STAFF PAPER

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Project	**FASB/IASB Joint Transition Resource Group for Revenue Recognition**
Paper topic	Consideration Payable to a Customer

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Purpose

1. Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, and IFRS 15 *Revenue from Contracts with Customers* (collectively referred to as the "new revenue standard"), includes guidance on the recognition, measurement, and presentation of consideration payable to a customer. Stakeholders have informed the staff that different interpretations have developed regarding (a) which entities meet the definition of a customer and (b) what payments to a customer could result in a reduction in revenue. In addition, some stakeholders have indicated that the guidance on timing of recognition of consideration payable to a customer may not reconcile to the guidance on including estimates of variable consideration in the transaction price.
2. This paper summarizes the potential implementation issues that were reported to the staff. The staff will seek input from members of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) on these potential implementation issues.

Accounting Guidance

3. The new revenue standard includes the following guidance about: (a) what constitutes consideration payable to a customer, (b) who are customers of the entity, and (c) how to account for and present consideration paid to a customer:

606-10-32-25 [70][1] Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 606-10-25-18[26] through 25-22[30]) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 606-10-32-5 through 32-13 [50-58].

606-10-32-26 [71] If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

[1] IFRS 15 references are included in "[XX]" throughout this paper.

4. Stakeholders have different views on whether an entity's customers include those outside of the entity's distribution chain.[2] Also, there are different views on which amounts paid to a customer[3] require an entity to assess whether the payment relates to a distinct good or service acquired at an amount that does not exceed fair value, and thus, would not require an entity to reduce the transaction price. Questions 1 and 2 in this memo address these two issues.

5. Paragraph 606-10-32-27[72] provides the following guidance on the timing of recognition of consideration payable to a customer:

> **606-10-32-27[72]** Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognize the reduction of revenue when (or as) the later of either of the following events occurs:
>
> a. The entity recognizes revenue for the transfer of the related goods or services to the customer.
>
> b. The entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

6. Stakeholders note that paragraph 606-10-32-5[50] requires an entity to estimate the amount of variable consideration to which it is entitled in exchange for transferring the promised goods or services. Subject to assessing whether the estimate of variable consideration is constrained as required by paragraphs 606-10-32-11[56] through 32-12[57], the estimated amount of variable consideration is included in the transaction price. Some stakeholders note that consideration payable to a customer can be variable consideration and think the requirement to include variable consideration in the transaction price (subject to the constraint) is potentially inconsistent with the requirement to delay recognition of consideration payable to a customer at least until

[2] The distribution chain includes those that purchase products directly from the entity and those that indirectly purchase through a distributor of the entity's products.

[3] Phrases like "amounts payable to a customer" or "payments to a customer" and similar phrases are used throughout this memo as short-hand for cash amounts that an entity pays to a customer, or expects to pay, and includes credits provided to the customer that can be applied against amounts owed to the entity.

the entity pays or promises to pay the consideration to the customer. Question 3 of this memo addresses this issue.

Background

7. Existing GAAP includes guidance on consideration payable to a customer (Subtopic 605-50, Revenue Recognition – Customer Payments and Incentives). Many of those concepts in existing GAAP are similar to the guidance in the new revenue standard. Existing guidance was partly developed in response to concerns about accounting issues that arose with the emergence of internet businesses in the late 1990s. Many stakeholders have stated that the guidance was issued in part because some companies were manipulating revenue; therefore, some stakeholders refer to existing GAAP as "anti-abuse" literature. Existing GAAP requires an entity to presume consideration payable to a vendor (cash or customer credits) or to any purchaser of the vendor's products at any point along the distribution chain is a reduction in revenue unless the entity receives an identifiable benefit (goods or services) and the vendor can reasonably estimate the fair value of that benefit.
8. Existing IFRS does not include any specific guidance on consideration payable to a customer.

Question 1: Which payments to a customer are in the scope of the consideration payable to a customer guidance?

