

STAFF PAPER

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| Project | FASB-IASB Joint Transition Resource Group for Revenue Recognition | | |
| Paper topic | Determining When Control of a Commodity Transfers | | |
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Background and Purpose

1. Some stakeholders informed the staff that there are questions about the guidance in Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and IFRS 15 *Revenue from Contracts with Customers* (collectively referred to as the “new revenue standard”), for determining when control of a commodity transfers.
2. Entities in certain industries routinely enter into contracts with customers to deliver commodities (for example, electricity, natural gas and heating oil). Some stakeholders raised questions about the nature of an entity’s promise in a contract to deliver a commodity to a customer. In other words, some stakeholders questioned whether the nature of an entity’s promise is to deliver a good (the commodity) at a point in time or to provide a service of delivering a commodity that the customer consumes and from which the customer receives benefits over time. Specifically, those stakeholders have questioned what factors an entity should consider when evaluating the criterion in paragraph 606-10-25-27(a) [35(a)] for determining whether a customer simultaneously receives and consumes the benefits provided by an entity’s performance as the entity performs in a contract to provide a commodity.

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3. The determination of whether an entity meets the criterion in paragraph 606-10-25-27(a) [35(a)] not only affects the timing of when revenue is recognized, but also could create practical challenges because it could affect an entity's ability to apply the series guidance in paragraphs 606-10-25-14 and 25-15 [22-23].

Accounting Guidance

4. The relevant accounting guidance has been included in Appendix A of this paper.

Question: What factors should an entity consider when evaluating whether a customer simultaneously receives and consumes the benefits of a commodity as the entity performs?

5. The staff is aware of the following views reported by stakeholders:
 - (a) *View A*—An entity should consider only the inherent characteristics of the commodity.
 - (b) *View B*—An entity should consider all relevant facts and circumstances, including the inherent characteristics of the commodity, the contract terms, and information about infrastructure or other delivery mechanisms.

View A

6. Proponents of *View A* think that when evaluating the criterion in paragraph 606-10-25-27(a) [35(a)] an entity should consider only the inherent characteristics of a commodity (that is, whether the commodity can be stored), regardless of the terms of the contract or whether the customer will actually choose to store the commodity. Under *View A*, commodities that cannot be stored (and therefore must be immediately consumed) would likely always meet the over time criterion in paragraph 606-10-25-27(a) [35(a)]. Conversely, commodities that are capable of being stored likely would never meet the over time criterion in paragraph 606-10-25-27(a) [35(a)].
7. Proponents of *View A* think that only the inherent nature of the commodity is determinative in evaluating whether a commodity is simultaneously received and consumed because an entity may not have access to information about whether the commodity will be consumed or stored by its customer. As a result, the timing of

when revenue for similar contracts is recognized could differ based on whether an entity knows if its customer will immediately consume or store the commodity. To avoid these potential disparities, proponents of *View A* think that an entity should evaluate only the attributes of the actual commodity to determine if it is capable of being stored, regardless of whether the customer has the intent or ability to store it.

8. Proponents of *View A* also think that the guidance in BC101 for determining whether a good or service is capable of being distinct suggests that because it is difficult, if not impossible, for an entity to know a customer's intentions in a given contract, such information should not be considered when applying the guidance in the new revenue standard.
9. Opponents of *View A* think that only considering the inherent nature of a commodity would likely result in most commodity contracts being recognized at a point in time because most commodities other than electricity can be stored. As a result, the recognition of revenue from contracts for different commodities that are used by customers for similar purposes may differ. For example, the recognition of revenue from a contract to provide electricity to a customer for use in a home oven may differ from a contract to provide natural gas to a customer for a similar purpose because natural gas can be stored and electricity cannot.
10. Opponents of *View A* also think that there may be diversity in the evaluation of whether a commodity can be stored. For example, some stakeholders think that electricity cannot be stored while other stakeholders think that electricity can be stored in the form of a battery. Under *View A*, those stakeholders that think electricity can be stored would recognize revenue related to a contract to deliver electricity at a point in time. However, the staff note that BC114 provides an example of a contract to deliver electricity for which revenue is recognized over time using the series guidance in paragraph 606-10-25-15 [23].

View B

11. Proponents of *View B* think that an evaluation of whether a commodity is simultaneously received and consumed is not limited to the inherent characteristics of the commodity. Rather, proponents of *View B* think that an entity should consider all *known* facts and circumstances relevant to the evaluation. For example, an entity

may consider not only the inherent nature of the commodity, but also specific contract terms (for example, a continuous supply contract to meet immediate demands) and information about infrastructure or other delivery mechanisms (for example, a natural gas utility that delivers directly to residential consumers). As a result, revenue related to the sale of a commodity may or may not be recognized over time depending on whether the facts and circumstances of the contract indicate the customer will immediately receive and consume the benefits of the commodity.

