

Issues Paper

Revenue Recognition from Licences for the Right to Charge Users in the context of Service Concession Arrangements

Summary of Issue¹

- 1 In exchange for a service concession asset, a grantor may compensate the operator for the asset either by making payments to the operator or by other means such as granting the operator a licence for the 'right to charge users'. At its July 2012 meeting, the AASB considered the IPSAS 32 requirement for a grantor to recognise a liability representing the 'unearned portion of the revenue'² arising from the exchange of assets between the grantor (i.e. the licence for the 'right to charge users') and the operator (i.e. the service concession asset and related future services). (Appendix 1 of this paper outlines the relevant requirements of IPSAS 32.)
- 2 At the same time, the AASB noted that the requirements of IPSAS 32 was inconsistent with the proposals in the IASB/FASB Revenue project for an entity to recognise revenue from granting a licence at the point in time at which the customer obtains control of the licence³. Accordingly, the AASB directed staff to consider the implications and suitability of applying the application guidance on licences being developed in the IASB/FASB Revenue project to service concession arrangements. (Appendix 2 of this paper outlines the relevant requirements of IFRS 15 *Revenue from Contracts with Customers*).

Objective of this paper

- 3 This issues paper considers the suitability of applying, by analogy, IFRS 15's application guidance on licences to service concession arrangements that involve a grantor providing a licence for the 'right to charge users' in exchange for a service concession asset and related future services. This paper asks the Board to provide staff with direction as to whether the application, by analogy, of IFRS 15 should be pursued further.⁴

1 Refer to Issue 2 of Agenda paper 8.1 for a full background of the Issue.

2 IPSAS 32.AG47 rationalises the unearned portion of the revenue from the exchange as follows: "When the grantor compensates the operator for the service concession asset and service provision by granting the operator the right to earn revenue from third-party users of the service concession asset, the operator is granted the right to earn revenue over the period of the service concession arrangement. Likewise, the grantor earns the benefit associated with the asset received in the service concession arrangement in exchange for the right granted to the operator over the period of the arrangement. Accordingly, the revenue is not recognized immediately. Instead, a liability is recognized for any portion of the revenue that is not yet earned."

3 At that meeting the AASB noted that the IASB and the FASB's revised Exposure Draft ED/2011/6 *Revenue from Contracts with Customers* proposed that an entity granting a distinct licence to a customer would recognise revenue at the point in time when the licence is granted, as "those promised rights give rise to a performance obligation that the entity satisfies at the point in time when the customer obtains control of the rights" (see paragraph B34 of ED/2011/6).

4 Note that staff have not analysed other alternatives for determining revenue recognition from licences in the context of service concession arrangements at this stage. Staff will provide the Board with this analysis at a future Board meeting, subject to the Board's decisions at this meeting.

- 4 The analysis in this paper focuses on whether the licence for the ‘right to charge users’ is analogous to granting either:
- (a) a ‘right to access’ an entity’s intellectual property as it exists throughout the licence period (in which case the licence would transfer to the customer over time and, hence, revenue would be recognised over time); or
 - (b) a ‘right to use’ an entity’s intellectual property as it exists at the point in time the licence is granted (in which case, the licence would transfer at a point in time and, hence, revenue would be recognised at that time).
- 5 This issues paper does not consider whether a service concession arrangement would be within the scope of IFRS 15, which among other things would require concluding that the operator is a customer of the grantor.

