the accumulation of unrecorded immaterial items and communications with audit committees of the boards of directors. Messrs. Linsmeier and Siegel believe that it is unnecessary to amend Topic 606 as a result of concerns not stemming from the guidance, but instead from the basis for conclusions of Update 2014-09 and audit requirements about immaterial items.

Messrs. Linsmeier and Siegel also are concerned that this amendment could set a far-reaching precedent for the Board and implies that there is significant confusion about the application of the "materiality box," which is codified in paragraph 105-10-05-6 as "the provisions of the Codification need not be applied to immaterial items." They believe that including this sentence in the Codification avoids the need for the Board to prescribe in Topic 606 that "an entity is not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract." Furthermore, Messrs. Linsmeier and Siegel are concerned that if the Board needs to prescribe that immaterial promises need not be assessed, they see no reason why the Board will not need to specify that immaterial lease obligations need not be recognized in the statement of financial position, as well as immaterial capital expenditures. They note that after the Board concluded to make the amendments in this Update,

the Board decided to propose an amendment to Topic 235, Notes to Financial Statements, on how to apply materiality in the context of disclosures. Specifically, the Board concluded, in part, that if an entity does not provide a GAAP disclosure because management has decided the information is not material, the omission should not be considered an accounting error. Messrs. Linsmeier and Siegel believe that those isolated decisions represent a fundamental shift in thinking about materiality and accounting errors and that the Board should deliberate them more holistically, in conjunction with a broader discussion among the interested parties, such as the U.S. Securities and Exchange Commission and the U.S. Public Company Accounting Oversight Board.

In the interim, Messrs. Linsmeier and Siegel would have addressed stakeholders' concerns about assessing immaterial performance obligations by emphasizing the discussion in the TRG minutes that, generally, TRG members believe that other than for certain material rights, Update 2014-09 will not require recognition of significantly more promised goods or services than those that are identified as deliverables in today's practice. Furthermore, Messrs. Linsmeier and Siegel believe that the Board could highlight in the basis for conclusions in this Update the Board's thinking in this area, as well as the substance of the TRG discussion confirming the Board's intention in issuing Update 2014-09. They believe that those two steps would be sufficient without amending the Codification.

Regarding the decision about shipping and handling, Messrs. Linsmeier and Siegel agree with the Board's decision to clarify that shipping and handling that occur before a customer obtains control of the good are a fulfillment activity. However, they disagree that the decision represents an improvement in financial reporting to provide an accounting policy election to account for shipping and handling as a fulfillment activity even if it occurs after a customer obtains control of the good. They believe that this amendment will create an exception to the model and potentially introduces noncomparability between entities. Because this policy election is available to all entities, they are concerned that entities with significant shipping operations could make different elections in this regard, which will make the comparison of one entity to another by users much more difficult. Messrs. Linsmeier and Siegel prefer that, because the Board found it appropriate to clarify that entities are not required to assess goods or services promised to a customer that are immaterial in the context of the contract, the Board rely on that provision to alleviate the issue without creating a new exception to the new revenue recognition model and introduce a policy election. They believe that shipping and handling activities that are material should be analyzed like other material promises in the contract and accounted for in a similar manner.

Messrs. Linsmeier and Siegel believe that stakeholders have correctly identified some challenges with the application of the licensing guidance in Update 2014-09 that necessitate that the Board make changes to Topic 606 to make the licensing guidance more operable. However, they believe that the amendments in this Update go too far, overriding the basic principle of the licensing guidance in Topic 606 that was agreed upon jointly by the Boards and increasing the potential that

the resulting licensing guidance in Topic 606 diverges significantly from that in IFRS 15.

Messrs. Linsmeier and Siegel believe that the outcome of the amendments is a presumption that revenue will be recognized over time for all licenses except licenses of intellectual property for which one or both of the following criteria are not met:

- a. The functionality of the intellectual property to which a customer has rights is expected to substantively change during the license period as a result of an entity's activities that do not transfer a good or service to the customer.
- b. The customer is contractually or practically required to use the updated intellectual property resulting from criterion (a).

Messrs. Linsmeier and Siegel believe that this outcome represents a fundamental and significant change in the licensing guidance that is inconsistent with the TRG process and objectives. They also believe that these amendments could have been written more directly and succinctly, consistent with the language above. Writing the amendments in this manner also will make it clear that the amendments represent a change in the fundamental principle by focusing primarily on the nature of the intellectual property (that is, whether or not the intellectual property has the ability to process a transaction, perform a function or task, or be played or aired) and not on whether the entity is expected to undertake activities that significantly affect the utility of the intellectual property to which the customer has rights.

Messrs. Linsmeier and Siegel agree with the amendments that address stakeholders' operability concerns by making it clear that revenue should be recognized at a point in time if (a) the licensed intellectual property has the ability to process a transaction, perform a function or task, or be played or aired (that is, it has standalone functionality) and (b) a customer is not contractually or practically required to use the updated intellectual property as that functionality changes over time on the basis of activities undertaken by the entity that do not transfer a good or service to the customer. Messrs. Linsmeier and Siegel agree with those amendments because they continue to focus on whether or not the entity is expected to undertake activities that significantly affect the utility of the intellectual property to which the customer has rights, while making the evaluation more operable by permitting the entity to focus only on activities that change the standalone functionality of intellectual property that has the ability to process a transaction, perform a function or task, or be played or aired. They believe that those activities are most likely to expose the customer to positive or negative effects that do not result in the transfer of a good or service to the customer and, therefore, find it a cost-beneficial accommodation to permit the entity to ignore other activities undertaken by the entity that are unrelated to changes in the standalone functionality of the intellectual property.

In contrast, Messrs. Linsmeier and Siegel disagree with the amendments that address stakeholders' operability concerns by no longer requiring an evaluation

for each license as to whether an entity is expected to undertake activities that significantly affect the utility of the intellectual property to which a customer has rights for all licenses of intellectual property that do not have the ability to process a transaction, perform a function or task, or to be played or aired. Messrs. Linsmeier and Siegel believe that change will override the core principle of the licensing implementation guidance in Topic 606 that was agreed upon jointly by the Boards and, instead, will create a presumption that those activities always will occur when that intellectual property is licensed. They note that the IASB also disagreed with this presumption. They further note that IASB members expressed a willingness to converge with the revised guidance substantially in line with the alternative approach that was considered by the Board (see paragraphs BC60 and BC61). That alternative approach for licenses of intellectual property that do not have the ability to process a transaction, perform a function or task, or be played or aired will continue to require that an entity determine whether the entity's promise in granting a license provides a customer with either a right to access or a right to use the entity's intellectual property on the basis of whether the entity is expected to undertake activities that significantly affect the utility of the intellectual property to which the customer has rights without resulting in the transfer of a good or service to the customer. This also is the approach preferred by Messrs. Linsmeier and Siegel.

Messrs. Linsmeier and Siegel also recognize that some have asserted that differences in financial reporting outcomes likely will be minimal between their preferred alternative and the amendments. They are uncomfortable with that assertion, however, given the wide variety of licenses that exist today and, more important, the potential for even a wider variety of licenses to arise in the future. For those reasons, they prefer that the core principle for differentiating licenses in Topic 606 be retained for licenses of intellectual property that do not have the ability to process a transaction, perform a function or task, or be played or aired.

Messrs. Linsmeier and Siegel also disagree with the amendments that unnecessarily will introduce two classes of intellectual property (functional and symbolic). They believe that this change may cause confusion because those two classes fail to capture differences in the nature of all licenses and, therefore, stakeholders may find it difficult to classify intellectual property as either functional or symbolic. Messrs. Linsmeier and Siegel would prefer that the amendments differentiate between intellectual property on the basis of whether or not it has the ability to process a transaction, perform a function or task, or be played or aired.

(which is how standalone functionality is described in the amendments), rather than labeling some intellectual property as functional (that is, having significant standalone functionality) and the remainder as symbolic.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. On May 28, 2014, the FASB issued Update 2014-09 and the IASB issued IFRS 15 (collectively, the new revenue standard). The new revenue standard is largely converged for GAAP and IFRS. In June 2014, the FASB and the IASB announced the formation of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG). One of the objectives of the TRG is to inform the Boards about potential implementation issues that could arise when organizations implement the new revenue standard. The TRG also assists stakeholders in understanding specific aspects of the new revenue standard. The TRG does not issue authoritative guidance. Instead, the Boards evaluate the feedback received from the TRG and other stakeholders to determine what action, if any, is necessary for each potential implementation issue.

