

TRG Snapshot

Joint Meeting on Revenue

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This *TRG Snapshot* summarizes the January 26, 2015, meeting of the joint revenue transition resource group (TRG) created by the FASB and IASB.

The purpose of the TRG is not to issue guidance but instead to seek and provide feedback on potential issues related to implementation of ASC 606¹ and IFRS 15² (collectively, the “new revenue standard”). By analyzing and discussing potential implementation issues, the TRG will help the boards determine whether they need to take additional action, such as providing clarification or issuing other guidance. The TRG comprises financial statement preparers, auditors, and users from “a wide spectrum of industries, geographical locations and public and private organizations,” and board members of the FASB and IASB attend the TRG’s meetings.

Representatives from the SEC, PCAOB, IOSCO,³ and AICPA are also invited to observe the meetings.

Editor’s Note: There were significantly more agenda items (13) for this meeting than there were for the TRG’s first two meetings, and the TRG expressed consensus views on certain questions covered in the topics discussed below.

The agenda included an update on research projects that the staffs of the FASB and IASB have undertaken related to licenses of intellectual property and identifying performance obligations, and the agenda noted that the staffs plan to discuss these topics publicly with the boards at their February 2015 meetings. The staffs also continue to gather information on issues related to an entity’s assessment of whether it is a principal or an agent under the new revenue standard.

In addition, the boards noted that they are considering whether to allow entities to use certain practical expedients in the new revenue standard on, for example, the presentation of sales taxes, whether shipping represents a separate performance obligation, and the treatment of contract modifications for transition purposes.

The FASB staff is also continuing its outreach efforts to help the Board determine whether to defer the effective date of the new standard, and the FASB staff noted that the FASB remains on track to make such a determination in the second quarter of 2015.

Topic 1 Identifying Promised Goods or Services in a Contract With a Customer

Background: Step 2 in the new revenue standard requires an entity to identify the performance obligations in contracts with its customers by identifying the promised goods or services. In addition, paragraph BC87 of the standard’s Background Information and Basis for Conclusions indicates that before an entity can identify performance obligations in a contract with its customers, it must first identify all promised goods or services in the contract. Paragraph BC89 notes that the FASB and IASB “decided that all goods or services promised to a customer as a result of a contract give rise to performance obligations.” Further, paragraph BC90 states that the boards “decided not to exempt an entity from accounting for performance obligations that the entity might regard as being perfunctory or inconsequential.”

Many stakeholders have noted their belief that paragraph BC90 effectively removes from U.S. GAAP the guidance in SAB Topic 13⁴ on “perfunctory or inconsequential” performance obligations. Stakeholders have further noted that it is unclear whether the boards intended the concepts of “promised goods or services”

¹ For titles of *FASB Accounting Standards Codification* (ASC or “Codification”) references, see Deloitte’s “Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*.”

² IFRS 15, *Revenue From Contracts With Customers*.

³ International Organization of Securities Commissions.

⁴ SEC Staff Accounting Bulletin (SAB) Topic 13, “Revenue Recognition.”

under the new revenue standard and “deliverable” under current revenue guidance to be similar notions. With the removal of the concept of inconsequential or perfunctory, stakeholders believe that entities would be required to identify significantly more performance obligations under the new revenue standard than deliverables under current revenue guidance. Accordingly, stakeholders have questioned whether the boards intended that (1) entities would identify and account for more performance obligations and (2) certain activities that provide minor benefit would be considered performance obligations.

The discussion in [TRG Agenda Paper 12](#) on identifying promised goods or services in a contract with a customer does not address (and was not intended to address) how to determine whether a performance obligation in a contract is distinct. See the agenda paper for additional details.

Summary:

The TRG discussed various options, including whether to (1) specifically address “perfunctory or inconsequential” items in the text of the new revenue standard, (2) delete the wording from paragraph BC90 (as quoted above), and (3) add other implementation guidance.

While some TRG members discussed the potential need to add the concept of “inconsequential or perfunctory” to the new revenue standard, there appeared to be general agreement that such an addition would not be necessary. Although a TRG member noted that the new standard is different from current revenue guidance and in some cases may result in more (or different) performance obligations than under existing revenue guidance (e.g., some marketing activities), most TRG members believed that the evaluation of promised goods or services in a contract would lead to about the same number of deliverables that are identified today. Many TRG members were in favor of requiring the use of judgment and materiality to identify promised goods or services as performance obligations and supported clarifying the wording in the new revenue standard’s Background Information and Basis for Conclusions.