IFRS 15 principles for recognising revenue – licensing guidance

- 6 The licensing application guidance in IFRS 15 is focussed on licences of intellectual property. The IASB acknowledged that there was significant diversity in practice for the accounting for licence agreements because previous revenue recognition requirements for licences required revenue to be recognised ‘in accordance with the substance of the agreement’, but minimal guidance was provided on how an entity should make that assessment [paragraph BC467 of IFRS 15]. Accordingly, IFRS 15 includes application guidance on how an entity should assess and account for its license arrangements. That guidance is anchored in applying key steps of the revenue recognition model—specifically, in identifying the performance obligations in a contract and assessing the transfer of control, which the IASB operationalised by differentiating between the two types of licences [paragraph BC468 of IFRS 15].
- 7 Paragraph B57 of IFRS 15 states the following:
- To determine whether an entity’s promise to grant a licence 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 shall consider whether a customer can direct the use of, and obtain substantially all of the remaining benefits from, a licence at the point in time at which the licence is granted. A customer cannot direct the use of, and obtain substantially all of the remaining benefits from, a licence at the point in time at which the licence is granted if the intellectual property to which the customer has rights changes throughout the licence period. The intellectual property will change (and thus affect the entity’s assessment of when the customer controls the licence) 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 licence provides the customer with a right to access the entity’s intellectual property (see paragraph B58). In contrast, a customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence at the point in time at which the licence is granted if the intellectual property to which the customer has rights will not change (see paragraph B61). In those cases, any activities undertaken by the entity merely change its own asset (ie the underlying intellectual property), which may affect the entity’s ability to provide future licences; however, those activities would not affect the determination of what the licence provides or what the customer controls.
- 8 Paragraph B58 of IFRS 15 states the following:
- The nature of an entity’s promise in granting a licence is a promise to provide a right to access the entity’s intellectual property if all of the following criteria are met:

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

9 Paragraph B59 further explains:

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.

10 Paragraph B60 states:

If the criteria in paragraph B58 are met, an entity shall account for the promise to grant a licence 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...

Staff analysis

- 11 Staff observe that the key determining factor as to whether a grantor's licence for the 'right to charge users' is analogous to a 'right to access' to an entity's intellectual property, and accordingly, for the grantor to recognise revenue over the term of the licence is paragraph B58 of IFRS 15.
- 12 In applying paragraph B58 of IFRS 15, staff also observe that judgement is required to analyse the following:
- (a) What are the activities that a grantor would be required by contract, or expected by the operator, to perform; and whether those activities would significantly affect the 'right to charge users' [this relates to the criterion in paragraph B58(a) of IFRS 15]. Analysis is required to identify the activities that a grantor may be bound to undertake that would significantly affect the 'right to charge users'; and
 - (b) Would those activities expose the operator to positive or negative effects [this relates to the criterion in paragraph B58(b) of IFRS 15]. The grantor's actions, as contracted or expected, may change the grantor's 'right to charge users' but IFRS 15 requires a further condition, and that is, the change in the 'right to charge users' must have an effect on the operator positively or negatively. Paragraph BC409 of IFRS 15 explains, "it was not enough that the entity undertook activities but that those activities affected the intellectual property to which the customer has rights, and thus, exposes the customer to positive or negative effects. When the activities do not affect the customer, the entity is merely changing its own asset, which, although it may affect the entity's ability to provide future licences, would not affect the determination of what the licence provides or what the customer controls". Accordingly, analysis is

required on how the effects of a grantor's activity would impact the operator's activities; and

- (c) Would those activities relate to a transfer of a good or service (a separate performance obligation) to the customer [this relates to the criterion in paragraph B58(c)]. The contractual service concession arrangement may outline a series of activities that a grantor is required to undertake, and consideration is required as to whether any of those activities represent a good or service that transfers to the customer as those activities occur. Activities that represent a separate promise are required to be separately accounted for in accordance with paragraphs 22-30. Activities that are not a separate promise are performance that the grantor undertakes to improve its underlying assets.

13 In addition, staff consider that the suitability of applying the licences application guidance by analogy to service concession arrangements depends on the following considerations:

- (a) whether the pattern of revenue recognition that would apply for the granting of a licence to the operator would reflect the economic substance of the arrangement, in particular the satisfaction of the grantor's obligations under the arrangements; and
- (b) whether the licences application guidance is capable of being clearly and consistently applied to various fact patterns that are common in service concession arrangements.