BC3. Issues related to identifying performance obligations and licensing were discussed at TRG meetings on July 18, 2014, October 31, 2014, January 26, 2015, and November 9, 2015. From those discussions, the Boards learned about potential challenges with consistent application of those aspects of the new revenue standard. Following the TRG meetings, the FASB and the IASB directed their respective staffs to perform additional research and outreach on identifying performance obligations and licensing. The focus of the additional research and outreach was to understand whether there were specific improvements each Board could make that would assist stakeholders with consistent application of the new revenue standard.

BC4. The FASB issued a proposed Update, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, on May 12, 2015. The proposed Update was open for public comment for 45 days, and the Board received 47 comment letters. Overall, respondents to the proposed Update expressed support for the proposed amendments, citing that the amendments improve the operability of the guidance on identifying performance obligations and licensing. The IASB issued its Exposure Draft, *Clarifications to IFRS 15*, on July 30, 2015.

BC5. There are three principal areas of this Update that could create generally minor differences in financial reporting outcomes between GAAP and IFRS.

- a. IFRS guidance does not allow an entity to make a policy election to account for shipping and handling activities that occur after the customer has obtained control of a good as an activity to fulfill the promise to transfer the good rather than as an additional promised service.
- b. The IASB's amendments to the licensing application guidance in IFRS 15 are different from the amendments in this Update because although most licenses to symbolic intellectual property will be recognized over time under the IASB's Standard, revenue may be recognized at a point in time in those cases in which the entity will undertake no activities that significantly affect the ability of the customer to obtain benefit from the intellectual property during the license period. Such cases are expected to be relatively rare. In contrast, as a result of the amendments in this Update, revenue for all licenses to symbolic intellectual property is recognized over time (over the license period or the remaining economic life of the intellectual property, if shorter).
- c. The FASB's amendments to the licensing implementation guidance and illustrative examples clarify that a renewal or extension of a license is subject to the use and benefit guidance in paragraph 606-10-55-58C, which will result in revenue recognition at the beginning of the renewal period. In contrast, the IASB has decided not to amend its guidance in this area. As such, under IFRS, revenue for the same types of arrangements may be recognized either when the parties agree to the renewal or when the renewal period begins, depending on the facts and circumstances.

BC6. The FASB concluded that the benefits of a converged standard on revenue will be diminished if there is significant diversity in applying main aspects of the standard. That is, converged guidance cannot achieve consistency and comparability across jurisdictions if there will be significant diversity in application of that guidance within each jurisdiction. Therefore, the benefits of a converged standard will be enhanced by amending Topic 606 to promote greater consistency in application within and across jurisdictions by enhancing the operability and understandability of the guidance before it becomes effective as long as the financial reporting outcomes of applying Topic 606 and IFRS 15 are substantially consistent, even if the articulation of the guidance in GAAP and IFRS is not identical and the financial reporting outcomes will not be the same in all cases. The Board expects that the amendments in this Update will reduce the cost and complexity of implementation by enhancing the operability and understandability of the guidance and will result in substantially consistent financial reporting outcomes in the vast majority of cases.

Scope

BC7. The scope of the guidance is the same as Topic 606 (see paragraphs 606-10-15-1 through 15-5).

Identifying Performance Obligations

Promises in Contracts with Customers (Paragraphs 606-10-25-16 through 25-18B)

BC8. Paragraph BC87 in Update 2014-09 explains that, generally, an entity should identify those goods or services promised in the contract before it can evaluate whether those goods or services are distinct. Stakeholders questioned whether an entity should identify items or activities as promised goods or services that are not identified as deliverables under the existing revenue guidance. Some stakeholders indicated that they are unsure whether “promised goods or services” and “deliverables” are similar notions. Those stakeholders also suggested that the Board’s decision not to include the U.S. Securities and Exchange Commission’s (SEC) guidance on inconsequential or perfunctory obligations in Topic 606 indicates that the guidance might require an entity to identify significantly more promised goods or services than the entity identified as deliverables under existing guidance. The SEC guidance on inconsequential or perfunctory obligations is included in Staff Accounting Bulletin Topic 13A, “Selected Revenue Recognition—Issue 3C: Inconsequential or Perfunctory Performance Obligations.”

BC9. Many of the implementation questions about this area result from paragraph BC90 in Update 2014-09. That paragraph states that the Boards decided not to exempt an entity from accounting for promised goods or services that the entity might regard as being perfunctory or inconsequential. Instead, an entity should assess whether those promised goods or services are immaterial to its financial statements as described in FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, or IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC10. The Board observes that it did not intend to imply that each and every activity performed in satisfying a contract must be a promised good or service for purposes of applying Topic 606. In issuing Update 2014-09, the Board had previously decided to exclude an exemption for inconsequential or perfunctory promises because it considered that notion to be similar to immateriality. Therefore, including that notion in the performance obligations guidance could have been viewed as duplicating the materiality concepts in other GAAP.

BC11. As described in paragraph BC84 in Update 2014-09, the Board intended the notion of a promised good or service to be similar to the notion of deliverables, components, or elements of a contract in previous revenue guidance. The Board

did not intend that an entity would identify significantly more promised goods and services that result in performance obligations than under existing revenue guidance except that certain material rights that are not identified as deliverables under existing revenue guidance will be identified as performance obligations under the new revenue standard.

BC12. The Board decided to amend Topic 606 to state that immaterial items are not required to be assessed as promised goods or services for purposes of identifying performance obligations (that is, for purposes of applying Step 2 of the revenue model in Topic 606). The Board decided that an entity is required to consider whether a promised good or service is material only at the contract level because it would be unduly burdensome to require an entity to aggregate and determine the effect on its financial statements of those items or activities determined to be immaterial at the contract level. This notion of determining material promised goods or services at the contract level also is used in Topic 606 for significant financing components and customer options for additional goods or services. As it is used in paragraph 606-10-25-16A, the term *immaterial* refers to the general notion of materiality. That is, an entity should consider the relative significance or importance of a particular promised good or service in the contract to the arrangement with the customer as a whole. In applying this notion, an entity should consider both the quantitative and the qualitative nature of the promised goods or services in the contract.

BC13. Assessing only those goods or services promised to a customer that are material is consistent with the objective of identifying the nature of an entity's performance obligation(s) to the customer. Assessing immaterial goods or services might obscure, rather than clarify, the nature of an entity's performance obligation(s) in the contract. An entity is not required to allocate revenue to promised goods or services that are immaterial in the context of the contract.

BC14. Assessing whether promised goods or services are immaterial at the contract level will require the use of judgment. Many entities routinely make similar judgments about (a) materiality in applying other GAAP and (b) whether an obligation to a customer is inconsequential or perfunctory (under previous GAAP). Assessing the materiality of promised goods or services in a contract with a customer includes consideration of quantitative and qualitative factors. The Board expects that the assessment of whether a good or service is immaterial in the context of the contract should be straightforward in many cases because it would be clear that the item is immaterial when considering the nature of the entity's arrangement with the customer. If multiple goods or services in a contract are individually immaterial in the context of the contract, but those individually immaterial items are material in the aggregate to the contract, then an entity should not disregard those (or all of those) goods or services when identifying performance obligations.

BC15. The Board decided that the guidance in paragraph 606-10-25-16A does not apply to customer options for additional goods and services when those

options provide a customer with a material right. The Board determined that when assessing whether optional goods and services provide the customer with a material right, an entity would apply the guidance in paragraphs 606-10-55-42 through 55-43. The entity would apply the guidance in those paragraphs to determine whether an option gives rise to a material right that a customer will not receive without entering into that contract.

BC16. The Board decided to include guidance in Topic 606 that requires an entity to accrue the costs, if any, to transfer immaterial goods or services to the customer in instances in which the costs will be incurred after the satisfaction of the performance obligation (and recognition of revenue) to which those immaterial goods or services relate. The Board concluded that this will more appropriately align the recognition of revenue and costs in the financial statements. While the proposed Update, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, did not include this requirement, it included a similar notion in the basis for conclusions. On the basis of stakeholder feedback, the Board decided to include the requirement in the Codification. Under previous GAAP, SEC guidance in SAB Topic 13 requires that the cost to fulfill remaining performance obligations considered inconsequential or perfunctory should be recognized (that is, accrued) when revenue from the arrangement is recognized. That guidance states that if revenue is recognized upon substantial completion of the terms specified in the arrangement related to the unit of accounting at issue, all related costs of performance or delivery should be accrued. The wording of the SEC requirement was used as the basis for drafting the cost accrual requirements in paragraphs 606-10-25-16A and 606-10-25-18A. As such, the Board would expect this cost accrual guidance in Topic 606 to be applied similarly to how the cost accrual guidance in SAB Topic 13 was applied. The Board also observed that the cost accrual requirement only applies to items that are determined to be promises *to the customer* in the contract. Some items that a few stakeholders have discussed in the context of this requirement may not constitute promises to the customer and, therefore, would not be subject to the guidance in paragraph 606-10-25-16A. For example, an entity typically would not be required to accrue costs for answering general questions about a product. The operation of a call desk for general inquiries that is available broadly is an example of an activity that is not fulfilling a promise to a customer.

