

STAFF PAPER

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Project	Revenue from Contracts with Customers		
Paper topic	Identifying performance obligations—issues emerging from TRG discussions		
CONTACT(S)	Henry Rees	hrees@ifrs.org	+44 (0)20 7246 6466

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Purpose of the paper

1. The purpose of this paper is to explain the specific issues relating to identifying performance obligations in contracts with customers that were highlighted during the Revenue Transition Resource Group (TRG) discussions so that the IASB can decide what, if any, action it would like to take at this stage to address those issues.
2. The paper discusses the following three issues:
 - (a) Issue 1: Promised goods or services
 - (b) Issue 2: ‘Distinct within the context of the contract’
 - (c) Issue 3: Shipping and handling services
3. Issue 1 was discussed at the January 2015 TRG meeting and Issue 2 at the October 2014 TRG meeting. Issue 3 was mentioned as part of wider TRG discussions in July 2014 and January 2015, although it has not been discussed as a separate topic at TRG meetings to date. The staff have included a discussion of the issue in this paper because it is addressed within the FASB memo on identifying performance obligations.
4. TRG [agenda paper 12](#) (click the link to access the paper) of the January 2015 meeting sets out the TRG discussion on issue 1. TRG [agenda paper 9](#) (click the link to access the paper) of the October 2014 meeting sets out the TRG discussion on issue 2.

5. This paper refers to analysis and alternatives proposed in FASB Memo No. 1: *Identifying Promised Goods or Services, Distinct, and Shipping Services*—that memo has been distributed to IASB members and should be read in conjunction with this paper.

Staff recommendations

6. The staff recommend the following:
- (a) Regarding Issue 1: Promised goods or services, that the IASB does not undertake any standard-setting in response to the concerns raised.
 - (b) Regarding Issue 2: ‘Distinct within the context of the contract’, that the IASB explore adding some illustrative examples (subject to the additional consultation noted in Agenda Paper 7A).

Staff analysis

Issue 1: Promised goods or services

Background

7. IFRS 15 *Revenue from Contracts with Customers* and Accounting Standards Update No. 2014-09 *Revenue from Contracts with Customers* (collectively referred to as the ‘new revenue Standard’) require an entity to assess the promised goods or services in identifying the performance obligations in a revenue contract with a customer.

Paragraph 22 of IFRS 15 states the following in this respect:

At contract inception an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- (a) a good or service (or a bundle of goods or services) that is distinct; or

- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.
8. Some stakeholders have questioned whether the new revenue Standard would require an entity to identify a significant number of additional goods or services that are promised in a contract with a customer but that are not identified as ‘deliverables’ or ‘components’ under existing revenue standards. Some of the examples that have been raised are:
- (a) A requirement to stand-ready to answer questions about a product via a helpline provided for customer questions or complaints.
 - (b) A promise to deliver periodic account statements to the customer within the context of account management services.
 - (c) A promise by a homebuilder to provide particular amenities after the construction of a home, such as street lights.
 - (d) A promise to deliver *additional* copies of licensed intellectual property (eg a promise to deliver ten additional copies of software or media content to the customer beyond the initial copy that makes available the intellectual property for the customer’s use).
 - (e) Shipping and handling services (discussed later in this paper as Issue 3).
9. A specific concern has been raised about the explanation for the Boards’ decisions on promised goods or services in paragraphs BC89-BC90 of IFRS 15. Paragraph BC90 explains that ‘the boards decided not to exempt an entity from accounting for performance obligations that the entity might regard as being perfunctory or inconsequential. Instead, an entity should assess whether those performance obligations are immaterial to its financial statements as described in IAS 8 [*Accounting Policies, Changes in Accounting Estimates and Errors*] and FASB Concepts Statement No. 8 *Conceptual Framework for Financial Reporting*’. Some are interpreting this explanation to mean that an entity would have to identify considerably more promised goods or services than is the case when applying existing standards. They think this could significantly change practice in this respect.

