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Staff Paper

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Project	**Revenue Recognition**
Topic	**Determining the transfer of goods and services**

Purpose and summary of staff recommendations

1. This paper seeks the Boards' views on the fundamental issue of how an entity should determine when goods or services are transferred to a customer and, hence, when an entity would recognize revenue.

2. The staff recommends the following:

   (a) The revenue standard should have separate requirements for goods and services for the purpose of determining when an entity should recognize revenue.

   (b) A service should be described as performing, or standing ready to perform, an agreed-upon task or series of tasks for the benefit of a customer. The performance of a task transfers a benefit to the customer and, hence, would meet the description of a service in each of the following circumstances:

      (i) The task would not need to be reperformed if the obligation were transferred to another entity,

      (ii) The customer owns the work-in-process, and

(iii) The performance of the task does not create an asset that is independent of the contract, and the customer cannot avoid paying for performance of that task.

(c) An entity should recognize revenue continuously for a service using one of the proposed methods (i.e. an output method, an input method, or a method based on the passage of time) only if the entity can reasonably measure its progress toward completion of the service.

(d) An entity should recognize revenue for a good when the customer obtains control of the good. The revenue standard should carry forward much of the proposed guidance on control and should:

(i) describe rather than define control,

(ii) add “risks and rewards of ownership” as an indicator of control, and

(iii) eliminate “the design or function of the good or service is customer-specific” as an indicator of control.

(e) If an entity promises to transfer both goods and services, the entity should first determine whether the goods and services are distinct (in accordance with the guidance on identifying separate performance obligations).

(i) If the goods and services are distinct, the entity would account for them as separate performance obligations.

(ii) If the goods and services are not distinct, the entity would account for the bundle of non-distinct goods and services as a service.

3. This paper is organized as follows:

(a) Affirmation of a transfer model (paragraphs 4–9)

(b) Feedback on the proposed control guidance (paragraphs 10–21)

(c) Identifying a service (paragraphs 22–35)

(d) Measuring performance for a service (paragraphs 36–48)

(e) Determining the transfer of a good (paragraphs 49–54)

(f) Determining the transfer of both goods and services (paragraphs 55–61)

(g) Appendix A Paragraphs 25–31 of the Exposure Draft

Affirmation of a transfer model

4. The core principle of the proposed revenue model is that an entity should recognize revenue to depict the transfer of goods and services to customers. Most respondents to the Exposure Draft agree with that core principle.

5. However, some respondents disagree with a transfer model because they think it would not faithfully depict an entity's performance in some construction-type and services contracts. To depict the entity's performance in those contracts, some respondents think revenue should be a measure of the entity's activities to fulfil a contract. One respondent noted:

> We are still not convinced that the transfer of control is the best basis for the recognition of the turnover of an entity as it does not reflect the way entities manage their activities. [Comment Letter No. 278]

6. Another respondent suggested an alternative core principle in which revenue would "be a measure of the establishment of an irrevocable right to consideration, subject to continued performance, that arises as the entity fulfils the contract with the customer." [Appendix 3 of Comment Letter No. 394] Several comment letters expressed support for that alternative model.

7. The staff thinks it is not necessary for the Boards to develop an alternative revenue model that focuses on the activities of an entity or on irrevocable rights to consideration. The concerns about a transfer model have arisen mainly from questions about how an entity would apply the control concept to a construction-type or services contract. The staff thinks those concerns would largely be addressed by the recommendations of this paper.

8. In addition, participants at the Boards' roundtables confirmed that their primary concern was with the articulation of control in the Exposure Draft, rather than with the core principle of recognizing revenue when goods or services are transferred. They think that a construction-type contract is a service because it results in a continuous transfer of benefits to a customer.

9. The remainder of this paper assumes that the core principle of the revenue standard is to recognize revenue that depicts the transfer of goods or services to customers.

Feedback on the proposed control guidance

10. The Boards proposed that a good or service is transferred when the customer obtains control of the good or service. To help an entity apply the control concept, the Boards also proposed a definition of control and accompanying indicators. The following sections summarize respondents' views on the proposed control guidance. The staff thinks those views were consistent for both public and private entities.