14 Staff have analysed how the licences application guidance might apply to five fact patterns common to many service concession arrangements that relate to toll roads, tunnels and bridges. In each fact pattern, the grantor transfers a licence for the 'right to charge users' to the operator in exchange for a service concession asset and related future public services. The five fact patterns represent the additional facts that might be present in a service concession arrangement. Fact pattern 1 is included for illustrative purposes. Fact patterns 2 to 5 are derived from the summary of key grantor activities that are typically included in contractual service concession arrangements (outlined in paragraph 16 of Agenda paper 8.2). This list of fact patterns is not exhaustive and is not intended to discuss all factors that may be relevant to the assessment of the grantor's licence for the 'right to charge users' nor specify the relative importance of the factors. Those fact patterns are:

- (a) Fact pattern 1—the grantor has no ongoing involvement and is not committed or expected to undertake any activities that might affect the operator's rights under the service concession arrangement;
- (b) Fact pattern 2—the grantor is liable for penalties or the operator has the right to renegotiate the terms and conditions of the service concession arrangement if the grantor's actions adversely affect the operator's rights under the service concession arrangement;
- (c) Fact pattern 3—the grantor is obliged to assist the operator in identifying non-paying vehicles and in the collections of toll fares;
- (d) Fact pattern 4—the grantor is entitled to a share of the toll revenue if actual toll revenue is higher than the forecasted revenue; and

- (e) Fact pattern 5—the grantor is obliged to undertake various activities that are specified in the service concession arrangement.
- 15 In each of the fact patterns, Board members should consider whether they think that the licences application guidance would result in the grantor recognising revenue on a basis that is consistent with the economic substance of that arrangement. The IPSASB conclusion on the substance of the arrangement was that “the grantor earns the benefit associated with the asset received in the service concession arrangement in exchange for the right granted to the operator over the period of the arrangement. Accordingly, revenue is not recognised immediately” [paragraph AG47 of IPSAS 32]. In contrast, the IFRS 15’s licences application guidance would likely require:
- (a) a grantor in some service concession arrangements initially recognising a contract liability when control of the service concession asset transfers to the grantor (which would be similar to the IPSAS 32 requirements). This is because the licences in some service concession arrangements could be analogised to licences for the ‘right to access’ the grantor’s underlying asset (which leads to revenue being recognised over time); and
 - (b) a grantor in some service concession arrangements recognising revenue upfront. This is because the licences in some service concession arrangements could be analogised to licences for the ‘right to use’ the grantor’s underlying asset (which leads to revenue being recognised at a point in time).
- 16 The following table details the fact patterns common to many service concession arrangements, the staff analysis on the application of IFRS 15’s licences guidance to the fact patterns, and staff preliminary views on whether the grantor’s licences for the ‘right to charge users’ could be analogised to licences for the ‘right to access’ or ‘right to use’ the entity’s intellectual property.

Fact pattern 1 – revenue recognition at a point in time
<p><u>Background</u></p> <p>The contractual service concession arrangement does not oblige the grantor to undertake any further activities as part of the arrangement. In addition, based on the grantor’s customary business practice, the operator has no expectation that the grantor would perform any further activities as part of the service concession arrangement.</p>
<p><u>Staff analysis</u></p> <p>The criterion in paragraph B58(a) is not met because the contract does not require, and the operator does not reasonably expect, that the grantor will undertake activities that significantly affect the ‘right to charge users’ to which the operator has rights.</p>
<p><u>Staff preliminary views</u></p> <p>Because the criteria in paragraph B58 are not met, the licence for the ‘right to charge users’ in this fact pattern should be analogised to a licence that provides the customer with a ‘right to use’ the entity’s intellectual property as it exists at the point in time when the licence is granted.</p> <p>Consequently, the grantor would recognise revenue <u>at the point in time</u> when the operator obtains control of the licence, which would represent a different outcome from that contemplated by IPSAS 32.</p>

Fact pattern 2 – revenue recognition at a point in time

Background

The service concession arrangement obliges the grantor to renegotiate the term of the licence, toll price, and its financial or operational contribution to the arrangement, or the grantor may be required to reimburse the operator, if the grantor undertakes activities that would negatively impact the operator's collection of toll revenue (for example, by implementing 'competing road projects' and interrupting traffic connections to the toll road).