TRG members also discussed examples in which the application of the new revenue standard raises questions, including whether marketing and sales incentives provided to a customer and certain shipping arrangements are promises that give rise to performance obligations. Under existing guidance, an entity that provides an incentive — such as a bank that gives a customer golf clubs for opening an account — generally would treat the incentive as a marketing expense. Similarly, some entities may account for shipping arrangements as perfunctory and inconsequential under existing revenue guidance. One TRG member indicated that the only potentially necessary additional guidance would be to reinforce that such determinations require judgment and largely depend on the nature of the promise. However, other TRG members mentioned the need to clarify whether items of this nature are considered a performance obligation.

Editor’s Note: The FASB staff noted in introductory remarks at the meeting that the FASB is considering whether to include a practical expedient for shipping.

Topic 2

Collectibility

Background:

The new revenue standard requires an entity to assess collectibility at contract inception. If collectibility is not probable, the entity cannot conclude that it has a contract and thus cannot recognize revenue if it satisfies a performance obligation. When the collectibility threshold is not met, revenue can be recognized only if (1) the entity has fully performed under the contract and has received all or substantially all consideration that it expects to receive, and such consideration is not refundable; (2) the contract is terminated, and consideration received is not refundable; or (3) the collectibility threshold has subsequently been met (i.e., collectibility was later determined to be probable⁵). Consideration received before any of these three conditions are met should be recorded as a liability.

Questions have arisen about the following:

- *Collectibility for a portfolio of contracts* — Views differ on how much revenue to recognize when an entity has a history showing that it will not collect from some customers in a portfolio of contracts (e.g., 2 percent of invoiced amounts have not been collected historically). Some believe that an entity should record revenue net of uncollectible amounts (i.e., 98 percent of the invoiced amount if the remaining 2 percent is uncollectible); however, others believe that an entity should record revenue at the expected amount (i.e., 100 percent of the invoiced amount) and that it should record the uncollectible amount as an impairment loss (i.e., if 98 percent of the invoiced amount is collectible, the entity should record the remaining 2 percent as bad debt expense).

⁵ ASC 606-10-25-6 through 25-8; paragraphs 14 through 16 of IFRS 15.

- *Reassessments of collectibility* — The new standard requires a reassessment of collectibility when there is a significant change in facts and circumstances after the initial assessment. Stakeholders have questioned how to evaluate this requirement to determine when to reassess whether a contract continues to meet the collectibility threshold.
- *Subsequent assessments concluding that collectibility is not probable* — Given that when collectibility is not probable, an entity is prohibited from recognizing revenue under the new revenue standard unless certain conditions are met (see above), stakeholders have questioned how to recognize revenue for a contract that initially met the collectibility threshold but was later determined not to meet the threshold. One view is that the reassessment has effectively “terminated” the original contract (i.e., the contract term has been modified to end on the reassessment date when collection is no longer probable), and consideration received for performance obligations satisfied under the revised contract should be recognized as revenue. Consideration received for future goods or services should be recognized as a liability.
- *Assessments of price concessions*⁶ — The new revenue standard requires an entity to assess whether its contract includes a price concession by considering both its past practices and its current intentions. If the contract includes a price concession, the entity should reduce the consideration by the price concession it provides before performing the collectibility assessment. While the new revenue standard provides an example⁷ that illustrates the interaction between an entity’s assessment of price concessions and collectibility, stakeholders have noted that collectibility determinations involving price concessions are complex and require significant judgment.

See [TRG Agenda Paper 13](#) for additional information.

Summary: TRG members generally agreed on the following:

- When collectibility is probable for a portfolio of contracts, the expected amount should be recognized as revenue, and the uncollectible amount should be recorded as an impairment loss in accordance with ASC 310 or IFRS 9.⁸ Therefore, in the example above, the entity would recognize revenue for 100 percent of the expected amount and an impairment loss of 2 percent as bad debt expense.
- To determine when to reassess collectibility, an entity needs to exercise judgment on the basis of the facts and circumstances.
- The new revenue standard clearly prohibits entities from recognizing revenue when collectibility is not probable despite any nonrefundable cash payments that may have been received. Essentially, cash-based accounting will no longer be permitted under the new revenue standard. TRG members questioned whether the deferral of revenue for cash received truly reflects the economics of certain transactions (e.g., long-term service contracts) and whether such deferral is an unintended consequence of the collectibility assessment’s inclusion in step 1 of the model instead of step 5.