Overall views on the concept and definition of control

11. Control was the issue on which respondents mostly commented. Some respondents acknowledge the conceptual merit of using control as the basis for determining when a good or service is transferred. However, nearly all respondents think that the proposed guidance on control is insufficient and would lead to significant diversity in practice—especially for construction-type and services contracts.

12. Many responses were consistent with the following:

> In our view, the single biggest deficiency of the ED is the inadequate development of the control concept. If an effective standard is to result from the proposals, it is essential that this aspect be improved. In the ED, control is the main driver for revenue recognition, so it is very important (a) that the concept is properly developed so as to lead to

> appropriate accounting and (b) that it is explained in a way that is clear and meaningful to preparers and users of the standard, particularly preparers of financial statements. The ED attempts to deal with control by setting out a principle and listing four indicators. However, the intended meaning of the principle is not sufficiently clear and it is expressed in terms that preparers of financial statements may find very hard to translate into real situations. Further, the indicators are neither well developed nor well explained, and there is little or no guidance on the accounting that should be adopted when some, but not all, of the indicators are present. Whilst we do not advocate excessive guidance or prescriptive rules, which may add to complexity and difficulties in application in all cases - for such an important topic, more guidance will be required. Unless the standard is improved, it is likely to result in confusion and considerable diversity in practice. We note that it is particularly difficult to interpret the guidance in the context of contracts for services. [Comment Letter No. 614]

13. In addition, many respondents questioned the appropriateness of defining control in the context of revenue recognition because of the pervasive nature of the concept throughout financial reporting. Those respondents questioned the consistency between the proposed definition of control (of a good or a service) and the notions of control in other contexts (e.g. consolidation, derecognition, leases).

> The notion of control is pervasive in the IFRS body of accounting standards, with critical applications to financial statement consolidation (see IAS 27), definition of the reporting entity (see ED/2010/2) and revenue recognition. I therefore strongly urge the Boards to put the horse before the cart and to initiate a high-level conceptual debate on what control generally means in financial reporting, with a view to developing a substantive definition of control. This should be done in the context of the joint Conceptual Framework project. Using the definition as a frame of reference, the Boards can then more effectively consider how control should be consistently applied in the specific context of individual standards such as revenue recognition. [Comment Letter No. 11]

Overall views on the indicators of control

14. The following table summarizes some common responses to the proposed indicators of control:

Proposed indicator of control	**Common responses in the comment letters**
The customer has an unconditional	It is not clear how the indicator would be evaluated

obligation to pay.	when the customer has the right to terminate the contract or demand a refund because of non-performance by the seller. It is rare for the customer to have an obligation to pay that truly is unconditional (i.e. conditioned only on the passage of time).
The customer has legal title.	The indicator is too legalistic and can result in accounting that reflects form over substance. It is not clear how to evaluate the indicator in the light of lien rights or other protective rights. The indicator is not relevant to services contracts.
The customer has physical possession.	Applying this indicator could result in completed contract accounting for many construction and production-type contracts in which the entity performs continuously but the customer does not take physical possession until the end of the contract. The indicator is not relevant to services contracts.
The design or function of the good or service is customer-specific.	It is not clear how the indicator relates to the objective of determining transfer because the customer might clearly own an asset even though it is not a customer-specific design or function. Conversely, a customer might not own an asset with a customer-specific design or function. It is unclear how customized the asset must be in order to qualify for continuous transfer.

15. Respondents generally were concerned about the proposed elimination of “risks and rewards of ownership” as a consideration when determining when a good or service is transferred. Many respondents think that adding “risks and rewards of ownership” as an indicator of control would minimize the risk of an entity recognizing revenue on the basis of a contract’s form rather than its economic substance. To support that additional indicator, some respondents referred to the

IASB's project on consolidated financial statements and the Board's view in that project that exposure to risks and rewards is an indicator of control (of an entity) and an important factor to consider when assessing control.