The effects of the grantor's activities would cause material adverse effects on the operator's repayment of/on capital and debt relating to the project.

Staff analysis

The requirement for the grantor to renegotiate the licence for the 'right to charge users' (for example, the term of the licence and toll price) if the grantor undertakes activities that would adversely affect the operator's collection of toll revenue may not be considered to be an activity that significantly affects the grantor's 'right to charge users' could be regarded as a protective right that provides the operator with:

- assurance that the license for the 'right to charge users' is based on the conditions and parameters agreed in the service concession arrangement (ie the licence meets the promised specifications); and
- the right to seek redress for actions by the grantor that adversely affect the operator's license for the 'right to charge users'.

Accordingly, the renegotiation conditions in the service concession arrangement would not be expected to represent an activity that the grantor may be obliged to undertake. Support for this conclusion can be found in paragraph B62(b) of IFRS 15, which indicates that a right that "provides assurance to the customer that the licence transferred meets the specifications of the licence promised in the contract" should be disregarded as a factor when determining if a licence provides a 'right to access' or a 'right to use' the entity's intellectual property.

Staff preliminary views

Based on the staff analysis, it is unlikely that the criteria in paragraph B58 would be met. This would mean that the licence for the 'right to charge users' in this fact pattern should be analogised to a licence that provides the customer with a 'right to use' the entity's intellectual property as it exists at the point in time when the licence is granted.

Consequently, this type of fact pattern would lead us to conclude that the grantor would recognise revenue at the point in time when the operator obtains control of the licence, which would represent a different outcome from that contemplated by IPSAS 32.

Fact pattern 3 – revenue recognised at a point in time

Background

The contractual service concession arrangement obliges the grantor to assist the operator in identifying non-paying vehicles and in the collections of toll fares⁵. There is no requirement or expectation that the grantor will perform any further activities as part of the service concession arrangement.

Staff analysis

The grantor's activities of identifying and enforcing any infringements by the users of the toll

5 Most toll arrangements in Australia are electronic-based. Non-paying vehicles can occur when motorists are not registered users of the toll infrastructure.

infrastructure would seem to represent a separate service that the grantor provides to the operator. Assuming that those activities are services, they will not be considered in assessing the licence in accordance with the criteria in paragraph B58. Instead, the grantor would assess whether those promised services are distinct and should be accounted for as a separate performance obligation in accordance with paragraphs 22-30 of IFRS 15.

Because the grantor is not required or expected to undertake any other activities, the licence for the ‘right to charge users’ in this fact pattern would be analysed consistently with fact pattern #1.

Staff preliminary views

Consistent with the outcome of fact pattern 1, the licence for the ‘right to charge users’ would be analogised to a licence that provides the customer with a ‘right to use’ the entity’s intellectual property as it exists at the point in time when the licence is granted.

Assuming that the separate services are accounted for as a separate performance obligation, IFRS 15 would require the grantor to allocate the transaction price (i.e. the non-cash consideration in the form of the service concession asset and right to future services) to both the licence and to the enforcement services. It is expected that the amount of transaction price allocated to the enforcement services would be recognised as revenue when those services are provided.

Accounting for the licence revenue at a point in time and the separate service revenue over time would represent a different outcome from that contemplated by IPSAS 32.

Fact pattern 4 – revenue recognition at a point in time or over time

Background

The contractual service concession arrangement entitles the grantor to a share of the operator’s toll revenue if actual toll revenue is higher than the forecasted revenue.

Staff analysis

Staff consider that, if the threshold for revenue sharing is expected to be achievable, there may be an incentive for the grantor to undertake activities that significantly affect the ‘right to charge users’ to which the operator has rights. This fact pattern would seem to be addressed by the guidance in paragraph B59 of IFRS 15, which states that “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”. Based on that guidance, staff think that the criterion in paragraph B58(a) could be met.