9. The new revenue standard does not explicitly state whether the requirement to determine if an amount payable to a customer relates to a distinct good or service acquired at an amount that does not exceed fair value applies to **all** payments to a customer. The new revenue standard also does not state that some payments are excluded from the assessment. Stakeholders have identified three different interpretations on the scope of the consideration payable to a customer guidance:
    a. *Interpretation A:* Entities should assess all consideration payable to a customer
    b. *Interpretation B:* Entities should only assess consideration payable to a customer within a contract with a customer (or combined contracts)

c. *Interpretation C:* Entities should only assess consideration payable to a customer within a contract with a customer (or combined contracts) and customers in the distribution chain of that contract with a customer.

Interpretation A

10. Some stakeholders think that entities must apply the guidance on consideration payable broadly to all customer payments. Supporters of this interpretation believe the intent of the guidance is similar to existing GAAP; therefore, the accounting results should be similar.
11. Supporters of Interpretation A note the following paragraphs that discusses the basis for the assessment that an entity performs to determine if the consideration is a discount or refund for goods or services provided to a customer or a payment for goods and services received from the customer:

> BC256. To help an entity distinguish between those types of payments, the Boards decided that the **only circumstance** in which an entity should account for any good or service received in the same way as for other purchases from suppliers is if the good or service is distinct… [Emphasis added]
>
> BC257. The amount of consideration received from a customer for goods or services, and the amount of **any consideration paid to that customer for goods or services, could be linked even if they are separate events**. For instance, a customer may pay more for goods or services from an entity than it otherwise would have paid if it was not receiving a payment from the entity. Consequently, the Boards decided that to depict revenue faithfully in those cases, **any amount** accounted for as a payment to the customer for goods or services received should be limited to the fair value of those goods or services, with any amount in excess of the fair value being recognized as a reduction of the transaction price. [Emphasis added]

12. Stakeholders that support Interpretation A note that the Boards acknowledged that consideration received from a customer and consideration paid to a customer could be linked even if they are separate events. The only way to determine if consideration paid to the customer is linked to a revenue contract with a customer is to assess whether the consideration paid to the customer was for distinct goods or services acquired at an amount that does not exceed fair value. Said another way, because any payment to a customer "could be linked" an entity would need to assess whether each payment relates to a distinct good or service acquired at an amount that does not exceed fair value.
13. Supporters acknowledge that the new revenue standard does not explicitly state which payments should be considered. However, those stakeholders point out that the new revenue standard also does not explicitly state that some payments to a customer should be considered while others are not considered in context of the consideration payable to a customer guidance. Those stakeholders reason that the lack of explicit guidance is consistent with the Basis for Conclusions that all consideration payable to a customer should be assessed. They also think that conclusion is consistent with existing GAAP, which seems reasonable since the concepts related to consideration payable to a customer in the new revenue standard are similar to existing GAAP.

Interpretation B

14. Supporters of Interpretation B think the guidance on consideration payable to a customer is only applicable to amounts paid within the same contract or contracts that must be combined pursuant to paragraph 606-10-25-9[17]. That view is consistent with paragraph 606-10-10-4[4] which states that the new revenue standard "specifies the accounting for an individual contract with a customer." These supporters also note that when consideration payable to a customer is not for distinct goods and services acquired at an amount that does not exceed fair value, the standard requires an entity to reduce the "transaction price"[4] for the amount in excess of fair value. The transaction price notion is about the total consideration at the contract level and, therefore, the consideration payable to a customer needs to be within a contract (or combined contracts) with a customer.

[4] Paragraph 606-10-32-25[70]