10. Others note, however, the Boards’ explanation in paragraph BC84, which states that the ‘notion of a performance obligation is similar to the notions of deliverables, components, or elements of a contract in previous revenue guidance’. They think that the statement in paragraph BC84 is helpful and highlights that it was not the Boards’ intention that an entity would identify a significantly greater amount of promised goods or services compared to those identified under existing standards.

Analysis

11. It appears that, to date, this concern has been raised mainly in the US. In part, we think that this is because the new revenue Standard did not carry forward the existing SEC guidance on ‘inconsequential or perfunctory’ performance obligations. Some have asserted that some entities applying the SEC guidance effectively ‘bypass’ any consideration as to whether an item or activity is a deliverable if they would be able to conclude that the item would be inconsequential or perfunctory. Without this guidance, entities are concerned that they need to identify significantly more items or activities for the purposes of identifying performance obligations. IAS 18 *Revenue* does not have a similar notion of ‘inconsequential or perfunctory’ performance obligations.
12. The staff think that the January 2015 TRG discussion should have been helpful in educating stakeholders on this issue and, in due course, the TRG discussion will be reflected in its meeting report. Most TRG members did not think that the new revenue Standard would require a significantly greater number of promised goods or services to be identified compared to existing standards. Nonetheless, they did note that some additional promised goods or services might be identified compared to some existing practices, such as some marketing incentives (eg loyalty points).
13. The TRG discussion also highlighted the context in which the statement in paragraph BC90 should be read, namely as a statement capturing the Boards’ conclusion when developing the new revenue Standard that the perfunctory or inconsequential guidance in existing revenue standards was not considered necessary in the new revenue model. It should not be read as an instruction that an entity is necessarily required to identify all perfunctory or inconsequential goods or services promised in the contract. This reflects the Boards’ decisions in January 2011 that were

consequently subject to the full due process of the 2011 Exposure Draft. Nonetheless, some TRG members suggested that the Boards should consider amending the Basis for Conclusions to make this clear. Some TRG members also noted the risk of potential unintended consequences of attempting to incorporate an ‘inconsequential or perfunctory’ notion into the new revenue Standard. Other members suggested that guidance would, however, be necessary if the Boards had intended that entities should be able to apply an inconsequential or perfunctory notion (or something similar).

FASB further considerations

14. As noted above, at present, US stakeholders have expressed more concern about this issue than IFRS stakeholders. The FASB memo highlights that the assessment of materiality is subject to a rigorous process in the US. If an entity identifies a promised good or service as immaterial, the entity would need to quantify on an aggregated basis the potential effect on the financial statements at each reporting period to prove the immateriality of the promised goods or services that it has not identified and accounted for in accordance with the Standard. Accordingly, some think an explicit exemption from having to identify inconsequential or perfunctory goods or services (or similar guidance) could ease implementation, as well as reducing ongoing compliance costs and efforts.
15. For these reasons, in paragraphs 32-60 of the FASB memo the FASB staff have developed two alternatives for the FASB’s consideration:
 - (a) Alternative A: Incorporate the existing SEC guidance on inconsequential or perfunctory performance obligations into the new revenue Standard.
 - (b) Alternative B: Specify that an entity would not evaluate materiality in the aggregate when determining whether an item or activity promised in a contract should be identified as a promised good or service.
16. Alternative B is intended to work in a similar way to, and be consistent with, the assessment of whether a contract includes a material right or a significant financing component. As noted in paragraph BC234, ‘the boards clarified that an entity should consider only the significance of a financing component at a *contract* level rather than consider whether the financing is material at a *portfolio* level’. The FASB staff would

intend Alternative B to work in the same way within the context of identifying promised goods or services—ie in effect, an entity would identify only promised goods or services that are considered material within the context of the contract.