12. Proponents of *View B* further note that considering all relevant and known facts and circumstances in attempting to determine the nature of an entity's promise in a commodities contract (that is, as a contract to provide a service or a contract to deliver goods) would be consistent with the general consensus of TRG members at the October 2014 TRG meeting. At that meeting, TRG members expressed their views that an entity should consider all of the facts and circumstances when determining if multiple promised goods or services are distinct within the context of the contract (that is, whether the nature of the entity's promise in the contract is to transfer those multiple promised goods or services or a single good or service to which those multiple promised goods or services are inputs).
13. Opponents of *View B* note that consideration of factors other than the inherent nature of a commodity could result in revenue being recognized differently for sales of the same commodity. For example, opponents think that under *View B* an entity that provides natural gas for immediate consumption in a power plant may recognize revenue over time (that is, the natural gas is simultaneously received and consumed) while an entity that delivers natural gas into temporary storage for a similar power plant may recognize revenue at a point in time (that is, the natural gas is not simultaneously received and consumed).

Staff Analysis

14. The staff agree with *View B*. The staff think an entity should consider all relevant facts and circumstances when evaluating the criteria in paragraph 606-10-25-27 [35], and therefore, when determining the nature of an entity's promise to its customer, regardless of whether the contract is for the delivery of a commodity or a widget.

15. The staff think it is important to highlight that before evaluating the criteria in paragraph 606-10-25-27 [35], an entity must first evaluate all relevant facts and circumstances to appropriately identify the overall nature of the entity’s promise(s) in a contract. For example, an entity may conclude that the nature of its promise in a contract to provide natural gas to a customer upon demand differs from the nature of its promise in a contract to deliver natural gas into a customer’s temporary storage. That is, an entity may determine that providing natural gas upon demand is a repetitive service arrangement (or potentially a stand-ready obligation to provide a commodity to a customer on an as-needed basis) while the delivery of natural gas into temporary storage is more akin to the delivery of a good. In some cases, this evaluation will require the use of significant judgment. Further, the staff think that *View B* is most consistent with how facts and circumstances are considered in some other, very similar, circumstances (for example, the determining if multiple promised goods or services are distinct within the context of the contract) and that it may be inconsistent with other parts of the new revenue standard to conclude that, in this one case, only some facts and circumstances (that many view as relevant to determining the nature of the entity’s promise) should be considered.
16. After an entity identifies the overall nature of its promise to the customer in a contract it is in the proper position to evaluate the guidance in paragraph 606-10-25-27 [35], including whether a customer simultaneously receives and consumes the benefits provided by the entity’s performance *as the entity performs* [Emphasis added]. When making this evaluation, an entity also must consider the related implementation guidance in paragraphs 606-10-55-5 and 55-6 [B3-B4] pertaining to the criterion in paragraph 606-10-25-27(a) [35(a)].

Question for the TRG Members

1. Do the TRG members agree with the staff’s interpretations in this paper?

Appendix A: Relevant Accounting Guidance

Identifying Performance Obligations

17. Paragraph 606-10-25-14 [22] states that 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
 - b. A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 606-10-25-15 [23]).
18. Paragraph 606-10-25-15 [23] states that a series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:
 - a. Each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 606-10-25-27 [35] to be a performance obligation satisfied over time.
 - b. In accordance with paragraphs 606-10-25-31 through 25-32 [39-40], the same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

Performance Obligations Satisfied Over Time

19. Paragraph 606-10-25-27 [35] states that an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if one of the following criteria is met:
 - a. The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs 606-10-55-5 through 55-6 [B3-B4]).
 - b. The entity's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced (see paragraph 606-10-55-7 [B5]).

- c. The entity's performance does not create an asset with an alternative use to the entity (see paragraph 606-10-25-28 [36]), and the entity has an enforceable right to payment for performance completed to date (see paragraph 606-10-25-29 [37]).

Simultaneous Receipt and Consumption of the Benefits of the Entity's Performance

20. Paragraph 606-10-55-5 [B3] states that for some types of performance obligations, the assessment of whether a customer receives the benefits of an entity's performance as the entity performs and simultaneously consumes those benefits as they are received will be straightforward. Examples include routine or recurring services (such as a cleaning service) in which the receipt and simultaneous consumption by the customer of the benefits of the entity's performance can be readily identified.
21. Paragraph 606-10-55-6 [B4] states that for other types of performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially reperform the work that the entity has completed to date if that other entity were to fulfill the remaining performance obligation to the customer. In determining whether another entity would not need to substantially reperform the work the entity has completed to date, an entity should make both of the following assumptions:
- a. Disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity
 - b. Presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were to transfer to another entity.

