

STAFF PAPER

FASB | IASB Meeting

Project	Revenue recognition		
Paper topic	Identifying separate performance obligations		
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Purpose of the paper

1. This paper considers improvements and clarifications to the proposed requirements for identifying separate performance obligations included in the revised exposure draft *Revenue from Contracts with Customers* (2011 ED).

Staff recommendations

2. The staff recommend that the Boards should clarify and refine some of the concepts included in the 2011 ED as outlined in Appendix A. Specifically, the staff recommend the following:
 - (a) clarify the underlying principle of identifying separate performance obligations;
 - (b) *Retain and improve the distinct concept:* Clarify and refine the Boards' intent in paragraphs 28 and 29 of the 2011 ED by indicating that an entity should account for a promised good or service as a separate performance obligation if it would depict the substance of the contract with the customer and achieves two criteria:

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- (i) Capable of being distinct (principle that was included in paragraph 28(b)), and
 - (ii) Distinct in the context of the contract (Boards' intent of paragraph 29)
- (c) *Clarify the Boards' intent of paragraph 29 and improve application through the addition of indicators:* Improve the application of the 'distinct in the context of the contract' criteria by including indicators to assist in determining when an entity would assess that a performance obligation would be distinct in the context of the contract.
- (d) *Pattern of transfer – do not explicitly specify a practical expedient for concurrently delivered goods or services:* Remove the explicit practical expedient for concurrently delivered goods or services.
- (e) *Incorporate pattern of transfer as an indicator for consecutively delivered goods or services:* Include goods or services that are not consecutively delivered as an indicator of 'distinct in the context of the contract'.

Structure of the paper

3. This paper is organized into the following sections:
- (a) Background of the proposals to identifying separate performance obligations (see paragraphs 4-6 and Appendix B);
 - (b) Overview of the feedback on the exposure draft (see paragraphs 7-8);
 - (c) Clarifying the criteria for distinct goods or services (see paragraphs 9-31);
 - (d) Clarifying when goods or services have the same pattern of transfer (see paragraphs 32-53); and
 - (e) Putting it all together (see paragraph 54 and Appendix A).
 - (f) Appendices

- (i) Appendix A – Preliminary draft guidance of staff recommendation
- (ii) Appendix B – Reconciliation of 2011 ED to proposed changes

Background of the proposals to identifying separate performance obligations

4. The identification of the separate performance obligations in a contract with a customer is central to the operation of the revenue model because the performance obligation is the unit of account for the allocation of the transaction price and the recognition of revenue.
5. The notion of a performance obligation was introduced in the December 2008 discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers*. The June 2010 ED *Revenue from Contracts with Customers* introduced the notions of a separate performance obligation and a distinct good or service (which underlies a separate performance obligation) and those notions were refined further in the revised 2011 ED. The relationship between each of those notions can be described as follows:
 - (a) A performance obligation is a promise in a contract with a customer to transfer a good or service to the customer.
 - (b) A separate performance obligation is a promise in a contract with a customer to transfer a good or service that is distinct. Paragraphs 28 and 29 of the 2011 ED propose requirements for determining when a good or service is distinct.
 - (c) An entity may choose to account for two or more distinct goods or services promised in a contract as a single performance obligation if those goods or services have the same pattern of transfer to the customer.
6. The proposals in the 2011 ED regarding identifying separate performance obligations are included for reference in Appendix A to this memo.

Overview of the feedback on the exposure draft

7. Despite not asking a question in the 2011 ED about the proposals for identifying separate performance obligations, many respondents acknowledged the improvements made to the criteria for identifying separate performance obligations.

In general, we are pleased with the guidance provided in the Update (Revised) relating to the identification of separate performance obligations. At the time we submitted our Original Response, we felt very strongly that the 2010 Update was too prescriptive and, if not modified, would lead to accounting that would not reflect the underlying economics of many of the engineering, procurement, and construction contracts we perform. (CL#47 Engineering and Construction Companies)

8. However, many respondents requested further clarification and/or additional guidance or illustrative examples to assist them in applying the separation criteria to their contracts. In particular, many of those respondents (especially those from industries other than the construction industry) requested that the Boards:
- (a) Clarify the interaction between paragraph 28 and 29 and, in particular, clarify the factors identified in paragraph 29 that would result in a good or service not being distinct because of how the contract bundles that good or service with other promised goods or services in the contract.
 - (b) Clarify the application of the proposal in paragraph 30 to account for the promise to transfer two or more distinct goods or services to a customer as a single performance obligation if those goods or services have the same pattern of transfer to the customer (particularly for repetitive service contracts, utility contracts and other contracts for the supply of commodities and similar goods or services).