Possible approaches to clarifying the issue relating to promised goods or services

No standard-setting action

17. The IASB could decide not to take any action at this time. The TRG discussion highlighted that IFRS stakeholders can understand and apply the new revenue Standard. As far as we understand, the reporting requirements for misstatements do not prevent IFRS stakeholders from making reasonable judgements when assessing the promised goods or services in their contracts for the purposes of identifying performance obligations.
18. Although the question seems to have been prompted by the statement in paragraph BC90 that ‘the boards decided not to exempt an entity from accounting for performance obligations that the entity might regard as being perfunctory or inconsequential’, most IFRS stakeholders were not troubled by this paragraph. In addition, as noted above, the staff think that the statement in paragraph BC90 should be read within the context of the Boards’ explanation of the development of the new revenue Standard rather than as implying that an entity is necessarily required to identify all perfunctory or inconsequential goods or services promised in a contract. In particular, one of the reasons that the Boards did not include any guidance on perfunctory or inconsequential performance obligations is that it was not considered necessary, both because of how the concept of ‘distinct’ is applied and also because of the application of materiality. In assessing goods and services and identifying performance obligations, entities need to think about the overall objective of IFRS 15 as well as materiality considerations.

Amending the Standard

19. The IASB could consider addressing the issue raised by proposing limited targeted amendments to IFRS 15. As noted above, the FASB memo sets out two possible ways that this could be done:
 - (a) Alternative A: Incorporate the existing SEC guidance on inconsequential or perfunctory performance obligations into the Standard.
 - (b) Alternative B: Specify that an entity would not evaluate materiality in the aggregate when determining whether an item or activity promised in a contract should be identified as a promised good or service.

20. The staff do not recommend adding new guidance on perfunctory or inconsequential performance obligations (Alternative A). Any such guidance creates the risk of unintended consequences (eg possibly carrying forward industry practices that could lead to economically similar items being accounted for differently in different industries). In addition, as the FASB staff note, there is the possibility that it might actually exacerbate the problem. The main advantage noted in the FASB memo of incorporating the existing SEC guidance on perfunctory or inconsequential performance obligations is that US stakeholders are familiar with that guidance. This advantage does not exist, however, for most IFRS stakeholders that are not familiar with that guidance.

21. If the FASB decides to propose amendments to the guidance to specify that an entity would apply materiality at a contract level when identifying promised goods or services (Alternative B), the IASB could consider proposing a similar amendment to IFRS 15. Such an amendment would be a targeted amendment that could align the treatment of materiality of promised goods or services with other parts of the new revenue Standard.

22. In saying that, although likely to be limited in this case, there is always a risk of unintended consequences from any amendments to the Standard. For example, the proposed amendment specifically deals with any potential tension between applying materiality at the contract level and the guidance on a material right. However, there could be other cases for which there are unintended consequences of not identifying

promised goods or services that are material in the aggregate. Further, this issue touches on broader questions about the application of materiality.

Staff recommendation

- 23. The staff recommend that the IASB does not undertake any standard-setting at this time regarding promised goods or services. The TRG discussions highlighted that IFRS stakeholders can understand and apply the new revenue Standard.
- 24. Based on discussions to date, the staff also think that if the FASB were to amend the new revenue Standard in this respect and the IASB did not, this should not create any significant differences in outcomes between IFRS and US GAAP preparers.

Question 1: Promised goods or services

(a) Does the IASB agree with the staff recommendation not to take any standard setting action?

(b) Does the IASB disagree with any of the analysis in this paper regarding Issue 1: Promised goods or services?

Issue 2: ‘Distinct within the context of the contract’

Background

- 25. The new revenue Standard requires an entity to identify performance obligations on the basis of whether the promised goods or services are distinct.
- 26. Paragraph 27 of IFRS 15 describes the principle for determining whether promised goods or services are distinct, as follows:
 - 27 A good or service that is promised to a customer is distinct if both of the following criteria are met:
 - (a) 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 (ie the good or service is capable of being distinct): and
 - (b) the entity’s promise to transfer the good or service to the customer is separately identifiable from other

promises in the contract (ie the good or service is *distinct within the context of the contract*). [Emphasis added]

27. Paragraph 29 of IFRS 15 goes on to provide guidance on factors to consider in determining whether a good or service is separately identifiable, as follows:

29 Factors that indicate that an entity’s promise to transfer a good or service to a customer is separately identifiable (in accordance with paragraph 27(b)) include, but are not limited to, the following:

- (a) the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.
- (b) the good or service does not significantly modify or customise another good or service promised in the contract.
- (c) the good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services.