16. Respondents to the Exposure Draft also suggested additional control indicators such as customer acceptance of the good or service, and the entity's lack of continuing involvement (e.g. a call option on a delivered good). The Exposure Draft included implementation guidance to help an entity apply the model in those circumstances.

Control and services

17. Respondents overwhelmingly think the proposed control guidance is insufficient for services and construction-type contracts. Many responses were consistent with the following:

> We are very concerned that the principles addressing "control", as currently drafted, will not assist in assessing when control has passed for services arrangements, in particular construction and bespoke service contracts. The difficulties arise because the indicators of control appear to have been developed with sales of goods in mind and are less easy to apply to services. [Comment Letter No. 953]

18. Comment letters cited the following reasons for the proposed control guidance being insufficient for construction-type and services contracts.

    (a) The concept is too theoretical for services (i.e. the idea of a customer controlling an asset that is simultaneously created and consumed),

    (b) The definition of control is difficult to apply (e.g. how can a customer "direct the use of and receive the benefit from" a partially-completed asset that the seller is in the process of creating?), and

    (c) The indicators are irrelevant or unclear—half of the control indicators (physical possession and legal title) are not relevant to services. Respondents found the remaining indicators (unconditional payment and customer-specific design or function) to be unclear.

19. To address those concerns about the proposed control guidance, many respondents requested that the Boards specify indicators of a continuous-transfer contract. One comment letter noted:

> …we suggest adding the following factors to the boards' indicators of transfer of control to help entities determine when control is transferred continuously to a customer in such arrangements:
>
> • The customer immediately obtains the benefit of the entity's activities and no other customer can benefit from the entity's activities
>
> • Each task performed by the vendor progresses toward completion of the performance obligation (i.e., there is no need to re-perform work already performed, even if vendors change) rather than where successive tasks may not necessarily build towards a successful outcome (and a new vendor would need to re-perform the services) [Comment Letter No. 190]

20. Many respondents from the construction industry suggested indicators similar to the following:

> 1. The project owner has the right to require specific performance from the entity under the contract.
> 2. Under the contractual arrangement, the entity has no ownership claim to the work completed to date, but may have lien rights or other similar protective rights.
> 3. The project owner supports his ownership investment by agreeing to a payment structure that relates to the progress of the work.
> 4. The project owner or the project owner's agent(s) participate in the periodic evaluation of the work completed to date.
> 5. The project owner has a right to take over the work completed to date at their option, even though such a right may include a penalty to be paid by the project owner to the benefit of the entity.
> [Comment Letter No. 260]

21. Respondents from the transportation industry also questioned how to apply the proposed guidance to the provision of transportation services:

> NS recognizes transportation revenue proportionally as a shipment moves from origin to destination and related expenses are recognized as incurred. This methodology recognizes revenue within a given reporting period as the service performance obligations are fulfilled. NS believes this methodology is equivalent to the "continuous transfer of goods or services." The customer retains legal title to the goods being shipped (while not having physical possession) and receives benefit as the shipment moves from origin to destination. The customer can modify the service (they have control of the

> transportation service asset) by, for example, altering the final destination. However, the ASU could be interpreted otherwise leading to varying revenue recognition policies by transportation service providers. [Comment Letter No. 625]

Identifying a service

22. For the reasons in paragraph 18, the staff agrees with respondents that the concept of control is difficult to apply to services. The staff sees two alternatives for clarifying how an entity would identify a service.

    (a) Further develop the concept of control for services, or

    (b) Develop separate recognition requirements for services.

Alternative 1: Further develop the concept of control for services

23. The Boards could further develop the concept of control using some of the concepts from the December 2008 Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers*. The Discussion Paper explained that a service is an asset when received but often is not recognized as an asset because it is consumed immediately. Therefore, a customer can obtain control of a service, but only momentarily.

24. Respondents to the Discussion Paper thought it was awkward to describe the performance of a service in terms of transfer of control of an asset. For that reason, they asked the Boards to further develop the control concept and make it easier to apply. The Exposure Draft reflects the further development from the Discussion Paper. Some respondents to the Exposure Draft acknowledge the progress the Boards have made since the Discussion Paper but they still have concerns about how to apply the concept of control to a service.