One TRG member challenged the presentation of nonrefundable consideration received from a customer as a liability because in most cases involving a collectibility issue, an entity would neither refund cash it received nor recoup goods or services provided to a customer. TRG members also noted difficulties in applying the collectibility threshold to service contracts when a customer pays on a monthly basis for the services it receives from the entity but collectibility in future months may not be probable. In such a situation, the new revenue standard would require an entity to defer revenue until collectibility is probable regardless of the cash it received.

Discussion also centered on the punitive nature of the collectibility threshold in the new revenue standard, but board members reminded TRG members that the inclusion of collectibility in step 1 was intentional since revenue recognition is precluded when a valid contract does not exist (i.e., when the criteria in step 1, including the condition that collectibility must be probable, are not met). However, certain TRG members noted that it seems odd to conclude that revenue recognition is prohibited when a contract that may be valid from a legal perspective is invalid for accounting purposes simply because the collectibility criterion has not been met.

The TRG also acknowledged that an assessment of whether a price adjustment is due to collectibility (i.e., credit) or a price concession is complex but can be performed in practice.

⁶ ASC 606-10-32-7; paragraph 52 of IFRS 15.

⁷ Example 3, “Implicit Price Concession” (ASC 606-10-55-102 through 55-105; paragraphs IE10 through IE13 of IFRS 15).

⁸ IFRS 9, *Financial Instruments*.

Topic 3 Variable Consideration

Background:

Under step 3 of the new revenue standard, an entity is required to determine the transaction price, which is the amount of consideration to which it expects to be entitled in exchange for the promised goods or services in the contract. The transaction price can be a fixed amount, or it can vary because of “discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, or other similar items.” In determining the transaction price of a contract with a customer, an entity must consider several factors: (1) variable consideration, (2) significant financing components, (3) noncash consideration, and (4) consideration payable to a customer. Some or all of an estimate of variable consideration is only included in the transaction price to the extent that it is probable⁹ that subsequent changes in the estimate would not result in a “significant reversal” of revenue (this concept is commonly referred to as the “constraint”).

Several questions regarding the application of the new revenue standard have arisen related to consideration payable to a customer and the level (contract or performance obligation) at which the constraint should be applied to variable consideration.

Consideration Payable to the Customer

In a manner similar to existing revenue guidance, the new revenue standard requires an entity to reflect consideration payable to a customer as an adjustment to the transaction price unless the consideration is payment for a distinct good or service (as defined in the new revenue standard). However, questions have arisen about when to apply the new revenue standard’s guidance on (1) constraining variable consideration and (2) consideration payable to a customer. Many stakeholders believe that it is unclear from the new revenue standard how to account for consideration payable to a customer when an entity promises to pay consideration after it has already recognized revenue from transferring control of the goods or services to the customer. Some stakeholders believe that consideration payable to a customer (i.e., reduction of revenue) should be recognized when revenue is recognized. However, others believe that the guidance could be interpreted to allow recognition at a later date (i.e., when the entity promises or pays the consideration).

Constraining Estimates of Variable Consideration

The new revenue standard requires entities to perform a qualitative assessment that takes into account both the likelihood and the magnitude of a potential revenue reversal and provides factors that could indicate that an estimate of variable consideration is subject to significant reversal (e.g., susceptibility to factors outside the entity’s influence, long period before uncertainty is resolved, limited experience with similar types of contracts, practices of providing concessions, or a broad range of possible consideration amounts).

Questions have arisen about whether to apply the variable consideration and constraint guidance at the contract level or at the performance obligation level when variable consideration is not allocated proportionately to all performance obligations in a contract. For example, if one performance obligation is fixed (e.g., sale of equipment) and another performance obligation is variable (e.g., variable performance-based fee), an entity must assess the potential for a significant reversal of revenue for the variable consideration. Many stakeholders believe that it is unclear whether an entity should apply the constraint at the contract level (i.e., total transaction price for the contract) or at the performance obligation level (i.e., transaction price specific to the variable consideration).

See [TRG Agenda Paper 14](#) for more information.