Basis for Conclusions

22. BC101 states that the attributes of a distinct good or service are comparable to previous revenue recognition guidance for identifying separate deliverables in a multiple-element arrangement, which specified that a delivered item must have “value to the customer on a standalone basis” for an entity to account for that item separately. However, the Boards decided against using that terminology to avoid the implication that an entity must assess the customer’s intended use for the promised goods or services in identifying the performance obligations in a contract. The Boards observed that it would be difficult, if not impossible, for an entity to know the customer’s intentions in a given contract.
23. BC125 states that in many typical “service” contracts, the entity’s performance creates an asset only momentarily because that asset is simultaneously received and consumed by the customer. In those cases, the simultaneous receipt and consumption of the asset that has been created means that the customer obtains control of the entity’s output as the entity performs and, thus, the entity’s performance obligation is satisfied over time. For example, consider an entity that promises to process transactions on behalf of a customer. The customer simultaneously receives and consumes a benefit as each transaction is processed.
24. BC126 states that the Boards observed that there may be service-type contracts in which it is unclear whether the customer receives and consumes the benefit of the entity’s performance over time. This is because the notion of “benefit” can be subjective. Consider, for example, a freight logistics contract in which the entity has agreed to transport goods from Vancouver to New York City. Many respondents suggested that the customer receives no benefit from the entity’s performance until the goods are delivered to New York City. However, the Boards observed that the customer does benefit from the entity’s performance as it occurs because if the goods were delivered only part way (for example, to Chicago), another entity would not need to substantially reperform the entity’s performance to date that is, another entity would not need to take the goods back to Vancouver to deliver them to New York City. The Boards observed that in those cases the assessment of whether another entity would need to substantially reperform the performance completed to date can be used as an objective basis for determining whether the customer receives benefit from the entity’s performance as it is provided.

25. BC127 states that the Boards decided that an entity should disregard any contractual or practical limitations when it assesses the “simultaneously receives and consumes” criterion and whether another entity would need to substantially reperform the performance completed to date. This is because the objective of this criterion is to determine whether control of the goods or services has already been transferred to the customer. This is done by using a hypothetical assessment of what another entity would need to do if it were to take over the remaining performance. Thus, actual practical or contractual limitations on the remaining performance would have no bearing on the assessment of whether the entity has transferred control of the goods or services provided to date.
26. BC128 states that the Boards also observed that this criterion is not intended to apply to contracts in which the entity’s performance is not immediately consumed by the customer, which would be typical in cases in which the entity’s performance results in an asset (such as work in process). Consequently, an entity that applies Topic 606 [IFRS 15] to contracts in which the entity’s performance results in an asset (which could be intangible) being created or enhanced should consider the criteria in paragraph 606-10-25-27(b) and (c) [35(b) and (c)].
27. BC113 states that the Boards decided to specify that a promise to transfer a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer would be a single performance obligation if two criteria are met. The Boards decided to include this notion as part of the definition of performance obligation to simplify the application of the model and to promote consistency in the identification of performance obligations in circumstances in which the entity provides the same good or service consecutively over a period of time (for example, a repetitive service arrangement). To be accounted for as a single performance obligation, each of those promised goods or services must be performance obligations satisfied over time in accordance with paragraph 606-10-25-27 [35].
28. In BC114 the Boards observed that without this part of the definition, applying the model might present some operational challenges when an entity provides a series of distinct goods or services that are substantially the same. Otherwise, the entity would be required to identify multiple distinct goods or services, allocate the transaction

price to each of the resulting performance obligations on a standalone selling price basis, and then recognize revenue when those performance obligations are satisfied. For example, in a repetitive service contract such as a cleaning contract, transaction processing, or a contract to deliver electricity, an entity would be required to allocate the overall consideration to each increment of service (for example, each hour of cleaning) to be provided in the contract. The Boards decided that it would not be cost effective to apply the model in this manner and determined that including paragraph 606-10-25-14(b) [22(b)] as part of the definition of a performance obligation would alleviate costs. This is because when paragraph 606-10-25-14(b) [22(b)] applies (that is, the contract includes a promise to transfer a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer), an entity will identify a single performance obligation and allocate the transaction price to the performance obligation. The entity will then recognize revenue by applying a single measure of progress to that performance obligation.

29. BC115 states that the Boards noted that if an entity determines it has a performance obligation that meets the criterion in paragraph 606-10-25-14(b) [22(b)], an entity should consider the distinct goods or services in the contract, rather than the performance obligation for the purposes of contract modifications and the allocation of variable consideration.
30. In BC116, the Boards observed that paragraph 606-10-25-14(b) [22(b)] applies to goods or services that are delivered consecutively, rather than concurrently. The Boards noted that Topic 606 [IFRS 15] would not need to specify the accounting for concurrently delivered distinct goods or services that have the same pattern of transfer. This is because, in those cases, an entity is not precluded from accounting for the goods or services as if they were a single performance obligation, if the outcome is the same as accounting for the goods and services as individual performance obligations.