Clarifying the criteria for distinct goods or services

9. Paragraphs 28 and 29 of the 2011 ED specify a two-step approach for determining whether a promised good or service is distinct. Those paragraphs state:

28 Except as specified in paragraph 29, a good or service is distinct if either of the following criteria is met:

- (a) the entity regularly sells the good or service separately; or
- (b) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer. Readily available resources are goods or services that are sold separately (by the entity or by another entity) or resources that the customer has already obtained (from the entity or from other transactions or events).

29 Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both of the following criteria are met:

- (a) the goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted; and
- (b) the bundle of goods or services is significantly modified or customised to fulfil the contract.

Summary of feedback

10. Although a majority of respondents supported the principle of identifying separate obligations on the basis of distinct goods or services, many respondents raised concerns about the terminology and drafting of paragraphs 28 and 29, including requests for clarification on the meaning of terms such as *highly interrelated* (paragraph 29(a)), *significant service of integrating* (29(a)), and *significantly modified or customised* (29(b)). Furthermore, a minority suggested that the paragraphs appear to be too rules based and focus too much on the customer's perspective. As a result, some respondents suggested that a better approach for determining when performance obligations should be separated or combined may be to provide a clear underlying principle and include a list of factors or indicators to consider.

Paragraph 28 criteria

11. Feedback from respondents on the paragraph 28 criteria generally focused on concerns about the paragraph 28(a) criterion that would assess distinct on the

basis of whether, *‘the entity regularly sells the good or service separately’*. In particular, concerns included the following:

- (a) whether an entity would be required to exhaustively determine if a large entity with many operations in different parts of the world *regularly* sells a good or service separately.
 - (b) as a broader concern, whether the revenue model was internally inconsistent because some part of the 2011 ED adopted an entity perspective (eg the paragraph 28(a) criterion) whereas other parts of the 2011 ED adopted a customer perspective (eg the paragraph 28(b) criterion and the principles for satisfaction of performance obligations).
12. Feedback on paragraph 28(b) suggested that this criterion was generally understood and viewed to achieve the Boards’ objective of identifying when a good or service could be distinct. However, some expressed concern whether an entity would be required to exhaustively determine if the entity’s customer has access to readily available resources that would enable it to benefit separately from the promised good or service.
13. Furthermore, most respondents did not understand the interaction between the two criteria in paragraph 28. The staff note that the Boards intended paragraph 28(b) to be the principle for determining whether a good or service is distinct and paragraph 28(a) was intended to be a more practical means of applying the principle in many cases (refer to the discussion in paragraph BC74). Feedback indicates that this was not apparent to most readers of the 2011 ED.

Paragraph 29 criteria

14. Most respondents supported the concept in paragraph 29 that some or all of the promised goods or services in some contracts should be bundled together and accounted for as a single performance obligation. However, many respondents expressed concern that the paragraph 29 criteria are difficult to apply because they considered phrases such as ‘highly interrelated’, ‘significant service of integrating’ and ‘significantly modified or customised’ would require subjective assessments and could lead to varied interpretations (as mentioned in paragraph

- 10). In addition, some respondents mentioned that paragraph 29 did not provide a clear, unifying objective for bundling together goods or services and suggested developing one.
15. Consequently, some respondents are concerned that the criteria in paragraph 29 might be too restrictive and might force bundling or unbundling that does not reflect the economics of the arrangement. Furthermore, some respondents are concerned that the proposals are attempting to be more prescriptive in identifying the separate components of a contract compared to most existing standards.
16. Several respondents disagreed with including paragraph 29(b)¹ and questioned the reasons for the Boards' decision as discussed in the Basis for Conclusions. The Boards added this criterion because without it there was a risk that all contracts that include any type of integration service might be deemed to be a single performance obligation (eg a simple installation of standard equipment).
17. Those respondents specifically highlighted the difficulty in applying paragraph 29(b) because even in a construction contract it is difficult to see how the raw materials (eg bricks) are modified or customised to create the end product. Others, such as respondents in the software industry, highlighted difficulties in determining how much modification or customization would be considered 'significant' particularly in cases where the contract requires standard software plus customization services. Furthermore, they questioned whether the fact that another entity could provide a similar customization service meant that the criterion in paragraph 29(b) would not be met. Other respondents also suggested that paragraph 29(b) seems unnecessary, because it is difficult to identify transactions that would be inappropriately identified as a bundle by paragraph 29(a) and yet excluded by paragraph 29(b).
18. Other respondents viewed paragraph 29 to be an exception to the distinct principle. Part of this confusion can be attributed to the language used at the start of paragraph 29 'Notwithstanding the requirement of paragraph 28...'