BC17. The Board considered an alternative approach to the notion of immaterial in the context of the contract that would have included the SEC guidance on inconsequential or perfunctory obligations in SAB Topic 13. This approach was not pursued because of its potential disadvantages. The SEC guidance, which is an interpretation of previous GAAP, includes factors to be met in determining that an obligation is inconsequential or perfunctory. In practice, this could be a more costly approach than the approach adopted in this Update, and the Board expects it will not significantly change the quality of the information reported to financial statement users.

BC18. The guidance in paragraph 606-10-25-16 states that an implied promise in a contract with a customer may exist if a promise creates a *valid* expectation of the customer that an entity will transfer a good or service to the customer. The Board changed this term from *valid* to *reasonable* because stakeholders questioned what the Board intended for an expectation to be *valid* because paragraph BC87 in Update 2014-09 states that implied promises do not need to be enforceable by law.

Shipping and Handling Activities (paragraphs 606-10-25-18A through 25-18B)

BC19. Stakeholders have diverse views about whether and when Topic 606 requires shipping and handling activities (collectively referred to as shipping) that occur after the transfer of control of the good to the customer to be accounted for as a promised service or as a fulfillment activity. Under existing revenue guidance, many entities do not account for shipping provided in conjunction with the sale of their goods as an additional deliverable.

BC20. Requiring shipping to be accounted for as a promised service would be a significant change in practice for many entities because shipping generally is not a deliverable under existing guidance for arrangements involving the sale of goods. At present, there are many manufacturers, retailers, and others that do not consider their arrangements to include multiple deliverables (that is, a good and a shipping service). Consequently, they do not have the systems, processes, and internal controls to account for those arrangements as multiple-element arrangements. Requiring shipping to be identified as a performance obligation separate from the transfer of the good might diminish the usefulness of the information provided to financial statement users because users may combine the two pieces of revenue for their analyses. The Board decided to provide an accounting policy election, to be applied consistently to similar types of transactions, to account for shipping as a fulfillment activity because a change in practice for entities that do not account for shipping as a deliverable under existing revenue guidance would be costly to implement and apply going forward while providing financial statement users with little or no benefit.

BC21. In instances in which an entity is providing shipping along with a good, the shipping may or may not be a promised service depending on the facts and circumstances of the contract. The Board decided to provide an election that will allow an entity to account for shipping as an activity to fulfill the promise to transfer goods. The Board expects that this election will improve the operability of Topic 606 because an entity is not required to assess whether the shipping is a promised service. Furthermore, the Board expects that this election will not diminish the information provided to users of financial statements. This election is not intended to suggest that shipping that occurs after the transfer of control of a good is always a promised service. The Board decided that this should be an election, rather than a requirement, because it determined that an entity should not be precluded from accounting for shipping as a promised service if doing so would be more consistent

with the nature of the arrangement with a customer. The accounting policy election should be applied consistently to similar types of transactions. The Board recognized that some entities sell multiple classes of goods and the arrangements might vary significantly among those different classes of goods and therefore the policy election is not required to be made at an entity level.

BC22. The Board clarified that in instances in which shipping activities are performed before the transfer of control of a good to a customer (see paragraphs 606-10-25-23 through 25-30 for guidance on satisfying performance obligations), shipping is not a promised service to the customer in the contract. Rather, shipping is a fulfillment activity, and the costs are incurred to facilitate the sale of the good to the customer. The shipping relates to an entity's asset and not the customer's asset because control of the good has not been transferred. The entity's effort to deliver a good to the customer is no different from its effort to procure raw materials, manufacture the good, or ship the finished product from the entity's manufacturing facility to its warehouse. Therefore, the question as to whether shipping is an additional service in the contract is only relevant in instances in which shipping is performed after the customer has obtained control of the good.

BC23. The Board considered whether the accounting policy election should be limited to shipping or whether it should be applied more broadly to other activities that may occur after an entity transfers control of the good or goods. The Board decided to limit the scope of this guidance to shipping. Accordingly, it is inappropriate for an entity to apply the election by analogy to activities other than shipping, such as custodial or storage services. However, an entity should consider whether or not those other activities transfer a promised good or service to a customer in accordance with paragraph 606-10-25-17. If those activities transfer a promised good or service, an entity may consider whether those activities are immaterial in the context of the contract in accordance with paragraph 606-10-25-16A.

BC24. The Board explored an alternative approach that would have provided specific implementation guidance on shipping to distinguish when shipping is a fulfillment activity and when it is a promised service. This approach would have been similar in concept to the implementation guidance that the Board provided for warranties in paragraphs 606-10-55-30 through 55-35 (that is, providing guidance on when a warranty is a performance obligation). To pursue this approach, the Board would have needed to decide whether the implementation guidance would require that shipping is never a promised service or whether there are certain instances in which it is a promised service. The Board would have had to develop guidance to distinguish when shipping is a fulfillment activity versus when it is an additional promised service. The Board observed that the objective of addressing this issue is to reduce the cost and complexity of implementing and applying Topic 606 and that approach would not have reduced cost and complexity as much as the approach in this Update.

BC25. If revenue is recognized before shipping and handling activities occur, the Board decided to include a requirement in Topic 606 that the related costs of those shipping and handling activities should be accrued. The Board's rationale for including this requirement in Topic 606 is consistent with its rationale for the decision to require the recognition of cost accruals if revenue is recognized before the transfer of goods or services that are immaterial in the context of the contract (see paragraph BC16).

Distinct Goods or Services (Paragraphs 606-10-25-19 through 25-22)

BC26. Topic 606 requires distinct goods or services to be identified as performance obligations. There are two criteria that must be met for a good or service to be distinct. The first criterion is that a customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct). The second criterion is that an entity's promise to transfer a good or service to a customer is separately identifiable from other promises in the contract (that is, the promise to transfer the good or service is distinct within the context of the contract).

BC27. The criterion in paragraph 606-10-25-19(b) as well as the principle and the factors in paragraph 606-10-25-21 were developed with the understanding that application will require the exercise of judgment. This was in direct response to stakeholders' feedback received during the development of Topic 606. Stakeholders expressed concerns that the proposed separation guidance in the 2010 and 2011 proposed Updates did not appropriately address the wide variety of revenue arrangements that existed in practice across all industries. Stakeholders asserted that the separation guidance might have resulted in the identification of performance obligations that do not appropriately reflect the arrangement with a customer.

BC28. Stakeholders requested, and the Board decided to establish, guidance that permits judgment in this area. The Board observed that identifying separate deliverables or separate elements under existing revenue guidance also is challenging and judgmental, especially in particular industries. Although judgment is required, the Board has observed different interpretations of the criterion in paragraph 606-10-25-19(b) and the guidance in paragraph 606-10-25-21. For those reasons, the Board decided to clarify that guidance by better articulating the separately identifiable principle. Although the language describing the principle has been expanded, the amendments merely better describe the Board's intentions and are not a change to the underlying principle. Even with the improvements in this Update, the Board recognizes that judgment will be needed to determine whether promised goods or services are distinct.

BC29. The Board intends to convey that an entity should evaluate whether the contract is to deliver (a) multiple goods or services or (b) a combined item or items that is comprised of the individual goods or services promised in the contract. That

is, entities should evaluate whether the multiple promised goods or services in the contract are outputs or, instead, are inputs to a combined item (or items). The inputs to a combined item (or items) concept might be further explained, in many cases, as those in which an entity's promise to transfer the promised goods or services results in a combined item (or items) that is greater than (or substantively different from) the sum of those promised (component) goods and services.

