

AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT

FASB

SUBJECT

FASB ISSUES PROPOSED CLARIFICATIONS TO THE NEW REVENUE STANDARD FOR LICENSES AND IDENTIFYING PERFORMANCE OBLIGATIONS

SUMMARY

The FASB issued an exposure draft proposing amendments to the new revenue recognition standard that it issued jointly with the IASB in 2014. The proposed amendments would not change the core principles of the standard, but would clarify the accounting for licenses of intellectual property, as well as the identification of performance obligations in a contract. The proposal is open for comment through June 30, and is available [here](#).

DETAILS:

Background:

In May 2014, the FASB issued ASU 2014-09¹ ("the new revenue standard"), establishing a comprehensive revenue recognition standard for virtually all industries in U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries.

The FASB has recently issued a proposed ASU² which would clarify certain aspects of ASU 2014-09 but which would not alter the fundamental principles of the new revenue standard. The proposed amendments are the result of implementation issues identified by the joint FASB/IASB Transition Resource Group (TRG). After considering the issues, the FASB decided certain changes are needed to make the new revenue standard more operational. Comments are due by June 30, 2015.

The IASB is performing additional research and is expected to issue a similar (but not identical) proposal in the near future. The Boards do not expect significant divergence as a result of their respective amendments.



CONTACT:

ADAM BROWN
National Director of Accounting
214-665-0673 / abrown@bdo.com

KEN GEE
National Assurance Partner
415-490-3230 / kgee@bdo.com

CHRIS SMITH
Audit & Accounting Professional
Practice Leader
310-557-8549 / chsmith@bdo.com

¹ Revenue from Contracts with Customers (Topic 606) is substantially converged with IFRS 15, the IASB's companion standard.

² Proposed Accounting Standards Update, Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing

Main Provisions:

The proposed amendments provide more detailed guidance, including additional implementation guidance and examples in the following key areas: 1) identifying performance obligations, and 2) licenses of intellectual property.

Identifying Performance Obligations

In order to identify performance obligations, an entity must assess whether goods or services promised in the contract are distinct. The proposed amendments would more clearly articulate the guidance for assessing whether promises are separately identifiable, which is one of two criteria for determining whether the promises are distinct³. They would also modify the wording of the factors an entity should consider when assessing whether two or more promises are separately identifiable (paragraph 606-10-25-21), and provide additional examples within the implementation guidance for assessing these factors.

In addition, an entity would not be required to identify goods or services promised that are immaterial in the context of the contract, which some stakeholders believed was required based on language in the basis for conclusions in ASU 2014-09. Further, an entity would be permitted to account for shipping and handling activities occurring after the customer has obtained control of a good as a fulfillment activity rather than as an additional promised service. This would be an accounting policy election and related disclosures would be required. As such, if elected, those shipping and handling activities would not be identified as separate performance obligations, and no revenue would be allocated to them. Related costs would be presented as expenses.

Licenses of Intellectual Property

Topic 606 includes implementation guidance on determining whether an entity's promise to grant a license provides a customer with either a right to *access* the entity's intellectual property (IP) (which is satisfied over time) or a right to *use* the entity's intellectual property (which is satisfied at a point in time). To this end, the proposed amendments are intended to clarify whether a license of IP represents a right of use or a right of access by categorizing the underlying IP as either *functional* or *symbolic*.

Functional IP has significant standalone functionality because it can be used as is for performing a specific task, or be aired or played. A license to functional IP represents a right to use the IP as it exists at a point in time, and does not include supporting or maintaining the IP during the license period. A license to functional IP is generally satisfied at the point in time the customer is able to use and benefit from the license. Examples of functional IP include software, biological compounds or drug formulas, and completed media content.

Symbolic IP does not have significant standalone functionality. A license to symbolic IP represents a promise to both (a) grant the customer rights to use and benefit from the IP and make that underlying IP available for the customer's use and benefit and (b) support or maintain the IP during the license period (or over the remaining economic life of the IP, if shorter). This type of license is satisfied over time. Examples of symbolic IP include brands, team or trade names, logos, and franchise rights.

The implementation guidance would also be clarified to indicate that a promise to grant a license that is not a separate performance obligation must be considered in the context above (i.e., functional or symbolic), in order to determine whether the overall performance obligation is satisfied at a point in time or over time, and how to best measure progress toward completion if recognized over time.

Additionally, 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 IP. The proposed amendments would clarify two aspects of that guidance:

1. An entity would not split a sales-based or usage-based royalty into a portion subject to the guidance on sales-based and usage-based royalties and a portion that is not subject to that guidance. In other words, a royalty is either subject to the guidance on sales-based and usage-based royalties, or it is not.
2. The guidance on sales-based and usage-based royalties would apply to a sales-based or usage-based royalty whenever the predominant item to which the royalty relates is a license of IP.

³ The second criterion is that the customer can benefit from the good or service, either on its own or with other readily available resources.

The proposed amendments would further clarify that contractual restrictions on a customer's rights in a licensing arrangement do not affect the entity's identification of promised goods or services in the contract.

Effective Date and Transition:

The effective date and transition requirements for the proposed amendments would be the same as the effective date and transition requirements in ASU 2014-09. The Board has also recently proposed a delay to the effective date of ASU 2014-09. For more information, refer to [BDO's Flash Report](#) on the proposed delay.

On the Horizon:

The TRG continues to discuss a number of additional revenue recognition implementation issues. As a result, additional changes are likely to make the new revenue standard more operational. Therefore, stakeholders should monitor these developments during their implementation efforts.

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 58 offices and over 400 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,328 offices in 152 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit www.bdo.com.

Material discussed in this tax alert is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.