¹ 29(b) states: the bundle of goods or services is significantly modified or customised to fulfil the contract.

Suggested improvements

19. The feedback indicates that the Boards need to clarify the relationship between paragraphs 28 and 29 and to better explain the relevance and importance of some of the criteria proposed in those paragraphs.
20. Paragraphs 28 and 29 of the 2011 ED specify the two characteristics that are relevant in determining whether a good or service is distinct and, therefore, whether a separate performance obligation can be identified. The purpose of these paragraphs is to assess whether a good or service promised in a contract with a customer is:
 - (a) **Capable of being distinct**—specifically, paragraph 28 assesses the nature or function of each promised good or service to determine if each good or service is capable of being individually distinct (ie because the customer can benefit from the good or service on its own or with other readily available resources).
 - (b) **Distinct in the context of the contract**—specifically, paragraph 29 assesses the nature of the promises in the contract to determine if the entity would satisfy its promise by transferring those individually distinct goods or services to the customer, or by using some or all of those goods or services as inputs to provide the customer with the output promised.
21. Although some different language was used, both characteristics of distinct were also implicit in the 2010 ED. The concept and approach seems to have general support. Therefore, the staff think that concept and approach should be retained, with some improvements to clarify the Boards' intent and make the relationship clearer.
22. To accomplish this objective, the staff recommend improving the framework for determining whether a good or service is distinct by clearly identifying the two characteristics of distinct that a promised good or service must possess to be accounted for as a separate performance obligation. Additionally, the staff recommends adding indicators to help an entity to assess if a good or service is

distinct in the context of the contract. The staff was influenced by many of the responses in the comment letters that “...there is a danger for preparers to focus too much on the interpretation of particular words [in the criteria proposed in the 2011 ED] and too little on the underlying objective” (CL#75 Deloitte Touche Tohmatsu Limited).

23. Therefore, the staff recommend:
- (a) clarifying the underlying principle of identifying separate performance obligations,
 - (b) retaining and improving the concept of distinct by clarifying the two criteria of distinct:
 - (i) one that determines whether the good or service is capable of being distinct (paragraph 28) and
 - (ii) another that ensures that the good or service is distinct in the context of the contract.
 - (c) including some indicators to help determine whether the good or service is distinct in the context of the contract.

Clarifying the underlying principle

24. The 2011 ED states in paragraph 23, “An entity shall evaluate the goods or services promised in a contract and shall identify which goods or services (or which bundles of goods or services) are distinct...” While this focuses on the concept of distinct, the staff think that it may be contradictory to the bundling notion in paragraph 29. This is evidenced by the fact that respondents suggested that the Boards develop a principle that could indicate when to identify separate performance obligations inclusive of when certain promises in a contract should be combined.
25. Therefore, the staff recommend clarifying that the principle is for an entity to account for a promised good or service (or bundle of promised goods or services) as a *separate* performance obligation if accounting separately for that good or service (or bundle) would depict the substance of the contract with the customer.

This principle will help guide preparers as they determine whether the promised goods or services in their contracts possess the characteristics of distinct, both individually and in the context of the contract.

Retaining and improving the concept of distinct

26. Most respondents support the concept of distinct. In addition, the staff believe that it is important to maintain this concept because the accounting for contract modifications differs depending on whether the remaining goods or services are distinct.

Clarifying the two criteria of distinct

27. The staff recommend using the criterion from paragraph 28(b)² to determine whether the promised good or service is capable of being distinct. This criterion is important because it has the effect of establishing a ‘floor’ whereby an entity is precluded from disaggregating below this level. This is important because it prevents entities from inappropriately disaggregating a contract to accelerate revenue recognition. Feedback demonstrated that this criteria was generally understood and viewed to achieve the Boards’ objective of identifying when a good or service could be distinct.
28. Furthermore, the staff recommend explaining that the fact that the entity regularly sells the good or service separately could be used as an indicator that a good or service is capable of being distinct (paragraph 28(a)). These two changes will clarify the Boards’ intention of having paragraph 28(b) be the principle for determining whether a good or service is distinct and paragraph 28(a) be a more practical means of applying the principle in many cases (as mentioned above).
29. The second criterion of distinct is based on the bundling concept in paragraph 29. As mentioned previously, many respondents agreed with the objective of accounting for a bundle of promised goods or services as a single performance obligation in some types of contracts but expressed difficulty in applying the two

² 28(b) states: the customer can benefit from the good or service either on its own or together with other resources are goods or services that are sold separately (by the entity or by another entity) or resources that the customer has already obtained (from the entity or from other transactions or events).

criteria specified in paragraph 29. The staff thinks that the difficulty arises because determining whether a good or service should be bundled with other promised goods or services in the contract (ie whether it is distinct in the context of the contract) does not appear to lend itself to precise criteria. Instead, the feedback suggests that this determination is a matter of judgment that depends on the facts and circumstances of each particular contract.