For the licence to be analogised as a ‘right to access’, the remaining criteria in B58 would also need to be met. This fact pattern does not include information about the types of activities in which the grantor might be expected to undertake or whether those activities would directly expose the operator to any positive or negative effects.

Staff preliminary views

Based on this analysis, the presence of a revenue sharing mechanism in a service concession arrangement cannot, by itself, determine whether the licence can be analogised to a ‘right to use’ or a ‘right to access’. Other factors, such as the nature of activities that would be expected to be undertaken by the grantor, would also need to be assessed. Those types of factors are considered in fact pattern 5 below.

Fact pattern 5 – revenue recognition at a point in time or over time

Background

The service concession arrangement obliges the grantor to undertake the following activities:

- (a) consult with the operator on any improvements to the public transport services or future road projects that may include, for example, extending the operator's toll road or motorway, or implementing a new train route or train station;
- (b) fulfil the road projects identified as part of the State's master plan of the overall infrastructure network⁶;
- (c) coordinate with the operator in managing/facilitating daily traffic flows by identifying potential bottlenecks or addressing traffic issues between connecting arterial roads, freeways or other public road networks and the toll road, for example, in the event of accidents or approved lane closures for repairs on the toll infrastructure;
- (d) manage relationships and resolve disputes involving any public sector entity, the operator and the public during the course of the service concession arrangement, for example, dealing with a local council on the impact of construction or traffic on its precinct or suburbs; and
- (e) publish general information on the toll infrastructure on relevant government websites.

Staff analysis

Judgement will be required to determine whether any of these activities are separate goods or services that the grantor has promised to provide the operator. Although that determination will depend on a detailed assessment on the specific facts and circumstances relating to each activity, staff think that these activities will be undertaken by the grantor to manage or enhance its assets rather than to provide a separate good or service to the operator.

Judgement will also be required in determining whether any of these activities would 'significantly affect' the grantor's underlying assets [per criterion B58(a)] and whether the operator is directly exposed via its licence for the 'right to charge users' to any positive or negative effects of the grantor's activities [as per criterion B58(b)]. Activities relating to building connecting road networks and managing traffic flows on the road network would seem to be activities that could, at least in some circumstances, significantly affect the grantor's underlying assets and directly affect the operator's licence. Establishing whether other activities meet the criteria in B58 may be more difficult because it may also depend on other factors such as whether the outcome of consultation is binding on the grantor and whether any information published on the toll infrastructure is expected to lead to changes in usage of the road network. Making these determinations consistently in practice could be difficult.

Staff preliminary views

The conclusion will depend on the specific facts and circumstances, however staff think that some of these activities will meet the B58 criteria and, accordingly, the grantor would recognise revenue over the term of the licence. In those circumstances, the outcome may be comparable to the outcome under IPSAS 32.

Staff recommendation

- 17 Staff consider that there is more merit in the rationale of IFRS 15.B58 than IPSAS 32.AG47 for recognising grantor revenue. However, based on the staff analysis above, staff are concerned that the IFRS 15 requirements relating to licenses may not be appropriate for application, by analogy, to service concession

6 The Government's infrastructure master plan is typically shared with the operator early in the PPP process. The operator would project its traffic and financial models based on the grantor's planned road or other infrastructure projects. The operator determines whether to undertake the service concession project based on the projected revenue stream from the 'right to charge users' to which the operator would have rights if it is selected by the grantor.

arrangements due to the level of judgement, and therefore subjectivity, involved in determining whether common types of activities that a grantor may undertake in relation to a service concession arrangement would meet the criteria in paragraph B58 of IFRS 15. Because of the wide range of possible activities that a grantor might be expected to undertake in respect of its underlying assets and because of the judgement involved in determining whether those activities might directly affect the operator's licence, staff think that grantors may find it difficult to apply the criteria in paragraph B58 of IFRS 15 consistently to their service concession arrangements. Furthermore, staff think that some commentators might find it difficult to understand the difference revenue recognition patterns that might arise in accounting for different service concession arrangements, as the analysis of the five fact patterns above has shown.