BC30. As an alternative approach, the Board considered whether the principle should be based on the concept of separable risks. Under this alternative, individual goods or services in a bundle would not have been distinct if the risk that an entity assumes to fulfill its obligation to transfer one of those promised goods or services to the customer was inseparable from the risk relating to the transfer of the other promised goods or services in that bundle. The explanation in paragraph BC103 of Update 2014-09 highlights that when evaluating whether an entity's promise to transfer a good or service is separately identifiable from other promises in the contract, one should consider the relationship between the various goods or services within the contract in the context of the process of fulfilling the contract. The Board decided to exclude this terminology in Topic 606 because the Board understood from previous outreach efforts throughout the course of the development of Topic 606 that the concept was not well understood by stakeholders. However, the Board acknowledges that the notion of separable risks continues to influence the separately identifiable concept.

BC31. To assist an entity in applying the separately identifiable principle, paragraph 606-10-25-21 includes three factors that indicate that an entity's promises to transfer goods or services to a customer are not separately identifiable. Those factors are not an exhaustive list, and not all of the factors need to be met (or not met) to conclude that the entity's promises to transfer goods or services are not (are) separately identifiable. Similarly, the factors are not intended to be criteria that are evaluated independently of the separately identifiable principle. One of the reasons the Board decided to expand the articulation of the separately identifiable principle was feedback from stakeholders that the factors in paragraph 606-10-25-21 were being interpreted as criteria, rather than factors to consider in evaluating the principle. Given the wide variety of revenue arrangements that are within the scope of Topic 606, the Board concluded that there will be some instances in which the factors will be less relevant to the evaluation of the significantly identifiable principle. Therefore, stakeholders should consider the principle, not only the provided factors.

BC32. The Board decided to reframe the factors in paragraph 606-10-25-21 to more clearly align those factors with the re-articulated separately identifiable principle. This change primarily involves evaluating the separately identifiable principle in the context of the bundle of promised goods or services in the contract rather than in the context of each individual promised good or service. The effect of the previous singular structuring of the factors in Topic 606 (as issued in Update 2014-09) diluted the notion that the separately identifiable assessment is that for a *bundle* of goods and services to be a combined output, those goods or services

should significantly affect each other. The Board observed that the way the factors previously were written in Topic 606 was capturing scenarios in which only one good or service is significantly affecting the other. The separately identifiable principle is intended to consider the level of integration, interrelation, or interdependence among promises to transfer goods or services. That is, the separately identifiable principle is intended to evaluate when an entity's performance in transferring a bundle of goods or services in a contract is, in substance, fulfilling a single promise to a customer. Therefore, the entity should evaluate whether two or more promised goods or services (for example, a delivered item and an undelivered item) each significantly affect the other (and, therefore, are highly interdependent or highly interrelated) in the contract. The entity should not merely evaluate whether one item, by its nature, depends on the other (for example, an undelivered item that would never be obtained by a customer absent the presence of the delivered item in the contract or the customer having obtained that item in a different contract). Furthermore, the Board concluded that it may be clearer to structure those factors to identify when the promises in a bundle of promised goods or services are not separately identifiable and, therefore, constitute a single performance obligation.

BC33. In addition to reframing the factors in the context of a bundle of goods or services, the Board also:

- a. Revised the factor relating to a significant integration service in paragraph 606-10-25-21(a) to clarify that (1) the factor is not only applicable to circumstances that result in a single output and (2) a combined output may include more than one phase, element, or unit.
- b. Observed that the evaluation of whether two or more promises in a contract are separately identifiable also considers the utility of the promised goods or services (that is, the ability of each good or service to provide benefit or value). This is because an entity may be able to fulfill its promise to transfer each good or service in a contract independently of the other, but each good or service may significantly affect the other's utility to the customer. For example, in Example 10, Case C, or in Example 55, the entity's ability to transfer the initial license is not affected by its promise to transfer the updates or vice versa, but the provision (or not) of the updates will significantly affect the utility of the licensed intellectual property to the customer such that the license and the updates are not separately identifiable. They are, in effect, inputs to the combined solution for which the customer contracted. The "capable of being distinct" criterion also considers the utility of the promised good or service, but merely establishes the baseline level of economic substance a good or service must have to be "capable of being distinct." Therefore, utility also is relevant in evaluating whether two or more promises in a contract are separately identifiable because even if two or more goods or services are capable of being distinct because the customer can derive some economic benefit from each one, the customer's ability to derive its

intended benefit from the contract may depend on the entity transferring each of those goods or services.

BC34. The Board decided to incorporate additional examples about identifying performance obligations into Topic 606. The additional examples and revisions to the existing examples in Topic 606 in this Update demonstrate the application of the separation guidance and the series guidance (in paragraphs 606-10-25-14(b) through 25-15). The examples are not intended to establish explicit boundaries whereby an entity in an arrangement that does not have identical facts and circumstances would be precluded from reaching conclusions similar to those illustrated in the examples. The additional examples are based on fact patterns that some stakeholders thought were challenging to assess under Topic 606, as previously issued in Update 2014-09. No single fact or circumstance in the additional (or revised) examples should be viewed as determinative to the evaluation. Rather, the facts and circumstances presented, as well as the evaluation of the factors in paragraph 606-10-25-21, each contribute to the conclusion reached in accordance with the principles in paragraphs 606-10-25-19 through 25-22.

Licensing

BC35. The licensing implementation guidance that was issued in Update 2014-09 included criteria for determining when an entity's promise in granting a license is to provide a right to access the entity's intellectual property because the intellectual property to which a customer has rights is expected to change on the basis of the entity's activities that do not transfer a good or service to the customer. If those criteria were not met, the nature of the entity's promise in granting a license is to provide a right to use the entity's intellectual property as it exists at the point in time at which the license is granted. The guidance also included the effect of contractual restrictions on determining the nature of the entity's promise in granting a license.

BC36. Paragraph 606-10-55-65 of the issued guidance in Update 2014-09 provides an exception to the general guidance on recognition of variable consideration for sales-based and usage-based royalties promised in exchange for a license of intellectual property.

BC37. In order to apply the licensing implementation guidance in paragraphs 606-10-55-54 through 55-65B, an arrangement must include a license to intellectual property. The scope of the implementation guidance is included in paragraph 606-10-55-54. In accordance with the guidance in paragraph 985-20-15-5(a), a software hosting arrangement only includes a license to intellectual property when the customer both (a) has the contractual right to take possession of the software at any time during the hosting period without significant penalty and (b) can feasibly either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

BC38. A single performance obligation might include a license as well as other goods and services. Paragraph 606-10-55-56 describes some examples for which this might be the case. However, the licensing implementation guidance does not apply only to distinct licenses, as described in paragraph 606-10-55-57, and the guidance should be considered when assessing the satisfaction of a performance obligation that includes a license to intellectual property.

BC39. After the issuance of Update 2014-09, stakeholders raised concerns about the licensing implementation guidance. The principal concerns raised related to:

- a. Determining the nature of the entity's promise in granting a license of intellectual property
- b. The scope and applicability of the sales-based and usage-based royalties exception
- c. Distinguishing contractual provisions that require an entity to transfer additional licenses or other goods or services to a customer from contractual provisions that define the attributes of a single promised license (for example, restrictions of time, geographical region, or use)
- d. When the guidance on determining the nature of the entity's promise in granting a license applies.

BC40. Each of the sections below explains stakeholders' concerns and how the revisions to the licensing implementation guidance (including the licensing examples in the implementation guidance) in this Update address those concerns by improving the operability and understandability of the guidance in Topic 606.

Identifying Performance Obligations

BC41. The Board previously observed that all contracts require an assessment of the promised goods and services in the contract and the criteria for identifying performance obligations (see paragraphs 606-10-25-14 through 25-22). This includes an assessment of whether a customer can benefit from the license on its own or together with other resources that are readily available to the customer (see paragraph 606-10-25-19(a)) and whether the entity's promise to transfer the license is separately identifiable from other goods or services in the contract (see paragraph 606-10-25-19(b)). The Boards observed that this assessment might sometimes be challenging.

BC42. Identifying separate deliverables (or elements) in licensing arrangements often is challenging under previous GAAP (for example, in many software or biotechnology arrangements), and it was never the Board's intention to eliminate judgment in this area. While stakeholders in industries that engage in significant licensing activities have questioned this, the Board concluded that no additional guidance on identifying performance obligations specifically tailored to entities that license intellectual property is necessary. The Board expects that the improvements in this Update will assist all entities in applying the general identifying performance obligations guidance in paragraphs 606-10-25-14 through 25-22, including entities that license intellectual property.