Summary:

Paragraph 20 of TRG Agenda Paper 14 expresses the FASB and IASB staffs’ view that the reversal of revenue from variable consideration or consideration payable to a customer “should be made at the *earlier* of the date that there is a change in the transaction price in accordance with [ASC] 606-10-32-25 [paragraph 70 of IFRS 15] . . . or the date at which the consideration payable to a customer is promised in accordance with [ASC] 606-10-32-27 [paragraph 72 of IFRS 15].” While TRG members generally agreed and were pleased with the staffs’ conclusion in the agenda paper, certain TRG members noted that it is difficult to support that position on the basis of the wording in the new revenue standard (i.e., the standard contains internal inconsistencies that would need to be addressed to support the staffs’ position).

⁹ Like the term “probable” in step 1 regarding the collectibility threshold, “probable” in this context has the same meaning as in ASC 450-20-20: “the future event or events are likely to occur.” In IFRS 15, the IASB uses the term “highly probable,” which has the same meaning as the FASB’s “probable.”

TRG members also generally agreed with the staffs' view that the constraint on variable consideration should be applied at the contract level because "the unit of account for determining the transaction price (Step 3 of the model) is the contract, not the performance obligation" (emphasis omitted).

Topic 4 Noncash Consideration

Background:

The new revenue standard indicates that when consideration is in a form other than cash (i.e., noncash consideration), an entity should determine the transaction price by measuring the noncash consideration at fair value.¹⁰ Stakeholders have noted that there are different interpretations regarding when noncash consideration should be measured and that the measurement date for noncash consideration has been variously viewed as (1) the time of contract inception, (2) the time at which the noncash consideration is received (or is receivable), and (3) the earlier of when the noncash consideration is received (or is receivable) or when the related performance obligation is satisfied (or as the performance obligation is satisfied, if satisfied over time).

In addition, stakeholders have indicated that it is unclear from the new revenue standard (1) how to apply the guidance on the inclusion of variable consideration in the transaction price when variability in fair value is attributable to both the form of consideration and reasons other than the form of consideration and (2) how to apply the constraint to transactions in which variability in the fair value of noncash consideration is attributable to both the form of consideration and reasons other than the form of consideration. Views on this topic include (1) applying the constraint to variability attributable to both the form of consideration and reasons other than the form of consideration and (2) applying the constraint only to variability attributable to reasons other than the form of consideration.

For additional details, see [TRG Agenda Paper 15](#).

Summary:

Much of the TRG's discussion focused on the measurement date for noncash consideration. As noted in TRG Agenda Paper 15, several TRG members expressed the view that noncash consideration should be measured at the earlier of (1) when the noncash consideration is received (or is receivable) or (2) when the related performance obligation is satisfied; however, they noted that this interpretation may be difficult to apply, especially for determining the intervals for assessment when performance in a contract occurs over time. Other TRG members suggested support for the other two views. In addition, many TRG members noted that they can understand how entities might arrive at one of the other positions identified in TRG Agenda Paper 15 and that the boards should therefore clarify the guidance for practicality and to reduce potential diversity in practice.

Those who expressed views on variability attributable to the form of consideration and reasons other than the form of consideration agreed that the standard was unclear on this topic and some expressed uncertainty about whether the topic would be sufficiently prevalent to require further clarification of the guidance. However, participants at the meeting noted that while bifurcating noncash consideration may be the preferred method from a conceptual standpoint, it raises practicality issues in application.

Topic 5 Stand-Ready Obligations

Background:

The new revenue standard requires an entity to determine the goods and services it promises to transfer in contracts with its customers. In addition, the standard notes that promises in a contract with a customer may be explicit or implicit and lists examples of promised goods or services. One such example is "[p]roviding a service of standing ready to provide goods or services . . . or of making goods or services available for a customer to use as and when the customer decides,"¹¹ referred to as stand-ready obligations.

Stakeholders have identified four broad types of promises or arrangements that may constitute stand-ready obligations, including those for which the obligation to deliver goods or services is:

- Within the entity's control, but for which additional development of the goods, services, or intellectual property is required ("Type A").
- Outside both the entity's and customer's control ("Type B").
- Solely within the customer's control ("Type C").

¹⁰ ASC 606-10-32-21 and 32-22; paragraphs 66 through 69 of IFRS 15.

¹¹ ASC 606-10-25-18(e); paragraph 26 of IFRS 15.