30. Therefore, the staff recommend establishing a principle to capture the concept of being distinct in the context of the contract and support such a principle with indicators for when that criterion may be satisfied. Specifically the staff recommend using the criteria included in paragraph 29(a) and the basis for conclusions to derive a principle for when a good or service is distinct in the context of the contract. Such principle could read as follows:

the good or service is not highly dependent on, or highly interrelated with, other promised goods or services in the contract.

Indicators of when a good or service is distinct in the context of the contract

31. To support the principle for when a good or service is distinct in the context of the contract, the staff recommend using indicators instead of the standard specifying the circumstances in which a good or service should be bundled (as the 2011 ED does). Proposed indicators and their rationale are included below and included in Appendix A.

<p>(A) The entity does not provide a significant service of integrating the good or service (or bundle of goods or services) into the bundle of goods or services which the customer has contracted. In other words, the entity is not using the good or service as an input to produce the output specified in the contract.</p>	<ul style="list-style-type: none"> • This indicator is based on paragraph 29(a) of the 2011 ED. • The discussion of inputs and outputs is based on paragraph BC79.
<p>(B) The customer could choose to purchase, or not purchase, the good or service without significantly affecting the</p>	<ul style="list-style-type: none"> • This indicator suggests that the good or service can be accounted for separately because it is not highly

other promised goods or services in the contract.	dependent on, or interrelated with, other promised goods or services in the contract.
(C) The good or service does not significantly modify or customise another good or service promised in the contract.	<ul style="list-style-type: none"> This indicator suggests that the promised good or service is not the output for which the customer has contracted and is consistent with paragraph 29(b) of the 2011 ED.

Question 1: Suggested improvements for distinct criteria

Do the Boards agree with the staff recommendation to:

- 1) clarify the underlying principle of identifying separate performance obligations,
- 2) retain and improve the concept of distinct by clarifying the two criteria of distinct
 - (a) capable of being distinct (paragraph 28(b)), and
 - (b) distinct in the context of the contract (paragraph 29).
- 3) including some indicators to help determine whether the good or service is distinct in the context of the contract.

Clarifying when goods or services have the same pattern of transfer

32. Paragraph 30 of the exposure draft proposes:

- 30 As a practical expedient, an entity may account for two or more distinct goods or services promised in a contract as a single performance obligation if those goods or services have the same pattern of transfer to the customer. For example, if an entity promises to transfer two or more distinct services to a customer over the same period of time, the entity could account for those promises as one performance obligation if applying one method of measuring progress (as discussed in paragraphs 38–48) would faithfully depict the pattern of transfer of those services to the customer.

Summary of feedback

33. Many respondents highlighted difficulty understanding the phrase “same pattern of transfer” and whether or not the practical expedient could be applied to

consecutively transferred goods or services as well as concurrently transferred goods or services. These respondents highlight the following examples in the 2011 ED:

- (a) ***Concurrently and consecutively delivered services*** – paragraph 30, “For example, if an entity promises to transfer two or more distinct services to a customer over the same period of time, the entity could account for those promises as one performance obligation if applying one method of measuring progress would faithfully depict the pattern of transfer of those services to the customer.”
 - (b) ***Consecutively delivered services*** – implementation guidance example 13 (one-year asset management service contract), “Although each increment of service is distinct in accordance with paragraph 28 and 29, the entity accounts for the contract as a single performance obligation to provide investment management services for one year because the services have the same pattern of transfer to the customer (see paragraph 30).”
 - (c) ***Consecutively delivered services*** – basis for conclusions paragraph BC81, “For example, if an entity promises to provide professional services for one year, each increment of service may meet the criteria for being distinct. However, it is likely that an entity would account for the services as a single performance obligation if the entity could select a single method of measuring progress that appropriately depicts its performance throughout the year.”
34. Respondents generally understand the practical expedient when applied to concurrently delivered distinct goods or services; however, it is less clear to respondents whether the Boards intended for the practical expedient in paragraph 30 to apply to contracts to deliver repetitive services (eg cleaning service) or homogenous goods (eg energy) delivered consecutively.