25. The staff thinks it would be difficult to further develop the control concept in a way that could be applied intuitively and consistently in the context of services. Moreover, the staff thinks that further development of the control concept, if

undertaken, should be performed in a context broader than revenue recognition for a service.

Alternative 2: Develop separate recognition requirements for services

26. The staff thinks it would be more beneficial to develop separate recognition requirements for services. The revenue standard still would have one core principle of recognizing revenue to depict the transfer of goods and services. Control still would be the basis for that core principle. But the standard simply would be articulated in a way that is easier for entities to understand and apply. Many comment letters expressed support for developing separate requirements for services. For example:

> We consider that the thinking in the proposed standard defaults too readily to guidance that will be appropriate for goods but not services. Treasury recommends that the boards provide separate guidance on services… [Comment Letter No. 130]

27. If the Boards decide to develop separate recognition requirements for services, it would be necessary to differentiate services from goods. In many cases, the staff thinks it would be relatively straightforward and intuitive to distinguish a service from a good. Nevertheless, the revenue standard would need to include a description of a service.

28. A service could be described as an entity performing, or standing ready to perform, an agreed-upon task or series of tasks for the benefit of a customer. Hence, the distinguishing feature of a service is that an entity's act of performance transfers a benefit to a customer at the time the act is performed.

29. The staff thinks there are three ways an entity would determine if the performance of a task transfers a benefit to the customer and, hence, would meet the description of a service:

    (a) The task would not need to be reperformed if the obligation were transferred to another entity,

    (b) The customer owns the work-in-process, or

(c) The performance of the task does not create an asset that is independent of the contract and the customer cannot avoid paying for performance of that task.

The task would not need to be reperformed if the obligation were transferred to another entity

30. One way for an entity to determine whether the performance of a task transfers a benefit is to consider whether, if the obligation is transferred to another entity, the other entity would need to re-perform the task in order to fulfil the obligation. If not, then the entity's performance of the task would have transferred a benefit to the customer.

31. For example, consider a shipping company that has an obligation to transport a customer's asset by rail from California to New York. If the company transports the asset halfway to its destination, and then chooses to transfer the remaining obligation to another shipping company, that other shipping company would not need to reperform the shipping service provided to date.

The customer owns the work-in-process

32. A second way to determine whether the performance of a task transfers a benefit is to evaluate whether the customer controls the work-in-process (for contracts that have work-in-process). If so, then each act of performance by the entity would transfer a benefit to the customer by enhancing the customer's work-in-process. For example, most construction contracts would be identified as giving rise to a continuous transfer because the customer owns the work-in-process as it is built.

33. The Exposure Draft included implementation guidance to clarify that goods or services would be transferred continuously if the customer owns the work-in-process. Many respondents support that concept.

> We find the explanation in paragraph B64 of the application guidance helpful as it highlights the key in assessing which party controls the asset as it is constructed (i.e. who owns the work-in-progress). [Comment Letter No. 345]

The performance of the task does not create an asset that is independent of the contract and the customer cannot avoid paying for performance of that task

34. A third way to determine whether the performance of a task transfers a benefit is to consider whether the performance of the task creates an asset that is independent of the contract and whether the customer can avoid paying for performance of that task. If performance of the task does not create an asset that could be transferred to another customer and the customer is obliged to pay for performance of that task, then the customer would have received the benefit from performance of the task. For example, a consulting contract would be identified as continuous transfer if the consulting services do not create an asset that could be transferred to another client and the client is obliged to pay for the work completed to date.

35. The staff thinks that using the three criteria above would help an entity to determine appropriately that performance of a task transfers a benefit to a customer and, hence, would meet the description of a service. If the performance of a task does not transfer a benefit to the customer, then the entity effectively has promised to transfer a good (whether tangible or intangible) that is transferred at a point in time. Hence, the entity would apply the revenue recognition requirements for goods.

Question for the Boards

Question 1
Do the Boards agree with the staff's recommendation that the revenue standard should have separate recognition requirements for services? If so, do the Boards agree with the description of a service in paragraphs 28–34?