The fourth category identified is promises to make an entity's goods or services available to the customer continuously over the contractual period — such as a health club membership, which is the only example of a stand-ready obligation in the new revenue standard¹² ("Type D"). A potential way to account for a Type D arrangement is for the entity to record revenue ratably over the performance period on a straight-line basis. Straight-line revenue recognition results because (1) the customer is required to pay regardless of how frequently he or she uses the health club and (2) the entity stands ready or makes its goods or services available to the customer on a constant basis over the contract period.

Because the new revenue standard provides an example of Type D arrangements but not others, questions have arisen regarding the identification of other stand-ready obligations (i.e., Types A through C) and how to appropriately measure progress toward completion of delivering the promised goods or services. Specifically, views differ on (1) what constitutes the nature of the promise in the aforementioned arrangements (e.g., whether it is the act of standing ready or the actual delivery of the goods or services to the customer) and (2) the methods used to measure progress toward the complete satisfaction of a stand-ready obligation (e.g., a time-based, input, or output method).

For additional information, see [TRG Agenda Paper 16](#).

Summary:

TRG members generally agreed that the related guidance in the new revenue standard seems operational, especially when considered in light of the discussion and illustrations in TRG Agenda Paper 16. The principle in the new revenue standard requires an entity to understand the nature of the promise, and the agenda paper helps illustrate considerations for making that judgment. Some TRG members thought that additional language in the boards' summary of the January 2015 TRG meeting, specifically in connection with the discussion of specified and unspecified upgrades of software (see below), would be helpful in application.

One TRG member expressed the concern that paragraph 14 of TRG Agenda Paper 16, in which the FASB and IASB staffs indicate that an entity may promise a customer both specified and unspecified upgrades of software (i.e., although a contract refers only to unspecified upgrades on a when-and-if-available basis), may be interpreted to mean that unspecified upgrades should be recognized at a point in time rather than ratably over time¹³ as in current practice. The TRG member thought that such an outcome could arise as a result of requiring an entity to determine whether a plan to provide functionality enhancements that has not been communicated to the customer is a specified upgrade, which could potentially change what have historically been considered specified and unspecified upgrades. The FASB staff clarified that although [ASU 2014-09](#)¹⁴ removes the term "specified upgrade" from the Codification Master Glossary, step 2 in the new revenue standard states that an entity needs to consider when it has promised additional goods or services to a customer. Further, the FASB staff noted that it did not intend to change how to view specified and unspecified upgrades discussed in paragraph 14 of the agenda paper; rather, if an entity makes another promise to a customer, the additional promise needs to be accounted for (i.e., if there is a specified upgrade, it would need to be evaluated as a separate performance obligation).

A FASB member expressed the concern that the TRG's discussion may give rise to interpretations that result in too many stand-ready obligations. The Board member offered that the form of payment may help entities determine whether an arrangement is a stand-ready obligation. For example, if snow removal is paid on the basis of a fixed fee for a fixed period, such an arrangement may represent a stand-ready obligation (i.e., regardless of the number of times snow removal is performed). However, such a conclusion may not be appropriate for a pay-for-performance structure (e.g., a payment of \$50 each time the snow removal service is performed).

Topic 6

Application of the New Revenue Standard to Permitted Islamic Finance Transactions

Background:

Stakeholders in the Islamic finance industry have solicited views from the TRG on the implications of the new revenue standard for certain common transactions. A distinguishing feature of instruments in Islamic finance is that they do not include interest on loans. Instead, they involve financing of assets in the real, as opposed to the financial, economy. An Islamic financial institution must legally possess the underlying assets before it can resell or lease the underlying assets. While an Islamic financial institution may charge a

¹² ASC 606-10-55-184 through 55-186; paragraphs IE92 through IE94 of IFRS 15.

¹³ ASC 985-605-25-59, ASC 985-605-25-67, and ASC 985-605-25-70.

¹⁴ FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*.

markup on the sale of a real asset (e.g., a vehicle or real estate) to compensate for deferred payment, there is typically no anticipation of profit from the sale of the asset itself since such a markup would be deemed interest and therefore forbidden under Islamic law.

The types of transactions in question all possess the following three characteristics:

- For the seller, the transactions are in the form of cash purchases and, in almost all cases, immediate sales (i.e., sales within approximately 24 hours) with deferred payment.
- For the purchaser, the transactions are in the form of purchases on deferred payments.
- The financial instruments created by the transactions are within the scope of IFRS 9 and IAS 32,¹⁵ as are financing contracts provided to the customers of a business.