We support the practical expedient provision of the ED to account for two or more goods or services as a single

performance obligation if they have the same pattern of transfer to the customer. We believe that contracts for the sale of most energy commodities exhibit this characteristic due to repetitive deliveries of the same product (e.g., electricity or power). We strongly believe that the resulting use of the contract price for recognizing revenue is most consistent with the ED's core principle and is supported by application of the practical expedient. (CL#2A Edison Electric Institute)

35. In addition, respondents observed that whether the practical expedient in paragraph 30 is applied to these types of arrangements has implications on other parts of the model such as the allocation of the transaction price, the onerous test and the disclosure of remaining performance obligations. Therefore, they suggest that if the practical expedient is retained in the final standard, the Boards should clarify how it interacts with other parts of the standard.
36. Because of the implications to other parts of the model, some respondents were concerned about the practical expedient being optional, specifically in regards to repetitive service type arrangements. One respondent noted:

At present, paragraph 30 states that an entity "may" apply the practical expedient. This seems to leave open the possibility that an entity with an onerous performance obligation may use the practical expedient to pick and choose different performance obligations to combine with a view to avoiding recognition of an onerous obligation. (CL#64 KPMG)

Suggested improvements

37. The concerns raised by respondents on the pattern of transfer practical expedient have been difficult to resolve in part because there appears to be three types of arrangements that could have the same pattern of transfer:

- (a) Concurrent delivery of two or more distinct and *related* goods or services (meaning two or more different but related goods or services are provided on a single day).
- (b) Concurrent delivery of two or more distinct and *unrelated* goods or services (meaning two or more different and unrelated goods or services are provided on a single day).
- (c) Consecutive, or continuous, delivery of similar goods or services (meaning a good or service was provided first on Day 1, then again on Day 2, Day 3 and so on).

Concurrently delivered goods or services

38. The practical expedient is generally understood by respondents for concurrently delivered distinct goods or services that have the same pattern of transfer (as illustrated in paragraph 30 of the 2011 ED) and represents an optional simplification in applying the model. Additionally, the feedback regarding concerns about its interaction with the onerous test would be addressed with the staff recommendation in Agenda Paper 7E/Memo 161E. Furthermore, any additional implications with other parts of the model (eg disclosures) could be addressed when the Boards refine those other parts of the model. Therefore, the staff have identified two potential alternatives for concurrently delivered goods or services:
- (a) Retain in the standard the practical expedient and example in paragraph 30 of the 2011 ED
 - (b) Remove the practical expedient and allow practice to evolve.
39. The staff note the following regarding the practical expedient for concurrently delivered goods or services:
- (a) The practical expedient was included in the standard of both the 2010 ED and the 2011 ED.

- (b) The practical expedient simplifies the application of the model and provides preparers reassurance that less burdensome methodologies consistent with the principles of the standard are acceptable.
- (c) With or without a practical expedient in the standard, practice will evolve to apply the principles in a practical and cost-effective manner.

Staff recommendation

- 40. On balance, the staff believe that the standard should not explicitly specify a practical expedient for concurrently delivered distinct goods or services that have the same pattern of transfer, whether those goods or services are related or unrelated. However, clearly an entity would not be precluded from accounting for two or more distinct goods or services *as if* they were a single performance obligation if they have the same pattern of transfer. The staff thinks that any such practical expedient will evolve in practice.
- 41. If however, the Boards decide to retain the practical expedient for consecutively delivered goods or services as discussed below, the staff recommend retaining (and refining) the practical expedient in paragraph 30 of the 2011 ED to cover both concurrent and consecutively delivered distinct goods or services.

Consecutively delivered goods or services

- 42. As noted above, the majority of feedback on the practical expedient questioned whether it could or should apply to consecutively delivered goods or services. Consider the following examples:

Example 1 – Contract manufacturing

Entity A agrees to produce 1,000 widgets per month under a 2 year contract.

Example 2 – Cleaning services

Entity B has a 2 year office cleaning service agreement and the contract terms require that is provided at least daily on workdays.

Example 3 – Energy contract

Entity C provides a fixed energy supply (fixed price and quantity) daily in accordance with a 2 year contract.

43. The staff considered several alternatives to ensure consistent application of the model while addressing the feedback received, including the following:
- (a) Including a ‘pattern of transfer’ notion as a *criterion* for identifying a separate performance obligation.
 - (b) Retaining and improving the *practical expedient* to clearly address consecutive delivery of goods or services.
 - (c) Incorporating the ‘pattern of transfer’ notion within the improvements to distinct, specifically within the *indicators* for determining whether a performance obligation is distinct in the context of the contract.
44. Additionally, in addressing this issue, the staff considered whether both goods and services that are delivered consecutively, or only services that are delivered consecutively, could or should be accounted for as a single performance obligation. Since the Boards decided not to define goods or services in the 2011 ED, the staff think that consecutively delivered items to be accounted for as a single performance obligation could be either goods or services; however, the good or service (identified performance obligation) must meet the criteria for performance obligations satisfied over time in paragraph 35 of the 2011 ED.
- Including pattern of transfer as a criterion for identifying separate performance obligations*
45. The staff initially believed that including a ‘pattern of transfer’ concept as a third criterion for identifying separate performance obligations might be the best

alternative. However, based on our review of several examples, it does not appear that it is a distinguishing characteristic in all separate performance obligations. In pursuing this alternative, the staff incorporated a ‘pattern of transfer’ concept in a draft of the revised guidance for identifying separate performance obligations shared with several external reviewers. The feedback indicated that inclusion of a pattern of transfer criterion was too complex and difficult to understand. Therefore, the staff do not recommend pursuing this alternative to include ‘pattern of transfer’ as a criterion.