28. At its October 2014 meeting, the TRG considered issues relating to the principle in paragraph 27(b) regarding when a promised good or service is ‘distinct within the context of a contract’ and the supporting factors in paragraph 29.

29. The main issue arising from the discussion relates to potential diversity in stakeholders' present understanding of the factor in paragraph 29(c)—ie what does it mean for a good or service to be 'highly dependent on, or highly interrelated with, other goods or services promised in the contract'? Many goods or services in contracts could be considered to be highly dependent on or highly interrelated with each other. For example:
- (a) consider a contract for a product and related consumables to be delivered in the future (the consumables are also sold separately). Because the product requires the consumables to function, and/or because the consumables are of no value to the customer without the product, some might view the product and consumables as highly dependent on, or interrelated with, each other. Accordingly, although the product and consumables are 'capable of being distinct' in accordance with paragraph 27(a), some think that they are not 'distinct within the context of the contract' in accordance with paragraph 27(b). As a result they think that the promises to transfer the product and consumables should be combined as a single performance obligation.
 - (b) Another example might be a machine that requires installation at a customer's premises (when that installation is simply a process of installing the product rather than requiring any substantive modification to the product as part of the installation process). Some think that because the machine would not function without being installed and/or the installation services are dependent on successfully transferring the equipment, the promise to transfer the machine and the installation services are a single performance obligation.
30. So, put simply, there is a risk that paragraph 29(c) of the new revenue Standard is being read more broadly than was intended and could result in items being inappropriately combined together as a single performance obligation.
31. This discussion about these types of examples also highlighted that some may not be applying the factors in paragraph 29 in identifying when a promise to transfer a good or service is separately identifiable as intended. They are intended to be factors to

support the application of the principle in paragraph 27(b) but, instead, some appear to be applying those factors as a series of criteria.

32. In addition, and more importantly, the specific questions raised also point to some broader questions about stakeholders' present understanding of the principle in paragraph 27(b) in considering whether the promises to transfer goods or services are separately identifiable.
33. Another specific issue relates to the term 'combined output' in paragraph 29(a). Some stakeholders with long-term construction contracts expressed concern that this term might preclude identifying a single performance obligation when that output, for instance, comprises more than one unit of output or phase of a contract. For example, would a contract to build five identical units to a customer's design always be determined to be five performance obligations (or a series of performance obligations), or could the five units in some situations be determined to be a single performance obligation because they are not distinct within the context of the contract?

Analysis

34. The process for determining whether goods or services are distinct in the new revenue Standard is a two-step process.
 - (a) The first step is to determine whether the good or service is capable of being distinct, as required by the criterion in paragraph 27(a). As explained in paragraph BC97 of the Basis for Conclusions, the criterion in paragraph 27(a) specifies a minimum characteristic or attribute of a good or service underlying a performance obligation (ie a 'floor') to prevent overly granular disaggregation of the contract. Hence, the customer must be able to benefit from the good or service underlying a performance obligation either on its own or together with other resources that are readily available to the customer. This criterion is supported by guidance in paragraph 28.
 - (b) The second step is to determine whether the promise to transfer a good or service is separately identifiable from other promises in the contract, as required by the criterion in paragraph 27(b). This criterion assesses

whether a good or service that is capable of being distinct (in accordance with paragraph 27(a)) retains its distinct character within the context of the other goods or services promised in the contract. Although the good or service may be capable of being distinct in accordance with paragraph 27(a), is it distinct within the context of the contract in accordance with paragraph 27(b)?