The new revenue standard's scope includes "all contracts with customers" other than those that are excluded. Questions have arisen regarding whether the deferred-payment transactions described above are within the scope of the new revenue standard since an Islamic financial institution must possess the underlying assets and retain all the risks and rewards of ownership of the assets, even if only for a short period, before the subsequent sale to the institution's customer.

See [TRG Agenda Paper 17](#) for additional details.

Summary:

TRG members primarily focused on whether the accounting for the transactions described above should reflect the economic substance of the transactions (i.e., a financing) or the legal form of the transaction (i.e., a sale of goods legally owned by the Islamic financial institution). The TRG also noted that there are inconsistent views on whether an Islamic financial institution's ordinary activities are solely the provision of Shariah-compliant financing or the sales of cars, real estate, or other commodities, which would affect whether the transactions were within the scope of the new revenue standard's guidance. Ultimately, no consensus was reached by the TRG on whether such transactions were within the scope of the new revenue guidance, but one TRG member noted that an early-stage analysis by a group of accounting firms located in the Asia-Pacific region indicated that, in a manner consistent with current practice, the transactions are likely to be within the scope of IFRS 9 and therefore would be outside the scope of the new revenue standard (and thus not subject to its disclosure and presentation requirements).

Topic 7

Incremental Costs of Obtaining a Contract

Background:

The new revenue standard contains criteria for determining when to capitalize costs associated with obtaining and fulfilling a contract. Specifically, entities are required to recognize an asset for incremental costs of obtaining a contract (e.g., sales commissions) when those costs are expected to be recovered. Capitalized costs are then amortized in a manner consistent with the pattern of transfer of the goods or services to which the asset is related (which may extend beyond the original contract term in certain circumstances).

Because many entities pay sales commissions to obtain contracts with customers, questions have arisen regarding how to apply the new revenue standard's cost guidance to such commissions, including whether certain commissions qualify as contract assets.

Questions related to the following topics were submitted to the TRG for discussion:

- Commissions paid on renewals after the initial contract is obtained.
- Commissions on contract modifications.
- Commission payments that are contingent on future events.
- Commission payments subject to clawback.
- Commission payments subject to a threshold.
- Types of costs to capitalize. For example, should an entity consider fringe benefits in determining the amount of commissions to record as incremental costs (e.g., payroll taxes, pension, or 401(k) match)?

¹⁵ IAS 32, *Financial Instruments: Presentation*.

- Pattern of amortization for contract assets related to multiple performance obligations. For example, how should an entity determine the pattern of amortization for a contract cost asset related to multiple performance obligations that are satisfied over disparate points or periods of time?

For additional information and details, see [TRG Agenda Paper 23](#).

Summary:

Rather than discussing each topic and related question in detail, TRG members generally noted that they agreed with the FASB and IASB staffs' views in TRG Agenda Paper 23. They also noted that the examples outlined by the staffs may not reflect the level of complexity observed in practice.

Instead, discussion centered on the principles associated with capitalizing costs. Specifically, TRG members discussed whether the new revenue standard supersedes other GAAP related to liability accounting. Some TRG members noted that stakeholders may have concluded that the guidance in the new revenue standard overrides existing guidance on liability recognition, but a majority of TRG members agreed that entities would continue to first refer to existing GAAP on liability recognition to determine whether and, if so, when a liability needs to be recorded from a contract with a customer. For example, an entity would apply the specific GAAP on liability (e.g., commissions, payroll taxes, 401(k) match) and then determine whether to record the related debit as an asset or expense.

TRG members also noted that there is no need for prescriptive guidance on amortization periods and methods and that the standard is clear that an entity's method should be on a systematic basis and period should reflect the pattern of transfer of goods and services to a customer.

Topic 8 **Evaluating Contract Modifications Before the Adoption Date of the New Revenue Standard**

Background:

The new revenue standard provides guidance on transition and contract modifications. The transition provisions allow an entity to apply either a full retrospective approach (with certain practical expedients) or a modified retrospective approach.¹⁶ The standard defines a contract modification as "a change in the scope or price (or both) of a contract that is approved by the parties to the contract" and "might exist even though the parties to the contract have a dispute about the scope or price (or both) of the modification or the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price."