BC43. After the issuance of Update 2014-09, stakeholders raised questions about the effect of contractual restrictions on accounting for licenses of intellectual property in accordance with Topic 606. Stakeholders had different views about whether contractual restrictions could affect the entity's identification of the promised goods or services in the contract (that is, whether the presence of certain restrictions could affect the number of promises to the customer). Similarly, some stakeholders observed that it may be difficult, in some cases, to determine whether a provision in a contract (including one written in the form of a restriction) describes an attribute of a single license or, instead, describes an additional good or service promised to the customer.

BC44. The Board decided to make amendments to paragraph 606-10-55-64 and to revise, and add, certain examples. Those amendments are intended to confirm that an entity is required to distinguish attributes of a license (such as provisions that establish a defined license period or establish where or how licensed intellectual property may be used [for example, restrictions of time, geographical region, or use]) from other provisions in the contract that, while they may appear similar, indicate that the entity has additional promises to the customer to fulfill (in accordance with paragraphs 606-10-25-14 through 25-18). Consider and contrast Examples 59 and 61B in this Update. The license to the symphony recording in Example 59 includes multiple restrictions of time, geographical region, and use (for example, the license is limited to two years in duration, for use only within Country A, and may be used only in commercials). Those restrictions are attributes of a single promised license because once the customer controls the rights conveyed by that license, there is no additional promise for the entity to fulfill (for example, to transfer control of additional rights to use the intellectual property or transfer control of rights to use other intellectual property). In contrast, in Example 61B, the provision in the contract that precludes the customer from embedding the licensed intellectual property in the Class 2 consumer products until January 1, 20X2, is not solely an attribute of a single license. Rather, that provision demonstrates that the entity has a remaining promise to fulfill after conveying the initial right to embed the licensed intellectual property in the Class 1 consumer products. Because a customer does not control a license until it can begin to use and benefit from the rights conveyed, on January 1, 20X1 (after the customer can begin to use and benefit from its right to embed the licensed intellectual property in the Class 1 consumer products), the entity must still fulfill a second promise to transfer control to the customer of the right to embed the licensed intellectual property in the Class 2 consumer products (that is, a second license).

BC45. The Board evaluated a number of scenarios besides those in Examples 59 and 61B as part of its consideration of the questions raised about contractual restrictions. For example, the proposed Update had included an example illustrating when contractual provisions are (and are not) restrictions in the media and entertainment industry. Because of the industry-specific and fact-specific nature of that example, the Board decided not to include the example in the final guidance. Although the Board decided not to include that example in the final

guidance, the Board's view is that a substantive break between the periods for which the customer has the right to use the intellectual property might suggest that the customer's rights have been "revoked" for that period of time and that the entity has made an additional promise to transfer rights to use that same intellectual property again at the later date.

BC46. The Board observed that judgment often is required in distinguishing a single promised license with multiple attributes from a license that contains multiple promises to the customer in the contract that should be evaluated to determine if they represent separate performance obligations. The Board further observed that the guidance in Topic 606 about contractual restrictions in a license does not replace an entity's requirement to identify the goods and services promised to the customer in the contract in accordance with paragraphs 606-10-25-16 through 25-18B, which may include multiple performance obligations, each with different attributes (including their own restrictions). The Board also observed that distinguishing between attributes of a single promised good or service and multiple goods or services promised to the customer is not a unique requirement solely applicable to licensing arrangements. In some contracts, the judgment necessary to do so is minimal. For example, the Board observed that a manufacturer of widgets frequently will not have difficulty identifying whether it has promised the customer one widget with particular specifications or, instead, promised to sell the customer multiple widgets. In contrast, making those judgments may be more complex in some licensing arrangements. However, those judgments are made in applying previous GAAP. Topic 606 generally provides a more robust framework with which to make those judgments than under previous GAAP.

BC47. In many contracts, distinct sets of rights are coterminous. That is, the rights are transferred to the customer at the same point in time (in the case of licenses that provide a right to use intellectual property) or over the same period of time (in the case of licenses that provide a right to access intellectual property). Consistent with the discussion in paragraph BC116 of Update 2014-09, an entity would not be required to separately identify each set of distinct rights if those rights are transferred concurrently. For example, a licensor would not be precluded from accounting for the two sets of distinct rights in Example 61B as a single performance obligation if the facts of that example were modified such that the customer was able to begin to use and benefit from both sets of rights on January 1, 20X1 (rather than Class 1 on January 1, 20X1, and Class 2 on January 1, 20X2).

Renewals of Licenses to Intellectual Property

BC48. Stakeholders asserted that it is unclear when an entity should recognize revenue from a renewal (or extension of the license period) of a license that provides the customer with a right to use the entity's intellectual property. That is, they question whether to recognize revenue at the point in time the parties agree to the renewal or, rather, at the beginning of the renewal period. Those stakeholders question whether paragraph 606-10-55-63 (as it was issued in Update 2014-09), stating that "revenue cannot be recognized for a license that

provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the license," applies to the renewal of an existing license.

BC49. The Board amended the guidance in paragraph 606-10-55-63 (which was moved to paragraph 606-10-55-58C in this Update) and provided an additional example (Example 59, Case B) to clarify the timing of revenue recognition for renewals (or extension of the license period) for right to use licenses and when revenue recognition for right to access licenses should commence.

BC50. The Board considered the feedback from some stakeholders that revenue from the renewal of a right to use license should be recognized when the renewal is agreed to by the parties. Those stakeholders suggested that a renewal of such a license is different from granting a new license because the customer has already been provided a copy of the intellectual property (as part of the initial license) and already controls the rights that will be renewed. Therefore, those stakeholders assert that the renewal changes the time attribute of the license that the customer already controls. Although the Board considered this feedback, it ultimately concluded that the clarifications in this Update, which result in an entity recognizing the revenue from the renewal of a right to use license at the beginning of the renewal period, were more consistent with the overall licensing model for the following reasons:

- a. The Board agreed that the term of a license is an attribute of that license and, therefore, an entity recognizes revenue from a right-to-use license at a single point in time, when the customer obtains control of the license, regardless of the license period. The Board also agreed that time periods within a *single* license are not distinct from each other (although situations could exist in which a substantive break between time periods and the customer's right to use the intellectual property is revoked might create multiple licenses as discussed further in paragraph BC45 of this Update). However, the Board observed that Topic 606 applies to *contracts* with customers. Therefore, when two parties enter into a contract to renew (or extend the license period of) a license, the renewal contract is not combined with the original license contract unless the criteria in paragraph 606-10-25-9 have been met. The additional right granted by that renewal (that is, the right to use the entity's intellectual property for three additional years) should be evaluated in the same manner as any other additional rights that might be granted after the initial contract (for example, expanded geographical or use rights). Consequently, a renewal license is subject to the same revenue recognition requirements as any other license that grants additional rights to the customer. That is, the entity should not recognize revenue from the transfer of that license until the customer can begin to use and benefit from the license, which generally would be the beginning of the license renewal period.
- b. The guidance on accounting for license renewals in this Update should be more operable for entities to apply than the alternative suggested by

some stakeholders. This is because, in many cases, it alleviates the need to evaluate whether each renewal is for the same, or different, intellectual property as the initial license. Under the alternative approach, the timing of revenue recognition for initial licenses of intellectual property would have differed compared with the timing of revenue recognition for renewals. Stakeholders observed that distinguishing whether the renewal is for the same intellectual property as the initial license would have been operationally challenging.

Determining the Nature of the Entity's Promise in Granting a License

BC51. Implicit to the licenses implementation guidance in Topic 606 is that intellectual property is inherently different from other goods or services because of its uniquely divisible nature. The licenses guidance in Topic 606 recognizes that intellectual property can be licensed to multiple customers at the same time (for example, franchise rights or rights to use an entity's brand name or logo can be licensed to multiple customers concurrently) and can continue to be used by the entity during the license period for its own benefit (for example, a sports team continues to use its team name and logo throughout the license period so that it can continue to play games and sell tickets or television rights to those games). Therefore, in entering into a license contract, a customer may reasonably expect an entity to undertake activities from which the customer would expect to derive substantial benefit and that significantly affect its license (but that do not transfer a promised good or service specifically to that customer because the activities also benefit the entity and/or its other licensees).

BC52. The licenses implementation guidance is premised on the view that an entity's promise (explicit or implicit) to support or maintain the intellectual property to which the customer has rights is an inseparable component of its larger promise to the customer in granting a license when the entity's promise to do so *significantly* affects the utility of the intellectual property (that is, its ability to provide benefit or value) to the customer. The notion that the entity's promise includes supporting or maintaining the intellectual property if the entity's fulfillment of that promise significantly affects the utility of the intellectual property to the customer is broadly consistent with the overall separation guidance in Step 2 of the revenue model (identifying performance obligations). The guidance on identifying performance obligations similarly indicates that two or more promised goods or services may not be separable if the utility of those goods or services is significantly affected by the other (see paragraph BC33).