Promises that are separately identifiable

35. The criterion in paragraph 27(b) considers whether the promise to transfer a good or service is separately identifiable from other promises in the contract. By focusing on the separability of the *promise* to transfer the good or service, rather than on the good or service itself, the staff think that the Boards intended to convey the notion that the entity is evaluating whether the contract is to transfer, say, item A and item B, or whether, within the context of the particular contract, the entity has promised to transfer something that is more than, or different from, the sum of its parts. For example, in a contract to build a wall, the promise to provide bricks and the promise to provide labour are not separately identifiable from each other within the context of that contract, because those promises together comprise the promise to the customer to build the wall. The bricks and labour are integrated to provide what was promised in the contract. In another example, an entity may have a contract to undertake two phases of a larger construction contract. The promises to provide those two phases may not be separately identifiable because of significant interdependencies and relationships between the two; for instance, because a change made in the fulfilment of one phase leads to a substantial change in the other phase.
36. As noted in paragraph BC105 of the Basis for Conclusions, applying the principle in paragraph 27(b) requires judgement, taking into account all facts and circumstances. Accordingly, to assist entities in applying the principle, the Boards included three factors that indicate that an entity's promise to transfer goods or services is separately identifiable from other promises in the contract. However, paragraph 29 is clear that this is not an exhaustive list of factors. Further, as explained in paragraph BC106, the factors are not mutually exclusive. Consequently, it is clear that paragraph 29 is not

intended to be read as a checklist of criteria—ie not all of the factors need to be met to conclude that a promise is separately identifiable.

37. Indeed, when developing the requirements in the new revenue Standard, paragraph BC104(b) notes that the Boards avoided using ‘criteria’ to describe the factors in paragraph 29. They concluded that it could be too restrictive to express the factors in paragraph 29 as criteria that must be met in order to conclude that promises for goods or services are separately identifiable. Furthermore, they noted that it could force bundling and unbundling that would not reflect the economics of the contract.
38. Paragraph BC105 explains that the notion of ‘separately identifiable’ in paragraph 29(b) is based on the notion of separable risks. This is the notion that the individual goods or services in a bundle would not be distinct if the risk that an entity assumes to *fulfil* its obligation to transfer one of those promised goods or services to the customer is a risk that is inseparable from the risk relating to the transfer of the other promised goods or services in that bundle. The staff think that this explanation in the Basis for Conclusions highlights that the evaluation of whether an entity’s promise to transfer a good or service is separately identifiable from other promises in the contract should consider the relationship between the various goods or service within the contract in the context of the process of *fulfilling* the contract. That includes assessing whether the entity is providing any integration or contract management services that the entity undertakes in fulfilling the contract in managing and co-ordinating the various construction tasks and assuming the risks associated with the integration of those tasks. Paragraph BC107 notes the importance of the integration or contract management service in the evaluation of whether the promise to transfer a good or service is separately identifiable from other promises in the contract.

The good or service is not highly dependent on, or highly interrelated with, other goods or services

39. The staff think that the third factor in paragraph 29(c)—‘the good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract’—should be evaluated within the context described in paragraphs 34-38 of this paper. It was not the Boards’ intention that every good or service that might be regarded as highly dependent on, or interrelated with, another should be combined

into a single performance obligation. As with all of the factors listed in paragraph 29, the factor in paragraph 29(c) should be read within the context of the principle in paragraph 27(b) that the promise to transfer the good or service to the customer is separately identifiable from other promises in the contract. Accordingly, the relevant relationship between the goods and services in this respect is the transformative relationship between the two items in the *process* of fulfilling the contract, rather than a functional relationship between the two items. This is clarified by the second sentence of paragraph 29(c) which states ‘the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services’.

40. In assessing whether the promises in some of the examples noted earlier in this paper are separately identifiable, the staff would reach the following conclusions using the guidance in paragraph 27(b) and paragraph 29 of IFRS 15:

- (a) An entity agrees to provide a product and related consumables to a customer. The product does not function without the consumables, and the consumables are also sold separately by the entity.

The entity’s promise to provide the product is separately identifiable from the promise to deliver consumables, ie the entity has promised to deliver a product and consumables, not something that transforms those deliverables into a combined (and different) output. Although the product requires the consumables to function (and thus in this narrow sense there is a functional relationship between the product and the consumables), the entity can fulfil its promise to deliver the product separately and independently from its promise to also deliver consumables to the customer. Fulfilling the contract requires no significant integration or contract management services. The consumables do not significantly modify the product, nor vice versa. If the customer decided not to purchase the consumables, this would not affect the entity’s ability to transfer the product to the customer in any way, nor vice versa.

- (b) An entity agrees to provide a customer with a machine and install that machine at the customer’s premises. The machine will not work without being installed, and the installation is a simple process that does not modify the machine.