Under the standard, a contract modification is accounted for as (1) a separate contract (if the modification is distinct and priced at the stand-alone selling price), (2) a termination of the old contract and creation of a new contract (if the modification is distinct but not priced at the stand-alone selling price), or (3) a cumulative catch-up adjustment (if the modification is not distinct).

Given the high volume and long duration of customer contracts for some entities that are frequently modified, stakeholders have expressed concerns that applying the guidance will be challenging — if not impracticable¹⁷ — regardless of the transition method an entity applies. Furthermore, some believe that the costs may exceed the benefits because of the limited usefulness in applying the contract modification guidance to periods before the date of initial application. Accordingly, some stakeholders have requested that the FASB and IASB add practical expedients to the standard's contract modification guidance to address the issue.

For additional information, see [TRG Agenda Paper 24](#).

Summary:

TRG members generally agreed that assessing contract modifications for transition under the new revenue standard would be onerous and perhaps impracticable. Some TRG members challenged whether it would be impracticable, noting that impracticability is a high threshold under existing guidance. TRG members were supportive of ways to simplify the treatment of contract modifications for transition, particularly for contracts that may have been modified numerous times over many years.

Editor's Note: In introductory remarks at the meeting, the FASB staff noted that the FASB is considering whether to include one or more practical expedients for the treatment of contract modifications in the new revenue standard's transition provisions.

¹⁶ ASC 606-10-65-1(d) and (f); paragraphs C3 and C5 of IFRS 15.

¹⁷ As used in ASC 250; IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Research Project Updates

Licenses of Intellectual Property

The staffs of the FASB and IASB gave the TRG an update of the boards' actions related to the accounting for licenses of intellectual property (IP) under the new revenue standard, which was discussed at the previous two TRG meetings. Specifically, the staffs outlined the status of the following issues:

- When the guidance on sales-based and usage-based royalties for licenses of IP in ASC 606-10-55-65 (paragraph B63 of IFRS 15) applies.
- When the guidance on determining the nature of a license of IP applies (e.g., limited to when licenses are distinct or in additional circumstances as well).
- How certain contractual restrictions affect the identification of the promised goods or services in a contract.
- Whether, for licenses to represent a right to access the entity's IP (i.e., the license is a performance obligation satisfied over time) the contractual or expected activities of the licensor have to (1) significantly change the form (i.e., the design) or functionality (e.g., the ability to process a transaction, perform a function, or be played or aired) of the underlying IP or (2) significantly change the form, functionality, or value of the underlying IP.

The staffs noted that they are in the process of developing alternatives for the boards to consider that would potentially improve the articulation of the scope and application of the constraint for sales-based and usage-based royalties for licenses of IP. The staffs also indicated that they have developed potential improvements to be presented to the boards that would clarify:¹⁸

- (a) That, in some cases an entity would need to determine the nature of a license that is not a separate performance obligation in order to appropriately apply the general guidance on whether a performance obligation is satisfied over time or at a point in time and/or to determine the appropriate measure of progress for a combined performance obligation that includes a license.
- (b) The contractual restrictions of a license (for example, a restriction that content can be aired once per year on a specified date) are attributes of the license and, therefore, do not affect the identification of the promised goods or services in the contract.

The staffs further indicated that they have developed two articulations of potential improvements for presentation to the boards that would update the guidance on whether a license represents a right to access the entity's IP. The staffs' "Articulation A" would focus on defined criteria for determining whether a contract requires, or the customer reasonably expects, the licensor to undertake activities that significantly affect the utility of the IP to the customer. The staffs' "Articulation B" would classify IP into two categories: (1) "symbolic" IP (e.g., brand or trade names, logos, franchise rights) and (2) "functional" IP (e.g., software, completed media content, drug formulas). Under Articulation B, a promise to provide "symbolic" IP would always be satisfied over time, while a promise to provide "functional" IP would be recognized at a point in time unless the activities or actions of the licensor changed the form or functionality of the IP and the customer has rights only to the most recent version of the IP. Under both articulations, the staffs' potential improvements would attempt to more clearly communicate the following:¹⁹

- (a) A license is satisfied over time when the licensor's promise to the customer in granting a license includes undertaking activities that significantly affect the *utility* of the IP to the customer. "Utility" was drafted so as to clearly encompass changes to form, functionality, *and/or* value.
- (b) "Significantly affects the utility of the IP to which the customer has rights" is a high threshold that would generally not encompass solely promotional or other support activities when the underlying IP has significant standalone functionality When IP has significant standalone functionality, a substantial portion of its utility is derived from that functionality, and is unaffected by an entity's activities that do not change that functionality.