Measuring performance for a service

36. Once an entity has identified a promised service using the description of a service in paragraphs 28–34, the entity would recognize revenue by selecting a method of measuring performance of the service.

The proposed methods of measuring performance

37. The Exposure Draft proposed that an entity should select one of the following methods to best depict the continuous transfer to the customer, and apply that method consistently:

    (a) An output method,

    (b) An input method, or

    (c) A method based on the passage of time.

38. Respondents generally agreed with the Boards that an entity should select one of proposed methods in order to depict the transfer of goods or services to the customer. However, many respondents thought that the Exposure Draft was not sufficiently clear on which method an entity should select.

39. Some respondents thought the Exposure Draft was too strongly biased toward output methods.

> Why the rhetoric about the various suitable methods? Allow entities to select a method that will depict a continuous transfer of goods or services to the customer and then consistently apply that method to all performance obligations. Allowable methods should be stated in the exposure draft without the Board attempting to tell the entity which method would result in the most faithful depiction of the transfer of goods or services. How would the Board know which method is the most faithful depiction for a particular entity or industry? [Comment Letter No. 26]

40. To address those concerns about output versus input methods, some respondents recommended that the revenue standard carry forward existing requirements for construction contracts on measuring performance. For example, one respondent said:

> We do not feel that the Boards' intention is clear in the Proposed Standard and request that the Boards clarify through revised language that both input and output measures can be acceptable, depending on the circumstances. ASC 605-35-25 does a good job of communicating neutrality through the following language:
>
> Paragraph 71: "Both input and output measures have drawbacks in some circumstances...The use of either type of measure requires the exercise of judgment and the careful tailoring of the measure to the circumstances."
>
> Paragraph 81: "All three of these measures of progress [terms of cost, unit of work, or values added] are acceptable in appropriate circumstances." [Comment Letter No. 413]

41. The staff agrees that the revenue standard could be clearer on which method an entity should select to measure performance of a service. The Boards could provide that additional clarity by including some of the language from existing requirements.

An entity's ability to reasonably measure performance

42. Some respondents have questioned whether an entity should recognize revenue continuously for a service if the entity cannot reasonably measure its progress toward completion of the service.

43. Existing requirements for construction-type contracts state that an entity must have the ability to reasonably estimate the revenue, the costs, and the stage of completion in order to recognize revenue continuously (IAS 11 paragraph 23 and ASC 605-35-25-56).

44. Similarly, existing requirements for services in IAS 18 state:

> When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the balance sheet date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:
>
> (a) the amount of revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the entity;

(c) the stage of completion of the transaction at the balance sheet date can be measured reliably; and

(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

45. The staff thinks that the revenue standard similarly should require an entity to be able to reasonably measure its progress toward completion of a service in order to recognize revenue continuously.

46. An entity would be required to use judgment when determining whether it can reasonably measure its performance. In making that determination, the entity must consider whether it has access to the information that would be required to apply an output method, an input method, or a method based on the passage of time.

47. Consider the following examples:

(a) A real estate agent promises to provide an unknown amount of property-search services to a client for an uncertain period of time. Because of the significant uncertainty about the amount and timing of the services, the agent would not be able to reasonably measure the progress toward completion of the contract. Hence, the entity would not recognize revenue continuously.

(b) An attorney enters into a retainer agreement in which the attorney promises to stand ready to provide legal services for a period of one year up to a specified number of hours. The pattern and amount of services is uncertain. However, the time period in which the services are provided is fixed. Hence, the attorney might select a method based on the passage of time resulting in continuous revenue recognition.

(c) A shipping company agrees to transport a customer’s asset from Norwalk to London. The company can reasonably measure both the time and distance required to transport the asset. Hence, the company would select a method of measuring performance (e.g. on the basis of time elapsed or distance traveled relative to total time or total distance).