Assuming that the machine and installation are capable of being distinct, the entity’s promise to provide the machine is separately identifiable from the promise to install the machine, ie the entity has promised to deliver a machine and then install it; it has not promised to deliver an output that combines the machine and the installation and transforms those inputs into something that is different. The installation does not significantly modify the machine and fulfilling the contract requires no significant integration or contract management service. .Although, again in this example, there is a functional relationship between the machine and the installation (in that the machine does not work without being installed), the entity could fulfil its promise to deliver the machine without having to install the machine. Similarly, the entity would be fulfilling the same installation service even if the customer had acquired the machine from another entity.

Output

41. Paragraph 29(a) states that a factor that indicates that an entity’s promise to transfer a good or service is separately identifiable is that ‘the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined *output* for which the customer has contracted’. The staff do not think it was the Boards’ intention that the output referred to in paragraph 29(a) could include only one unit, element or phase of a contract. In some cases, the output specified by the contract will be a process or a project comprising a number of separate units, elements or phases, which could have separate functionality. Whether multiple units, elements or phases of a contract result in one or more performance obligations will depend on an assessment of the facts and circumstances, including the interrelationship and dependencies between those units, elements or phases in the process of fulfilling the contract, or the extent of the integration service or contract management service

required in fulfilling the contract (see paragraph 38 above). These integration or contract management services may relate to more than one unit, element or phase.

42. The staff think that the example included in paragraph BC112 of IFRS 15 indicates that an entity can conclude that there is a single performance obligation even when the output from the contract includes multiple units. In that example, the entity agrees to design an experimental product for a customer and to manufacture 10 prototype units of that product. The conclusion set out in paragraph BC112 is that, based on the facts and circumstances, the promises in the contract are not separately identifiable and, thus, the contract contains a single performance obligation, even though the customer will receive 10 prototype units of the product.
43. The staff do not think that the Boards intended the example in paragraph BC112 to imply that, when the output from a contract includes multiple units or phases, an entity could conclude that there is a single performance obligation only when the particular facts and circumstances of that example exists.

Possible approaches to clarifying the issues relating to ‘distinct’

No standard-setting action

44. The staff think that the nature of the issues raised does not require any amendments to IFRS 15. The concepts of ‘separately identifiable’ and ‘distinct within the context of the contract’ are new. It is therefore inevitable that questions will be raised about those concepts while an understanding of how to apply them to different types of contracts is developing in practice. Nonetheless the staff think that the discussion about these issues in this paper could serve as useful education materials to stakeholders.

Adding illustrative examples

45. Some of the above points could also be explained through the addition of illustrative examples. The IASB could develop an example or examples to (a) illustrate the application of the principle in paragraph 27(b) (including the highly dependent/highly interrelated factor) and (b) to clarify that a combined output can include multiple units or phases.

46. The FASB memo also suggests adding illustrative examples—five possible illustrative examples are set out after paragraph 86 of that memo. The FASB staff note that, in their view, adding illustrative examples might be the most effective way to provide additional clarity as to how the Boards intended the ‘distinct’ guidance to be applied.
47. Nonetheless, whilst additional examples might be useful, we need to be aware of the risk of creating a precedent or fuelling demands for further additional examples to address questions that essentially arise from specific fact patterns or from the need to exercise judgement. This could potentially undermine the principle-based nature of the Standard.

Amending the Standard

48. The IASB could consider clarifying the issues raised by proposing limited targeted amendments to IFRS 15.
49. Paragraphs 67-83 of the FASB memo suggest clarifying the guidance in the following ways:
- (a) improving the articulation of the principle in paragraph 27(b) of IFRS 15, principally by describing promised goods and services as ‘separately identifiable’ when the nature of the entity’s promise is to transfer each of the goods or services to the customer, rather than to transfer a combined item (or items) to which each of the goods or services is an input. This would build on the factor in paragraph 29(a) of IFRS 15 and use it to describe the principle in paragraph 27(b); and
 - (b) aligning the factors to the re-articulated principle, principally by evaluating the ‘separately identifiable’ principle within the context of the *bundle* of promised goods or services in the contract, rather than evaluating the promised goods or services individually. For example, the amended guidance in paragraph 29(c) would indicate that goods and services are highly interdependent or highly interrelated when *each* of the goods or services is significantly affected by one or more of the other goods or services in the contract.