- 18 As a consequence of these concerns, staff recommend that the Board does not pursue further the application of IFRS 15 by analogy to service concession arrangements. Instead, staff recommend that the Board considers developing specific principles suitable for grantor accounting to determine how revenue should be accounted for in a service concession arrangement.
- 19 In developing these principles, staff would intend to reach out to relevant stakeholders to help ensure the principles developed would be robust and would be capable of being applied consistently to differing facts and circumstances.
- 20 Note that if the Board agrees with the staff recommendation in paragraph 18 above, it is likely that significant additional staff time will be required to develop the principles.

Questions for the Board

1. Does the Board agree with the staff recommendation in paragraph 18 above to not pursue further the application of IFRS 15 by analogy to service concession arrangements?
2. If the Board agrees with Question 1, does the Board agree that staff develop project-specific principles to determine how revenue should be accounted for by the grantor in a service concession arrangement?
3. If the Board disagrees with Question 1, how would the Board wish staff to proceed for the purpose of drafting an Exposure Draft on the revenue recognition of licences for the 'right to charge users'? (For example, the Board may decide that components of IFRS 15's licence guidance should be used to develop specific guidance that is more suitable for service concession arrangements, or the Board may decide to apply the IPSAS 32 approach.)

Appendix 1

Extracts of IPSAS 32 as it relates to licences for the ‘right to charge users’

- 8 ...
- A service concession arrangement is a binding arrangement between a grantor and an operator in which:
- (a) the operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and
 - (b) the operator is compensated for its services over the period of the service concession arrangement.
- A service concession asset is an asset used to provide public services in a service concession arrangement...
- 9 The grantor shall recognise an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if:
- (a) the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
 - (b) the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.
- ...
- 14 Where the grantor obtains control of a service concession asset in accordance with paragraph 9... the grantor shall also recognise a liability. The grantor shall not recognise a liability when an existing asset of the grantor is reclassified as a service concession asset in accordance with paragraph 12, except in circumstances where additional consideration is provided by the operator, as noted in paragraph 15.
- ...
- 16 The nature of the liability recognised is based on the nature of the consideration exchanged between the grantor and the operator, determined by reference to the terms of the binding arrangement.
- 17 In exchange for the service concession asset, the grantor may compensate the operator for the service concession asset by any combination of:
- (a) making payments to the operator (the financial liability model);
 - (b) compensating the operator by other means (‘the grant of a right to the operator’ model) such as:
 - (i) granting the operator the right to earn revenue from third-party users of the service concession asset; or
 - (ii) granting the operator access to another revenue-generating asset for the operator’s use (e.g. a private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients or a private parking facility adjacent to a public facility).
- ...
- 24 When the grantor does not have an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, and grants the operator the right to earn revenue from third-party users or another revenue-generating asset, the grantor shall account for the liability as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.
- 25 The grantor shall recognise revenue and reduce the liability recognised in accordance with paragraph 24 according to the economic substance of the service concession arrangement.

- 26 Where the grantor compensates the operator for the service concession asset and the provision of services by granting the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset, the exchange is regarded as a transaction that generates revenue. As the right granted to the operator is effective for the period of the service concession arrangement, the grantor does not recognise revenue from the exchange immediately. Instead, a liability is recognised for any portion of the revenue that is not yet earned. The revenue is recognised according to the economic substance of the service concession arrangement, and the liability is reduced as revenue is recognised.

...

- AG47 When the grantor compensates the operator for the service concession asset and service provision by granting the operator the right to earn revenue from third-party users of the service concession asset, the operator is granted the right to earn revenue over the period of the service concession arrangement. Likewise, the grantor earns the benefit associated with the asset received in the service concession arrangement in exchange for the right granted to the operator over the period of the arrangement. Accordingly, the revenue is not recognized immediately...