BC53. The licensing implementation guidance that was issued in Update 2014-09 was intended to characterize the significance of those activities a customer would reasonably expect an entity to undertake in the context of whether those activities "change" the intellectual property to which the customer has rights. After the issuance of Update 2014-09, stakeholders communicated that the previous

licensing implementation guidance in Topic 606 was unclear about whether changes in the intellectual property referred solely to changes in the form or functionality of the intellectual property or also to changes in the value of intellectual property. This resulted in different interpretations of when that guidance would have resulted in a right to access (satisfied over time) versus a right to use (satisfied at a point in time) intellectual property. Because those interpretations were different, entities entering into substantially equivalent license arrangements were reaching significantly different accounting conclusions about how they should recognize revenue for licensing arrangements. The amendments to the licensing implementation guidance in this Update, which refer to the effect of an entity's activities or other actions on a customer's license in the context of "utility," and to define that term in the manner in the previous paragraph and in paragraph 606-10-55-59(a), are expected to resolve the confusion about what attributes of the intellectual property (that is form, functionality, and/or value) affect the nature of the entity's promise in granting a license.

BC54. The revised implementation guidance in this Update does not revisit the accounting approach to licenses of intellectual property included in Update 2014-09 (as described in paragraphs BC51 and BC52 above). Additionally, it does not change the fact that many licenses would be recognized over time on the basis of the proposed licensing implementation guidance while many other licenses would be recognized at a point in time (if separate performance obligations). However, the amendments in this Update attempt to articulate more clearly the licensing implementation guidance to enhance operability and ensure a more consistent application to similar facts and circumstances by more clearly delineating when an entity's promise to a customer in granting a license includes both of the following:

- a. Granting the customer rights to use and benefit from the entity's intellectual property
- b. Supporting or maintaining the intellectual property to which the customer has rights.

BC55. The concept in this Update of supporting or maintaining the intellectual property to which a customer has rights generally includes undertaking activities (that do not transfer a good or service to the customer) for which the performance or nonperformance significantly affects the utility of the intellectual property (for example, a sports team continuing to play games as in Example 61 or a comic strip producer continuing to produce a weekly comic strip as in Example 58), as well as not undertaking activities or otherwise taking actions that would significantly degrade the utility of the intellectual property.

BC56. The Board decided that whether an entity's promise to a customer includes supporting or maintaining the intellectual property to which the customer has rights largely depends on whether the intellectual property has significant standalone functionality (for example, the ability to process a transaction, perform a function or task, or be played or aired). An entity's ongoing activities that do not substantively change that functionality may affect the utility of functional intellectual

property but would not *significantly* affect its utility. Therefore, continuing to support or maintain the intellectual property is not part of the promise to the customer in transferring a license to functional intellectual property. Functional intellectual property generally includes intellectual property such as software, biological compounds or drug formulas, and completed media content (for example, films, television shows, or music). Patents underlying highly functional items (for example, a patent to a specialized manufacturing process that the customer can employ as a result of the patent regardless of the entity's ongoing activities) also would be functional intellectual property.

BC57. Symbolic intellectual property is any intellectual property that is not functional intellectual property. In other words, symbolic intellectual property is intellectual property that does not have significant standalone functionality. Substantially all of the utility of symbolic intellectual property is derived from the association of the intellectual property with the entity's past or ongoing activities that do not transfer a promised good or service to a customer, including its ordinary business activities. Symbolic intellectual property generally includes intellectual property such as brands, team or trade names, logos, and franchise rights. The absence of significant standalone functionality means that the utility of symbolic intellectual property to a customer largely depends on the entity supporting or maintaining that intellectual property (for example, a license to a sports team's name and logo typically will have limited residual value if the team stops playing games). Therefore, the entity's promise to a customer is both to (a) grant the customer rights to use and benefit from the entity's intellectual property, which includes making a copy of the underlying intellectual property available for the customer's use and (b) support or maintain the intellectual property. Consequently, a license to symbolic intellectual property is satisfied over time as the promise to the customer is fulfilled. In determining the period over which a performance obligation to grant a license to symbolic intellectual property is satisfied, the entity's obligation to support or maintain the intellectual property exists for the duration of the license period unless the license period is longer than the remaining economic life of the intellectual property. It is reasonable to assume an entity will not support or maintain intellectual property past the end of its economic life.

BC58. Licenses to functional intellectual property, if separate performance obligations, generally will be satisfied at a point in time. However, the Board included paragraph 606-10-55-62 in this Update because it would have been inconsistent with the broader rationale for the Board's revisions to the licensing guidance to conclude that an entity's expected activities that will (a) substantively change the functionality of functional intellectual property (that is, in a more than minor way) without transferring a good or service to the customer and (b) directly affect the customer because the customer is subject to those changes in functionality (for example, because of contractual or practical restrictions on using an unmodified version of the intellectual property) do not significantly affect the utility of the intellectual property to the customer. In those cases, the entity is, in effect, only granting the customer the right to access its intellectual property in its

present form. The customer does not obtain control of the license when it is first granted rights to the intellectual property. This is because when the rights are first granted, the customer obtains rights to intellectual property for which it will not have rights for the full license period and the entity continues to perform throughout the license period by making the changed intellectual property (for example, changed code, content, or design) available to the customer. The Board expects that, at the time of issuance of this Update, the criteria in paragraph 606-10-55-62 will be met only infrequently, if at all. This is because when an entity provides updates to functional intellectual property, the provision of those updates typically is a promised service to the customer and, therefore, the entity's activities involved in providing those updates would not meet the criterion in paragraph 606-10-55-62(a). For example an entity's activities to develop and provide software updates (such as in Example 10, Case C; Example 11; and Example 55) or provide software customization services (Example 11, Case B) would not meet the criterion in paragraph 606-10-55-62(a) because the updates and the customization services are additional promised services to the customer (that is, in addition to the license).

BC59. The discussion in paragraph BC58 should not be interpreted to indicate that revenue from licenses to functional intellectual property will be recognized over time only infrequently. The discussion merely explains that the provision of updates to licensed intellectual property (for example, software) that change the functionality of that intellectual property is a promised service to the customer and, therefore, the entity's activities involved in providing those updates would not meet the criterion in paragraph 606-10-55-62(a). In some cases, such as those in Example 10, Case C, and Example 55 in Topic 606, that promised service is not distinct from the license to the functional intellectual property and, therefore, the license revenue will be recognized over time.

BC60. The Board considered an alternative approach to clarifying the guidance on determining the nature of the entity's promise in granting a license. Consistent with the amendments in this Update, this approach would have clarified that:

- a. Expected effects on form, functionality, and value all affect the nature of the entity's promise in granting a license (and introduced the term *utility* to capture this).
- b. When intellectual property has significant standalone functionality, an entity's activities that do not change that functionality do not significantly affect its utility.
- c. The utility of intellectual property that does not have significant standalone functionality typically is derived from, and dependent on, the entity's ongoing activities, including its ordinary business activities.

BC61. This alternative approach would not have categorized the underlying intellectual property as either functional or symbolic or have derived the expectation of whether an entity's promise includes continuing to support or maintain the intellectual property from that categorization. Instead, the entity would

evaluate, for each license granted, whether the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the utility of the licensed intellectual property. This approach generally is consistent with the amendments in the IASB's Standard, *Clarifications to IFRS 15*.

BC62. Those stakeholders who supported the alternative approach during outreach suggested that the amendments in this Update will result in some licenses of symbolic intellectual property being recognized over time even though there is no expectation that the entity will have to continue to perform after transferring the license to the customer.

BC63. While the Board acknowledged those stakeholders' concerns, the Board decided in favor of the amendments in this Update, rather than the alternative approach, for the following reasons:

- a. Outreach suggested that the number of licensing arrangements for which the outcome would be likely to differ between the two approaches is small. This is because most licensors continue to be involved with their symbolic intellectual property throughout its economic life.
- b. Outreach also suggested that the approach in this Update would be more operable, particularly for entities with a significant number of licensing arrangements and entities with diversified operations. This is because the presumption of continuing support or maintenance by the entity created by the functional versus symbolic categorization will eliminate the requirement that would exist under the alternative approach for those entities to evaluate whether a customer reasonably would expect the entity to undertake activities that could affect the utility of the licensed intellectual property and whether those activities would *significantly* affect that intellectual property for each license (and maintain related processes and controls). Because research and outreach have suggested that the number of licensing arrangements for which the outcome would be likely to differ between the two approaches is small, the Board decided that the amendments in this Update are a more practical way to draw the line between those licenses that include an implied promise to continue to support or maintain the intellectual property to which the customer has rights and those that do not.