50. The limited amendments proposed in the FASB memo are all intended to clarify, rather than change, the existing principles in the new revenue Standard.
51. Nonetheless, this has always been a difficult part of the new revenue Standard to articulate and in which to clearly convey the Boards’ intentions. Moreover, experience during the development of the Standard over many years has shown that there are inevitably unintended consequences with each round of amendments.

Staff recommendation

52. The staff acknowledge that the questions relate to a fundamental part of the new revenue Standard (ie Step 2—identifying performance obligations). Nonetheless, the staff do not recommend amending IFRS 15. We think the nature of the questions relating to ‘distinct within the context of the contract’ point to the need for explanation of what is already in the new revenue Standard. Furthermore, amending IFRS 15 in this area within a short time period would appear to create a risk of unintended consequences and the need for additional guidance to explain the amended requirements. It would therefore seem better to let practice emerge, as judgement is exercised in the application of the existing principle-based framework to specific fact patterns, and we should continue to monitor how well that process is working.
53. The staff think that the discussion of the issues in this paper could help educate and inform practice, without any further action being taken. However, in this instance, we think that adding illustrative examples could be helpful in explaining what is already in the new revenue Standard. We therefore recommend that the IASB explore adding some illustrative examples regarding ‘distinct within the context of the contract’ (subject to the additional consultation noted in Agenda Paper 7A).

Question 2: Distinct within the context of the contract

(a) Does the IASB agree with the staff recommendation to explore adding some illustrative examples (subject to the additional consultation noted in Agenda Paper 7A)?

(b) Does the IASB disagree with any of the analysis in this paper regarding Issue 2: Distinct within the context of the contract?

Issue 3: Shipping and handling services

54. When identifying the promised goods and services in a contract with a customer, the treatment of shipping and handling services has attracted some attention in the US.
55. The question that has arisen is whether an entity should account for shipping and handling services as a promised service or, instead, treat them as a cost of fulfilling the promise to deliver goods to the customer. In particular, concerns have been raised when shipping occurs after the transfer of control of the related goods. If an entity were to account for shipping and handling services as a promised service, the FASB staff note that this might create a significant change for many entities as compared to existing practice. This is because the FASB staff understand that, under existing revenue guidance, an entity generally does not account for shipping services provided in conjunction with the sale of goods as an additional deliverable. Instead, shipping and handling costs are generally treated as fulfilment costs. The FASB memo notes that this change could be operationally difficult for entities to apply in practice.
56. It is noteworthy that the FASB memo indicates that feedback on this issue is mixed. Preparers have said that they have the best understanding of their business, contracts, and customers and are able to identify circumstances for which shipping is a promised service and when it is solely a fulfilment cost. They have some concerns about introducing additional prescriptive guidance and would prefer to be able to apply judgement in dealing with this issue. Some auditors, on the other hand, think that leaving this to preparer judgement could result in diversity in practice and would prefer clearer guidance.
57. Paragraphs 99-112 of the FASB memo suggest some ways in which the FASB might provide guidance regarding shipping and handling services:
- (a) Alternative A would introduce a practical expedient that allows entities to choose to account for shipping as a fulfilment cost, rather than as a promised service.
 - (b) Alternative B would provide new implementation guidance on shipping to help determine when shipping is, or is not, a promised service.

- (c) Alternative C would rely on the decision regarding Issue 1 discussed earlier in this paper, ie the issue would be addressed by either adding guidance on (i) inconsequential or perfunctory performance obligations, or (ii) applying materiality at the contract level.
58. At this stage, the IASB staff do not know whether shipping is an issue for IFRS stakeholders. IFRS stakeholders have not raised concerns with us, either formally or informally. Consequently, the staff is not recommending that the IASB take any standard setting action at this stage in this respect. We will consult with IFRS stakeholders to identify whether this is an issue for them.