The staffs have indicated their intention to present these issues for public consideration to the boards in February 2015 to discuss the feedback from the TRG as well as the staffs' research and outreach activities. The staffs emphasized that the potential improvements discussed above have not been reviewed or approved by the boards and reminded TRG members that revisions to the guidance in the new revenue standard would be subject to each board's due process, including an exposure document for public comment.

See [TRG Agenda Paper 21](#) for additional information.

¹⁸ Quoted from TRG Agenda Paper 21.

¹⁹ See footnote 18.

Identifying Performance Obligations

At its October 31, 2014, meeting, the TRG discussed implementation issues related to identifying performance obligations, specifically whether a good or service is distinct if it can be separately identifiable (also referred to as distinct in the context of the contract). As a result, the boards directed their staffs to perform additional outreach on implementation issues with various stakeholders. The outreach yielded two primary issues for consideration: (1) the identification of promised goods and services in a contract with a customer and (2) the determination of whether the goods and services are distinct in the context of the contract.

In response to the first issue, the TRG discussed the identification of promised goods and services in TRG Agenda Paper 12 (see [Topic 1](#) above). The staffs discussed the second issue in [TRG Agenda Paper 22](#) and are performing additional research. They are expected to discuss these issues at the FASB's and IASB's February 2015 meetings.

Topics For Future Consideration

The topics below and related agenda papers were direct submissions from TRG members and not prepared by the FASB and IASB staffs. The submissions and related discussions at the meeting were intended to provide the boards and the staffs with preliminary feedback and views. Accordingly, no definitive views were expressed. In addition, the staffs will perform research on the issues related to each topic and draft comprehensive staff papers for consideration at future TRG meetings.

Material Rights

Several TRG members indicated that they would generally view a customer's exercise of a material right as a continuation of the initial contract. However, they could also understand why others might view such an exercise as a contract modification or variable consideration, depending on the facts and circumstances. Similarly, TRG members noted that whether a significant financing component (associated with the material right) exists depends on the facts and circumstances (see the significant financing component discussion below). Lastly, TRG members briefly touched on the determination of a material right for nonrefundable up-front fees.²⁰ They stated that current practice varies by industry, and that views also differ under the new revenue standard. For additional information, see [TRG Agenda Paper 18](#).

Consideration Payable to a Customer

The TRG discussed whether the assessment should be performed on the individual contract (or combined contract) or extend more broadly to the customer relationship as a whole. TRG members also discussed whether the determination of a customer would include only those customers in the distribution chain or more generally to all of the customers of the entity's customers. In addition, the TRG briefly discussed situations in which consideration paid to a customer exceeds consideration received from a customer. The TRG also provided some views on whether the net contract loss would be presented as negative revenue or an expense. For additional information, see [TRG Agenda Paper 19](#).

Significant Financing Components

TRG members shared their views on how an entity would apply the factors listed in the new revenue standard that indicate when a significant financing component is, and is not, present in an arrangement. Although the discussion paper included examples, TRG members indicated that the examples would need to be further developed before they could properly conclude on the matter. TRG members acknowledged the complexity of the calculations that can arise when a significant financing component is present in an arrangement and observed that the standard does not specify a method under which periodic interest income or expense is to be calculated. For additional information, see [TRG Agenda Paper 20](#).

Next Steps

As intended, no conclusions were reached at the meeting. The boards and their staffs will consider the feedback from the meeting to determine whether to provide additional guidance or clarification and, if so, what it should be. In summarizing the meeting, the FASB and IASB vice-chairmen noted that in addition to considering potential practical expedients, the boards would consider the need for clarification of the guidance on identifying performance obligations (e.g., assessing items given "for free" as marketing activities or performance obligations), noncash consideration, collectibility, and consideration payable to a customer. Participants were also reminded that stakeholders should continue to submit implementation issues for discussion at future TRG meetings.

The TRG's next meeting is scheduled for March 30, 2015.

²⁰ This issue was also discussed at the last TRG meeting. See Deloitte's October 2014 [TRG Snapshot](#).

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