Retaining the pattern of transfer as a practical expedient

46. Retaining the ‘pattern of transfer’ concept as a practical expedient is a viable option if the Boards clarify its application to distinct goods or services that are delivered consecutively. Based on the staff’s analysis, we think that such a practical expedient should define ‘pattern of transfer’ to include two key elements:
- (a) The goods or services transfer to the customer over time in accordance with the criteria in paragraph 35 of the 2011 ED, and
 - (b) The entity uses the same method for measuring progress to depict the transfer of those goods or services to the customer.
47. Applying the practical expedient with these elements, the staff think that both Examples 2 and 3 above *could* be evaluated as consisting of a single performance obligation. However, Example 1, assuming that each widget is transferred at a point in time (rather than over time), would not be within the scope of the practical expedient.
48. The staff note the following regarding retaining a practical expedient:
- (a) May limit unintended consequences including consequences to other aspects of the model.
 - (b) Would address the feedback that was principally requesting clarification about when the practical expedient should apply and

requesting clarification of when consecutively delivered distinct goods or services could be within the scope of the practical expedient.

- (c) May allow for circumventing other aspects of the model without additional changes; however, the staff could address such changes (eg onerous test and disclosures)

Incorporating pattern of transfer as an indicator of distinct in the context of the contract

49. While refining the criteria for a distinct performance obligation as noted above the staff continued to evaluate the ‘pattern of transfer’ notion and feedback received. The staff evaluated additional options to incorporate the notion of ‘pattern of transfer’ as applied to consecutively delivered goods or services into the *requirements* for identifying separate performance obligations (rather than as only a practical expedient). Additionally, the staff evaluated if there were specific circumstances whereby the separation or combining of individually consecutively delivered goods or services should be *required*. Referring back to the examples:

Example 2 – cleaning services

- A) One performance obligation – the 2 year contract period.
B) Each individual work day when cleaning is delivered should be considered a separate performance obligation so approximately 600 performance obligations.

Example 3 – energy contract

- A) One performance obligation – the 2 year contract period.
B) Each day energy is delivered is a separate performance obligation; therefore there are 730 separate performance obligations.

50. Assuming the Board agrees with the recommendations in question 1 above regarding improvements to the distinct assessment, the staff think the ‘pattern of transfer’ notion could be incorporated into the assessment of whether a good or service is distinct in the context of the contract.

51. In this alternative, it is critical that the indicator addresses only consecutively delivered goods or services because the indicator is designed to identify a good or service that is distinct (and, therefore, represents a separate performance obligation). For instance, it would be counterintuitive to identify two products (transferred at the same point) together as distinct, because those two goods could be very different. Additionally, use of the same measure of progress is critical to the assessment of when a series of goods or services is a single performance obligation. If the same measure of progress cannot be utilized, then the goods or services are not a single item being delivered continuously but rather individual items that should be treated separately. Under this alternative, an indicator of when something is distinct in the context of the contract, could be:

The good or service is not part of a series of goods or services promised in the contract that meets both of the following conditions:

- a) the entity transfers the goods or services to the customer over time (rather than at a point in time); and
- b) the entity utilizes one method for measuring progress to depict the transfer of those goods or services to the customer.

52. The staff note the following regarding incorporating the pattern of transfer as an indicator:

- (a) It reduces options that may increase complexity by eliminating the practical expedient.
- (b) The ‘pattern of transfer’ concept is consistent with other indicators identified for when a performance obligation is distinct in the context of the contract.
- (c) Use of an indicator potentially may have other unintended consequences; however, the staff will continue to perform outreach to mitigate such consequences.

Staff recommendation

53. The staff think that incorporating as an indicator the ‘pattern of transfer’ notion into the framework for identifying separate performance obligations will eliminate the need for the practical expedient in paragraph 30 of the 2011 ED and, therefore, optional accounting within the revenue model. While there may be some unintended consequences of this approach, the staff think those implications are mitigated by the use of ‘pattern of transfer’ as an indicator rather than a criterion. Finally, the staff think that it is consistent with the ‘distinct in the context of the contract’ improvement suggested in question 1 above. Therefore, the staff recommend adding an indicator to the determination of whether a performance obligation is distinct in the context of the contract.