48. In some cases, an entity might be reasonably assured that a loss will not be incurred for a fixed-price contract. However, the entity might not be able to reasonably measure the amount of profit, if any, for the contract. That is, the entity can reasonably estimate the maximum amount of costs expected to be incurred. In those circumstances, the staff thinks that it would be appropriate for an entity to recognize revenue continuously, but without recognizing a profit margin. That method is consistent with existing requirements (IAS 11, IAS 18, and ASC 605-35).

Question for the Boards

Question 2
Do the Boards agree that an entity should recognize revenue continuously for a service only if the entity can reasonably measure its progress toward completion of the service?

Determining the transfer of a good

49. The staff thinks the revenue requirements for determining the transfer of goods should continue to use the term "control" to describe when an entity would recognize revenue. Respondents' concerns about control related primarily to control in the context of services. Hence, the Boards could carry forward much of the proposed guidance from the Exposure Draft when describing control. Appendix A includes the proposed requirements from the Exposure Draft on satisfaction of performance obligations.

50. The staff thinks that control is the appropriate basis for determining transfer of a good for the following reasons:

(a) Control is the concept used in the Boards' respective Conceptual Frameworks' definitions of an asset, and

(b) Control is more intuitive in the context of a tangible asset, than it is in the context of a service.

51. Some respondents are concerned about using control for goods because of uncertainty about how the proposed definition of control relates to notions of control in other projects (e.g. Leases, Derecognition, and Consolidations). The staff thinks that those concerns can be adequately addressed only by further developing the control notion in the Conceptual Framework project. Hence, the staff thinks the revenue standard should describe control but should not define control.

52. Paragraph 27 of the Exposure Draft describes control in a way that some respondents found useful when applying the indicators of control was inconclusive. For example, one respondent noted:

> …we recommend that the standard could add language to clarify that in a situation with mixed indicators, the overriding principle falls back to the control definition in paragraphs 26 and 27 ie whether the customer can obtain cash flows from an asset directly or indirectly in ways such as by using, consuming, selling, exchanging, pledging or holding the asset. [Comment Letter No. 345]

Indicators of control

53. As discussed in paragraph 15, respondents also are concerned about the proposed elimination of the "risks and rewards of ownership" as a consideration when determining the transfer of a good. The staff thinks that exposure to risks and rewards is a consequence of controlling an asset. Hence, the Boards should consider adding that indicator of control.

54. In addition, the staff thinks the Boards should eliminate the indicator "the design or function of the good or service is customer-specific" (paragraph 30(d) of the Exposure Draft). That indicator was intended mainly for services and would not be necessary if the Boards develop separate requirements for services.

Question for the Boards

Question 3
The staff recommends: (a) using the term "control" for determining the transfer of a good, (b) describing rather than defining control of a good in the revenue standard, (c) adding "risks and rewards of ownership" as an indicator of control, and (d) eliminating "the design or function of the good or service is customer-specific" as an indicator of control of a good. Do the Boards agree?

The transfer of both goods and services

55. If the revenue standard has two sets of recognition requirements, it would be necessary to clarify which set of requirements an entity should apply to a contract that includes both goods and services. For those contracts, the staff thinks an entity first should apply the guidance for identifying separate performance obligations to determine whether the goods and services are distinct.

56. If the goods and services are distinct, then an entity would separate them and account for them accordingly.

57. If the goods and services are not distinct, then the staff sees the following alternatives for accounting for the bundle of non-distinct goods and services:

    (a) Alternative 1: Account for the bundle as a good or a service depending on the facts and circumstances, or

    (b) Alternative 2: Account for the bundle as a service in all circumstances.

58. The two alternatives would result in the same accounting if an entity applying Alternative 1 concludes that the bundle (of non-distinct goods and services) is a service. The staff thinks that most contracts for non-distinct goods and services would be construction-type or services contracts with a transfer of benefits over

time. Hence, in most cases there would not be a difference between the two alternatives.

59. However, in some cases it is less clear whether the bundle of non-distinct goods and services should be accounted for as a service. For example, consider a manufacturer that promises to deliver and install highly specialized equipment. Applying the guidance on identifying separate performance obligations, the manufacturer concludes that the equipment and installation are not distinct. For those types of contracts, the staff thinks the customer likely would not obtain control of the equipment until successful installation. Moreover, the installation likely would not meet the description of a service. Hence, revenue would not be recognized continuously.