BC64. In its redeliberations of the proposed Update, the Board considered whether to establish an override to the guidance that all licenses of symbolic intellectual property are satisfied over time. Under that alternative approach, an entity would have presumed that its promise in granting a license to symbolic intellectual property is to provide access to the intellectual property throughout the license period. However, that presumption could be overcome if it was reasonably certain that the entity will undertake no activities to support or maintain the intellectual property during the license period.

BC65. The Board decided not to add this override for licenses to symbolic intellectual property to the guidance principally because of concerns about adding

complexity to licensing proposals that most respondents to the proposed Update expressed would accomplish the Board's goal of significantly improving the operability and understandability of the licensing implementation guidance in Topic 606. The Board concluded that the clarity and the simplicity of the requirement that all licenses to symbolic intellectual property be recognized over time were more important than the identified conceptual rationale for including the override. The Board concluded that this alternative would have introduced at least some additional judgment and complexity to the licensing model and that it was preferable not to introduce that additional judgment or complexity. In addition, some Board members expressed the view that, so long as the entity owns the symbolic intellectual property, the entity is supporting or maintaining the intellectual property by not undertaking actions that could significantly degrade the utility of the intellectual property and retains the right to decide to undertake activities in the future that could significantly affect the utility of the intellectual property.

When to Consider the Nature of an Entity's Promise in Granting a License

BC66. After the issuance of Update 2014-09, some stakeholders questioned when the guidance on determining the nature of an entity's promise to grant a license of intellectual property applies. For example, paragraph 606-10-55-57, as originally issued, suggested that an entity would consider the nature of its promise in granting a license only when the license is distinct. Some stakeholders noted that an entity would have to consider the nature of its promise in granting a license even when the license is not distinct to appropriately (a) determine whether a combined performance obligation that includes a license of intellectual property is satisfied over time or at a point in time and (b) measure progress toward complete satisfaction of that combined performance obligation if it is satisfied over time. The Board agreed with those stakeholders and, therefore, decided to revise the guidance in paragraph 606-10-55-57. The amendments to Topic 606 state that when a single performance obligation includes a license of intellectual property and one or more other goods or services, the entity considers the nature of the combined good or service for which the customer has contracted (including whether the license provides a customer with a right to use or right to access intellectual property) in (a) determining whether that combined good or service is satisfied over time or at a point in time in accordance with paragraphs 606-10-25-23 through 25-30 and (b) selecting an appropriate method for measuring progress in accordance with paragraphs 606-10-25-31 through 25-37. The Board concluded that not considering the nature of the entity's promise in granting the license that is part of the single performance obligation would result in accounting that does not best reflect the entity's performance, in some cases. For example, if an entity grants a 10-year license that is not distinct from a 1-year service arrangement, it would be inappropriate to conclude that the combined performance obligation is satisfied over the one-year service period if the nature of the entity's promise in granting the license would be that of a right to access the entity's intellectual

property over the 10-year license period (that is, satisfied over time) if the license was a separate performance obligation.

BC67. In addition to making amendments to paragraph 606-10-55-57, the Board decided to revise the Examples in Topic 606 that include a single performance obligation comprising a license and another good or service (that is, Example 10, Case C; Example 11, Case B; Example 55; and Example 56, Case A) to help entities understand the intention of the Board's amendments to paragraph 606-10-55-57.

BC68. Considering the nature of the entity's promise in granting a license that is part of a single performance obligation is part of the overall requirement within Step 5 of the revenue model (see paragraph 606-10-25-33) to determine the nature of the good or service (which may be a combined item, including a combined item that includes a license) in order to determine whether that good or service is satisfied over time or at a point in time and the appropriate measure of progress to apply. It is not a separate step or evaluation. Considering the nature of the entity's promise in granting the license within a single performance obligation also is necessary to apply the principle of recognizing revenue when (or as) an entity satisfies its performance obligation and, therefore, is already an implied requirement of the guidance. The Board observed that it is not possible to appropriately recognize revenue when (or as) the entity satisfies its performance obligation if the entity does not first understand whether its promise in granting the license requires continued performance by the entity. For example:

- a. It is only possible to conclude that the combined license and customization services performance obligation in Example 11, Case B, is completely satisfied over the customized installation service period if one concludes that the license provides the customer with a right to use the entity's software. It is only based on that conclusion that the entity has completely satisfied the single performance obligation at the point in time the customization of the software is complete. In contrast, if the license were deemed a right to access the entity's software, the entity would adopt a different measure of progress toward complete satisfaction of the performance obligation, recognizing revenue over a longer period and in a different pattern, which would reflect the entity's continuing performance obligation to provide access to the software over the license period after completion of the customized installation services.
- b. In Example 56, Case A, it is only by determining the nature of the entity's promise in granting the license within the single license/manufacturing service performance obligation that the entity can appropriately apply the principle of recognizing revenue when (or as) the entity satisfies its performance obligation to the customer. If the license provides a right to use the entity's drug patent, the entity's performance is complete under the single performance obligation when the manufacturing service is complete. In contrast, if the license were to provide a right to access the entity's drug patent, the performance obligation is not completely satisfied

until the end of the license period such that some portion of the transaction price would be recognized after the manufacturing service is complete.

BC69. The amendments to paragraph 606-10-55-57 were made for many of the same reasons that paragraph BC407 was included in Update 2014-09. The Board considered the Example included in BC66, and other similar Examples, when it drafted paragraph BC407. Therefore, the amendments to paragraph 606-10-55-57 and the discussion in the preceding paragraph of this Update supersede the discussion in paragraph BC407 in Update 2014-09.

Consideration in the Form of Sales-Based or Usage-Based Royalties

BC70. The Boards decided in Update 2014-09 that for a license of intellectual property for which the consideration is based on a customer's subsequent sales or usage, an entity should not recognize any revenue for the variable amounts until the uncertainty is resolved (the royalties recognition constraint). Revenue derived from a sales-based or usage-based royalty is not recognized until (a) the customer's subsequent sales or usage occurs or (b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

BC71. Paragraph 606-10-55-65 addresses the *recognition* of sales-based or usage-based royalties and not when such amounts are included in the transaction price of the contract. That is, paragraph 606-10-55-65 functions as a recognition constraint, and the constraint on variable consideration in paragraphs 606-10-32-11 through 32-13 does not apply. Paragraph 606-10-55-65(b) is not intended to suggest that recognition of amounts from a sales-based or usage-based royalty as the customer's subsequent sales or usage occurs is inappropriate in all cases for performance obligations satisfied over time. Rather, it is merely intended to ensure that the royalties guidance does not subvert one of the key principles of Topic 606, which is to recognize revenue only when (or as) an entity satisfies a performance obligation. An entity recognizes revenue from a sales-based or usage-based royalty when (or as) the customer's subsequent sales or usage occur unless recognition in that manner would accelerate the recognition of revenue for the performance obligation to which the royalty solely or partially relates ahead of the entity's performance toward complete satisfaction of the performance obligation based on an appropriate measure of progress. An example of when revenue recognition might be accelerated ahead of the entity's performance is an arrangement in which the royalty rate declines over the license period (for example, the entity receives 8 percent of sales until cumulative sales equal \$1 million, then receives 4 percent up to the next \$3 million, and 2 percent after that) in a manner that does not reflect changing value to the customer. In that case, recognition of royalties as they are due, in accordance with the formula, on a license that provides the customer with the right to access the entity's intellectual property evenly over the license term may subvert the recognition principle of the

guidance. However, the existence of a declining royalty rate itself does not always mean that the guidance in paragraph 606-10-55-65(b) is not met. An entity will need to apply judgment to determine the appropriate pattern of revenue recognition based on the facts and circumstances of the arrangement.