Question 2: Suggested improvements for pattern of transfer concept

Do the Boards agree with the staff recommendation:

- a) removing the ‘pattern of transfer’ practical expedient for *concurrently* delivered goods or services and
- b) including a ‘pattern of transfer’ indicator for when performance obligations are distinct in the context of the contract for *consecutively* delivered goods or services.

If not, do the Boards prefer to retain the practical expedient for both concurrently and consecutively delivered goods or services?

Putting it all together

54. Based on the above staff recommendations, the process for identifying separate performance obligations in the contract would be as follows:

An entity shall evaluate the goods or services promised in a contract and shall account for a promised good or service (or a bundle of promised goods or services) as a separate performance obligation if accounting separately for that good or service (or bundle) would depict the substance of the contract with the customer.

Capable of being distinct:

The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.

Indicator:

The entity regularly sells the good or service separately.

No*

Yes

Distinct in context of Contract:

The good or service is not highly dependent on, or highly interrelated with, other promised goods or services in the contract.

Indicators:

- The entity does not provide a significant service of integrating the good or service (or bundle) into the bundle of goods or services which the customer has contracted.
- The customer could choose to purchase, or not purchase, the good or service without significantly affecting the other promised goods or services in the contract.
- The good or service does not significantly modify or customize another good or service promised in the contract.
- The good or service is not part of a series of goods or services promised in the contract that meets both of the following conditions:
 - Those goods or services transfer to the customer over time, and
 - The entity uses the same method for measuring progress to depict the transfer of those goods or services to the customer.

Yes

Account for the good or service (or bundle) as a separate performance obligation.

No*

* Combine the good or service (or bundle) with other promised goods or services in the contract with the customer until a separate performance obligation is identified.

Appendix A: preliminary draft guidance – identifying separate performance obligations (Step 2)

The preliminary draft wording included in this appendix has been prepared by the staff to help the Boards reach decisions regarding improvements to the identification of separate performance obligations in the redeliberations for the revenue recognition standard. The Boards have not yet made final decisions about the views reflected in this appendix, and, therefore, the wording is subject to change.

Identifying separate performance obligations

Draft requirements	Comments / remarks
1. An entity shall evaluate the goods or services promised in a contract and shall account for a promised good or service (or a bundle of promised goods or services) as a separate performance obligation if accounting separately for that good or service (or bundle) would depict the substance of the contract with the customer.	<ul style="list-style-type: none"> This is based on paragraph 23 of the 2011 ED. A principle for identifying <u>separate</u> performance obligations has been added to this paragraph to assist preparers in making judgements about whether a good or service is separate.
2. In accordance with the above paragraph, an entity shall account for a promised good or service (or bundle of goods or services) as a separate performance obligation only if the following criteria are met:	<ul style="list-style-type: none"> Based on first sentence of paragraph 27.
(a) Capable of being distinct – The customer can benefit from the good or service either on its own* or together with other resources that are readily available [#] to the customer [^] .	<ul style="list-style-type: none"> Based on paragraph 28(b). The purpose of this criterion is to determine whether the good or service is capable of being distinct. Therefore, this criterion establishes a floor and a separate unit of account cannot be identified without meeting this criteria. This criteria is important to maintain as the accounting for contract modifications differs depending on whether the remaining goods or services are distinct (paragraph 22(a)) or are not distinct and are part of a single PO (paragraph 22(b)).
(b) Distinct in the context of the contract – The good or service is not highly dependent on, or highly interrelated with, other promised goods or services in the contract (see paragraph 3).	<ul style="list-style-type: none"> This is based on the “bundled” concept that paragraph 29 was attempting to capture.