60. If the customer does obtain control of the equipment prior to successful installation, then applying the guidance on measuring performance of a service would result in a faithful depiction of the transfer of goods and services to the customer. For example, the manufacturer could select a cost-based input method in which revenue would be recognized for delivering the equipment (but the entity would recognize a contract-wide profit margin rather than estimating a profit margin for something that is not distinct).

61. For the reasons above, the staff recommends accounting for a bundle of non-distinct goods and services as a service in all circumstances. In addition, the staff thinks this recommendation will help when the Boards consider the accounting for rights to use intangible assets (e.g. licenses) with related services.

Question for the Boards

Question 4
The staff recommends that if an entity promises to transfer both goods and services, the entity should first determine whether the goods and services are distinct (in accordance with the guidance on identifying separate performance obligations). (i) If the goods and services are distinct, the entity would account for them as separate performance obligations. (ii) If the goods and services are not distinct, the entity would account for the bundle of non-distinct goods and services as a service. Do the Boards agree?

Appendix A Paragraphs 25–31 of the Exposure Draft

25. **An entity shall recognize revenue when it satisfies a performance obligation identified in accordance with paragraphs 20–24 by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service.**

26. A customer obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service. Control includes the ability to prevent other entities from directing the use of, and receiving the benefit from, a good or service.

27. The customer's ability to direct the use of a good or service (that is, an asset) refers to the present right to use the asset for its remaining economic life or to consume the asset in the customer's activities. The customer's ability to receive the benefit from an asset refers to its present right to obtain substantially all of the potential cash flows from that asset (either an increase in cash inflows or a decrease in cash outflows). The customer can obtain cash flows from an asset directly or indirectly in many ways such as by using, consuming, selling, exchanging, pledging, or holding the asset.

28. If an entity retains some rights to an asset solely as protection against the customer's failure to comply with the terms of the contract (for example, when an entity retains legal title as protection against the customer's failure to pay), those rights are protective rights and do not preclude a customer from obtaining control of an asset.

29. When assessing whether a customer obtains control of an asset, an entity shall consider any related arrangements entered into at or near the same time as, or in contemplation of, the contract (for example, repurchase agreements).

30. An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:

    (a) the customer has an unconditional obligation to pay—if a customer is unconditionally obliged to pay for a good or service, typically that is because the customer has obtained control of the good or service in exchange. An obligation to pay is unconditional when nothing other than the passage of time is required before the payment is due.

    (b) the customer has legal title—legal title often indicates which party has the ability to direct the use of, and receive the benefit from, a good. Benefits of legal title include the ability to sell a good, exchange it for another asset, or use it to secure or settle debt. Hence, the transfer of legal title often coincides with the transfer of control. However, in some cases, possession of legal title is a protective right and may not coincide with the transfer of control to a customer.

(c) the customer has physical possession—in many cases, the customer's physical possession of a good gives the customer the ability to direct the use of that good. In some cases, however, physical possession does not coincide with control of a good. For example, in some consignment and in some sale and repurchase arrangements, an entity may have transferred physical possession but retained control of a good. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of a good that the customer controls.

(d) the design or function of the good or service is customer-specific—a good or service with a customer-specific design or function might be of little value to an entity because the good or service lacks an alternative use. For instance, if an entity cannot sell a customer-specific asset to another customer, it is likely that the entity would require the customer to obtain control of the asset (and pay for any work completed to date) as it is created. A customer's ability to specify only minor changes to the design or function of a good or service or to choose from a range of standardized options specified by the entity typically would not indicate a customer-specific good or service. However, a customer's ability to specify major changes to the design or function of the good or service would indicate that a customer obtains control of the asset as it is created.

31. Not one of the preceding indicators determines by itself whether the customer has obtained control of the good or service. Moreover, some indicators may not be relevant to a particular contract (for example, physical possession and legal title would not be relevant to services).