BC72. In many right to access license arrangements that include royalties, application of the guidance in paragraph 606-10-55-65 may result in revenue recognition of those royalties as the subsequent sales or usage occurs. This is because an output-based measure of progress that is the same as, or similar to, application of the guidance in paragraph 606-10-55-18 (that is, when the right to consideration corresponds directly with the value to the customer of the entity's performance completed to date) will be appropriate because it will not accelerate revenue recognition ahead of the entity's expected performance over the performance obligation period. An output-based measure, similar to that in paragraph 606-10-55-18, could be an appropriate measure of progress when the royalties due each period by the licensor correlate directly with the value to the customer of the entity's performance (as described in paragraph 606-10-55-60) in providing access to the entity's intellectual property (for example, a contract in which the entity earns an additional \$1 in royalties for each additional \$10 in revenue that the customer generates from using the licensed intellectual property), or, as in the case of Examples 57 and 61, the combination of recognition of (a) a portion of the fixed fee in each example and (b) the royalties earned each period does not accelerate revenue recognition for the performance obligation ahead of the entity's expected performance. In addition, in many right to access license arrangements that include fixed consideration (such as a significant upfront payment) and variable consideration (such as a royalty), the license may constitute a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer in accordance with paragraph 606-10-25-14(b) (for example, a series of distinct periods [month, quarter, year] of access). In that case, the variable consideration would be allocated to the distinct periods of access in accordance with paragraphs 606-10-32-39(b) and 606-10-32-40, if the criteria in those paragraphs are met. Allocation of sales-based or usage-based royalties in this manner also generally would result in recognizing those royalties as revenue when the customer's subsequent sales or usage occurs.

BC73. The Boards included the guidance on sales-based or usage-based royalties in exchange for a license of intellectual property in Topic 606, as part of Update 2014-09, because both users and preparers of financial statements indicated that it would not be useful for an entity to recognize a minimum amount of revenue for those contracts. This is because that approach inevitably would have required the entity to report, throughout the life of the contract, significant adjustments to the amount of revenue recognized at inception of the contract as a result of changes in circumstances even though those changes in circumstances are not related to the entity's performance. The Boards observed that this would not result in relevant information, particularly in contracts in which the sales-based or usage-based royalty is paid over a long period of time. Entities also reported

that such accounting would be operably difficult and subject to significant judgments because of the long-term nature of many licensing arrangements (for example, 10 years, 20 years, or longer).

BC74. After the issuance of Update 2014-09, stakeholders communicated to the Board that it is unclear when a sales-based or usage-based royalty is “promised in exchange for a license of intellectual property.” Some stakeholders interpreted this provision broadly and concluded that the royalties recognition constraint applies whenever the royalty relates to a license of intellectual property, regardless of whether the royalty also is consideration for other goods or services in the contract. Other stakeholders had a more narrow view and suggested that the royalties recognition constraint applies only when the royalty relates solely to a distinct license or only when the license is the primary or dominant item to which the royalty relates. In addition to questions about when a royalty is promised in exchange for a license, stakeholders also communicated that the guidance is unclear about whether a single sales-based or usage-based royalty should ever be split between a portion to which the royalties recognition constraint would apply and a portion to which it would not (and, therefore, to which the general guidance on variable consideration applicable to goods and services other than licenses would apply), such as when a royalty relates to a license and another good or service that is not a license.

BC75. To enhance understandability and promote consistency in application, the Board decided to clarify that:

- a. An entity should not account for a single royalty under two constraint models. That is, the entity should not split a single royalty between a portion to which the royalties recognition constraint would apply and a portion to which the general constraint on variable consideration (in paragraphs 606-10-32-11 through 32-13) would apply. However, this amendment does not affect the requirement to allocate fees due from a sales-based or usage-based royalty to the performance obligations (or distinct goods or services) in the contract to which the royalty relates, regardless of the constraint model the entity is required to apply (see Example 35, Case B and Example 60 in Topic 606, which demonstrate that application of the royalties recognition constraint does not change the requirement to allocate the transaction price to the performance obligations in the contract).
- b. A sales-based or usage-based royalty is promised in exchange for a license and, therefore, the royalties recognition constraint applies whenever a license is the sole or predominant item to which the royalty relates. This would include situations in which no single license is the predominant item to which the royalty relates but the royalty predominantly relates to two or more licenses promised in the contract.

BC76. The Board decided that an entity should not account for a single royalty in accordance with two constraint models (as described in paragraph BC75(a))

because doing so would be overly complex. The Board concluded that splitting the royalty would have been more complex for preparers than accounting for the royalty under either one of those two models (that is, the royalties recognition constraint or the general constraint on variable consideration applied in determining the transaction price), while not providing more useful information to financial statement users. In fact, the financial reporting results from splitting a royalty might result in financial statement users receiving less useful information that complicates their analysis. The Board observed in paragraph BC415 of Update 2014-09 that the general guidance on variable consideration would not result in relevant information to users for contracts in which the sales-based or usage-based royalty is paid over a long period of time. However, some other stakeholders stated that any constraint (whether the general constraint applicable to variable consideration or the royalties recognition constraint) will result in delayed revenue recognition to later periods, thereby disassociating reported revenue from an entity's performance in satisfying a performance obligation. A royalty accounted for partially under each of two constraint models likely would satisfy none of those stakeholders because the amount recognized at contract inception would reflect neither the amount to which the entity expects to be entitled based on its performance nor amounts to which the entity has become legally entitled during the period.

BC77. In deciding when a royalty is promised in exchange for a license and, therefore, that the royalties recognition constraint should apply, the Board decided that applying the royalties recognition constraint only when the royalty relates solely to a license that is a separate performance obligation would have excessively restricted its application. Because the Board previously decided that the royalties recognition constraint generally will provide more useful information to users in licensing arrangements that contain sales-based and usage-based royalties, the Board decided that applying the royalties recognition constraint to those royalty arrangements in which the license is the predominant feature to which the royalty relates will provide more useful information to those users that are likely to view those arrangements as licensing arrangements. The Board further considered that restricting application of the royalties recognition constraint to only those cases in which the royalty relates solely to a distinct license likely would result in an entity frequently reporting throughout the life of the contract significant adjustments to the amount of revenue recognized at inception of the contract as a result of changes in circumstances (unrelated to the entity's performance), although the arrangement is predominantly a licensing arrangement. Therefore, while the Board acknowledges judgment will be required to determine when a license is the predominant item to which a sales-based or usage-based royalty relates, the judgment and complexity resulting from that determination are likely to be less than the judgment and complexity required to apply the general variable consideration guidance to those arrangements to which the royalties recognition constraint will not apply under a narrower application.

BC78. The Board decided not to expand the royalties recognition constraint beyond those situations in which a license is the predominant item to which a royalty relates. The Board considered, but rejected, expanding the royalties recognition constraint to include one or both of the following:

- a. Sales-based or usage-based royalties that relate to a license and another good or service, even if the license is not the predominant item to which the royalty relates. The Board rejected this because it inevitably would have expanded applicability of the royalties recognition constraint to arrangements the Board previously decided it should not apply to (for example, sales of tangible goods that include intellectual property, such as end-user software to which the customer obtains a license as part of the sale).
- b. Sales of intellectual property. The Board rejected expanding the royalties recognition constraint to include sales of intellectual property principally to retain a narrow scope to what is, fundamentally, an exception to the revenue guidance, but also in order to retain convergence in this respect with IFRS. In rejecting this expansion of the royalties recognition constraint, the Board acknowledged that some stakeholders were concerned that the royalties recognition constraint would not apply to licenses that some consider to be in substance sales of the underlying intellectual property. In deliberating whether to expand the scope of the royalties recognition constraint to include sales of intellectual property, the Board observed that Topic 606 does not make reference to in substance sales of intellectual property. Licenses are subject to the royalties recognition constraint; sales of intellectual property are not. An entity should not discern whether a license to intellectual property is an “in substance sale” of that intellectual property in deciding whether or not the royalties exception applies. The Board concluded that attempting to distinguish between licenses that are, or are not, in substance sales would add significant complexity to the guidance and that there can be legal differences between a contract for a license and a sale of intellectual property that it may not be appropriate or feasible to ignore, or attempt to override, from an accounting perspective.

Benefits and Costs

BC79. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board’s assessment of the costs and benefits of issuing

new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC80. The Board does not anticipate that entities will incur significant costs as a result of the amendments in this Update because those amendments affect guidance that currently is not effective. The objective of this Update is to reduce the risk of diversity in practice before organizations implement Topic 606, which will benefit financial statement users by providing more comparable information. Additionally, the amendments in this Update should reduce the cost and complexity of applying Topic 606 both at transition and on an ongoing basis.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*[®] in this Accounting Standards Update do not require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Any stakeholders who believe that changes to the Taxonomy are required should provide their comments and suggested changes through ASU Taxonomy Changes provided at www.fasb.org.