<p>3. Indicators that a good or service is not distinct in the context of the contract include:</p>	<ul style="list-style-type: none"> • Instead of the standard specifying the circumstances where a good or service is a separate component of the contract, we are suggesting using indicators because it allows an entity to use judgement to faithfully depict the substance of the contract.
<ul style="list-style-type: none"> • The entity does not provide a significant service of integrating the good or service (or bundle of goods or services) into the bundle of goods or services which the customer has contracted. In other words, the entity is not using the good or service as an input to produce the output specified in the contract. 	<ul style="list-style-type: none"> • This indicator is based on paragraph 29(a). • The discussion of inputs and outputs is based on paragraph BC79.
<ul style="list-style-type: none"> • The customer could choose to purchase, or not purchase, the good or service without significantly affecting the other promised goods or services in the contract. 	<ul style="list-style-type: none"> • This indicator suggests that the good or service can be accounted for separately because it is not highly dependent on, or interrelated with, other promised goods or services in the contract.
<ul style="list-style-type: none"> • The good or service does not significantly modify or customise another good or service promised in the contract. 	<ul style="list-style-type: none"> • This indicator suggests that the promised good or service is not the output for which the customer has contracted and is consistent with paragraph 29(b) of the 2011 ED.
<ul style="list-style-type: none"> • The good or service is not part of a series of goods or services promised in the contract that meets both of the following conditions: <ul style="list-style-type: none"> ○ Those goods or services transfer to the customer over time in accordance with the criteria in paragraph 35 [2011 ED], and ○ The entity uses the same method for measuring progress to depict the transfer of those goods or services to the customer. 	<ul style="list-style-type: none"> • This indicator is based on the pattern of transfer concept that was previously suggested as a practical expedient in paragraph 30.
<p>4. If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in an entity</p>	<ul style="list-style-type: none"> • Second and third sentences in paragraph 27.

accounting for all the goods or services promised in a contract as a single performance obligation.	
*A good or service is an asset that, on its own, can be used, consumed, sold for an amount other than scrap value, held or otherwise used in a way that generates economic benefits.	
# A readily available resource is a good or service that is sold separately (by the entity or by another entity) or a resource that the customer has already obtained (from the entity or from other transactions or events).	
^ An indicator that the good or service has standalone value is the entity regularly sells the good or service separately.	

Appendix B

A1. The following table lists the proposed requirements from the 2011 ED that relate to the identification of separate performance obligations and identifies which of those proposals might change as a result of the staff recommendations in this paper.

Proposals from the 2011 exposure draft	Anticipated change?
Identifying separate performance obligations (see paragraphs IG16, IG20, and IG62)	
<p>23 An entity shall evaluate the goods or services promised in a contract and shall identify which goods or services (or which bundles of goods or services) are distinct and, hence, that the entity shall account for as a separate performance obligation.</p>	A change is recommended – see paragraphs 22 and 23 of this paper for details
<p>24 A performance obligation is a promise in a contract with a customer to transfer a good or service to the customer. Performance obligations include promises that are implied by an entity’s customary business practices, published policies or specific statements if those promises create a valid expectation of the customer that the entity will transfer a good or service.</p>	No material change is anticipated
<p>25 Performance obligations do not include activities that an entity must undertake to fulfil a contract unless the entity transfers a good or service to the customer as those activities occur. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Hence, those promised set-up activities are not a performance obligation.</p>	No material change is anticipated
<p>26 Depending on the contract, promised goods or services may include, but are not limited to, the following:</p> <ul style="list-style-type: none"> (a) goods produced by an entity for sale (for example, inventory of a manufacturer); (b) goods purchased by an entity for resale (for example, merchandise of a retailer); (c) providing a service of arranging for another party to transfer goods or services to the customer (for example, acting as an agent of another party as discussed in paragraphs B16–B19); (d) standing ready to provide goods or services (for example, when-and-if-available software products); (e) constructing, manufacturing or developing an asset on behalf of a customer; (f) granting licences or rights to use intangible assets; (g) granting options to purchase additional goods or services 	No material change is anticipated

	(when those options provide the customer with a material right as discussed in paragraphs B20–B22); and (h) performing a contractually agreed-upon task (or tasks) for a customer.	
27	If an entity promises to transfer more than one good or service, the entity shall account for each promised good or service as a separate performance obligation only if it is distinct. If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in an entity accounting for all the goods or services promised in a contract as a single performance obligation.	No material change is anticipated.
28	Except as specified in paragraph 29, a good or service is distinct if either of the following criteria is met: (a) the entity regularly sells the good or service separately; or (b) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer. Readily available resources are goods or services that are sold separately (by the entity or by another entity) or resources that the customer has already obtained (from the entity or from other transactions or events).	A change is recommended – see paragraphs 24 through 26 of this paper for details
29	Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both of the following criteria are met: (a) the goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted; and (b) the bundle of goods or services is significantly modified or customised to fulfil the contract.	A change is recommended – see paragraphs 27 through 30 of this paper for details
30	As a practical expedient, an entity may account for two or more distinct goods or services promised in a contract as a single performance obligation if those goods or services have the same pattern of transfer to the customer. For example, if an entity promises to transfer two or more distinct services to a customer over the same period of time, the entity could account for those promises as one performance obligation if applying one method of measuring progress (as discussed in paragraphs 38–48) would faithfully depict the pattern of transfer of those services to the customer.	A change is recommended – see paragraphs 37 through 46 of this paper for details