Appendix 2

Extracts of the licences guidance of IFRS 15 as it relates to licences for the ‘right to charge users’

Licensing

- B52 A licence establishes a customer’s rights to the intellectual property of an entity. Licences of intellectual property may include, but are not limited to, any of the following:
- (a) software and technology;
 - (b) motion pictures, music and other forms of media and entertainment;
 - (c) franchises; and
 - (d) patents, trademarks and copyrights.
- B53 In addition to a promise to grant a licence 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 24). As with other types of contracts, when a contract with a customer includes a promise to grant a licence in addition to other promised goods or services, an entity applies paragraphs 22–30 to identify each of the performance obligations in the contract.
- B54 If the promise to grant a licence is not distinct from other promised goods or services in the contract in accordance with paragraphs 26–30, an entity shall account for the promise to grant a licence and those other promised goods or services together as a single performance obligation. Examples of licences that are not distinct from other goods or services promised in the contract include the following:
- (a) a licence that forms a component of a tangible good and that is integral to the functionality of the good; and
 - (b) a licence 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 licence, the customer to access content).
- B55 If the licence is not distinct, an entity shall apply paragraphs 31–38 to determine whether the performance obligation (which includes the promised licence) is a performance obligation that is satisfied over time or satisfied at a point in time.
- B56 If the promise to grant the licence is distinct from the other promised goods or services in the contract and, therefore, the promise to grant the licence is a separate performance obligation, an entity shall determine whether the licence transfers to a customer either at a point in time or over time. In making this determination, an entity shall consider whether the nature of the entity’s promise in granting the licence 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 licence period; or
 - (b) a right to use the entity’s intellectual property as it exists at the point in time at which the licence is granted.

Determining the nature of the entity’s promise

- B57 To determine whether an entity’s promise to grant a licence 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 shall consider whether a customer can direct the use of, and obtain substantially all of the remaining benefits from, a licence at the point in time at which the licence is granted. A customer cannot direct the use of, and obtain substantially all of the remaining benefits from, a licence at the point in time at which the licence is granted if the intellectual property to which the customer has rights changes throughout the licence period. The intellectual property will change (and thus affect the entity’s assessment of when the customer controls the licence) 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 licence provides the customer with a right to access the entity's intellectual property (see paragraph B58). In contrast, a customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence at the point in time at which the licence is granted if the intellectual property to which the customer has rights will not change (see paragraph B61). In those cases, any activities undertaken by the entity merely change its own asset (ie the underlying intellectual property), which may affect the entity's ability to provide future licences; however, those activities would not affect the determination of what the licence provides or what the customer controls.

- B58 The nature of an entity's promise in granting a licence is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:
- (a) the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights (see paragraph B59);
 - (b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities identified in paragraph B58(a); and
 - (c) those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 25).
- B59 Factors that may indicate that a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property include the entity's customary business practices, published policies or specific statements. Although not determinative, the existence of a shared economic interest (for example, a sales-based royalty) between the entity and the customer related to the intellectual property to which the customer has rights may also indicate that the customer could reasonably expect that the entity will undertake such activities.
- B60 If the criteria in paragraph B58 are met, an entity shall account for the promise to grant a licence 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 35(a)). An entity shall apply paragraphs 39–45 to select an appropriate method to measure its progress towards complete satisfaction of that performance obligation to provide access.
- B61 If the criteria in paragraph B58 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 licence 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 licence at the point in time at which the licence transfers. An entity shall 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 shall apply paragraph 38 to determine the point in time at which the licence transfers to the customer. However, revenue cannot be recognised for a licence 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 licence. For example, if a software licence 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 recognise revenue before that code has been provided (or otherwise made available).
- B62 An entity shall disregard the following factors when determining whether a licence provides a right to access the entity's intellectual property or a right to use the entity's intellectual property:
- (a) Restrictions of time, geographical region or use—those restrictions define the attributes of the promised licence, rather than define whether the entity satisfies its performance obligation at a point in time or over time.

- (b) Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorised 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 licence transferred meets the specifications of the licence promised in the contract.

Sales-based or usage-based royalties

B63 Notwithstanding the requirements in paragraphs 56–59, an entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

- (a) the subsequent sale or usage occurs; and
- (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).