15. Supporters of Interpretation B acknowledge that a payment to a customer could be related to a contract with a customer, but might not always be identified through the contract combination guidance because the two contracts may not be "entered into at or near the same time."[5] However, supporters of Interpretation B assert that if an entity considers the contract modification guidance in context to the overall objective of the new revenue standard, it should identify consideration payable to a customer that relates to a revenue contract. With a focus on the overall objective of the revenue standard, those stakeholders think an entity would not only assess if the contract with the customer was legally modified, but also assess whether the contract has been economically modified.
16. To illustrate, assume that a truck manufacturer sells to a dealer 100 trucks. Subsequent to delivery of the trucks, the dealer has difficulty selling the trucks to end customers. Six months after the delivery of the trucks to the dealer, the truck manufacturer communicates externally that it will provide $5,000 to each customer that purchases a truck from the dealer within 30 days. The contract for the sale of the 100 trucks and the contract for the rebate to the end customer might not be combined because the contracts were not entered into at or near the same time. The entity could conclude that the rebate to the end customer is not a contract modification, because the rebate does not change the scope or price of the contact with the dealer that is approved by both parties in accordance with paragraph 606-10-25-10[18]. However, those stakeholders think economically the rebate is a modification of the sales price of the contract with the dealer. The manufacturer would be indifferent if the $5,000 is provided to the dealer or the end customer as long as the incentive generates more truck sales. The mechanics of whether the $5,000 goes to the dealer or to the end customer does not change the economics that led the manufacturer to offer the incentive.
17. Supporters of Interpretation B also think that, with Interpretation A, an entity might not meet the "core principle" of the revenue standard in paragraph 606-10-10-2[2] that "an entity shall recognize revenue to depict the transfer of promised goods or services to customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services." They assert that,

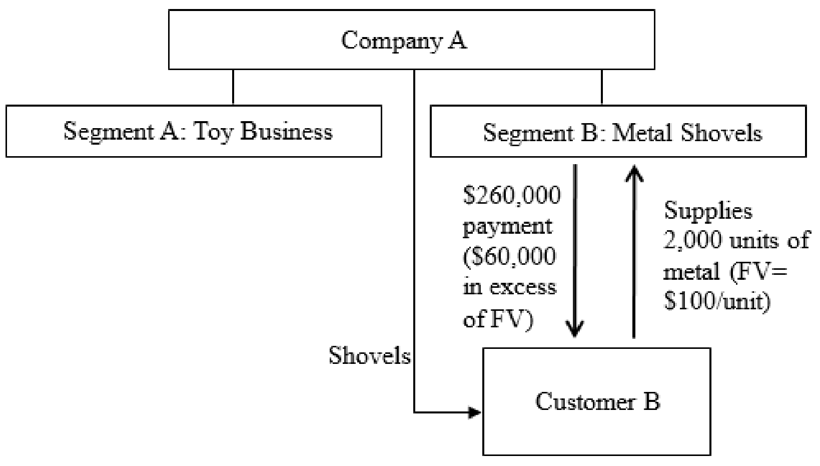
[5] Paragraph 606-10-25-9[17]

with Interpretation A, an entity could be required to recognize a payment to a supplier (that is also a customer) as a reduction of revenue because of an unrelated transaction in a different line of business with that same supplier. This could occur because the entity is unable to demonstrate that the payment represents the fair value of the distinct goods or services it receives from the vendor. In that circumstance, those stakeholders assert that an entity's revenue does not faithfully represent the consideration to which the entity expects to be entitled for providing goods and services.

Interpretation C

18. Supporters of Interpretation C agree with the arguments made by supporters of Interpretation B. However, they think that an entity should also assess consideration payable to customers for goods and services that are within the distribution chain of a revenue transaction for the entity. They think this approach mitigates the risk that a strict interpretation of the modification guidance may not identify all payments that are economically modifying the contract with a customer.
19. The difference between Interpretations B and C can be illustrated with an example. Assume Company A has two businesses, metal shovels and toys. Company A sells metal shovels to Customer B. Six months later Company A purchases metal used in the manufacture of those shovels from Customer B. The transaction and the difference between the two interpretations is illustrated below:

Case A: Customer B sells metal (for shovel segment)



Interpretation B: Would not consider whether the purchase of metal was at fair value because the contracts are not required to be combined
Interpretation C: Customer B is in the distribution chain of a related revenue transaction (metal shovel distribution chain); thus, excess $60,000 payment <u>would go through the model</u>

20. If the fact pattern was changed such that Company A did not purchase metal from Customer B, but instead purchased plastic from Customer B for use in its toy business, then under **both** Interpretation B and Interpretation C the payment for plastic would not be considered consideration payable to a customer in the scope of the guidance. The conclusion changes under Interpretation C, because the relationship with Customer B has changed. That is, customer B, when supplying plastic for the toy business segment, is not within the distribution chain related to the metal shovel revenue transaction for Company A.
21. In addition, supporters of Interpretation C point to the definition of a customer in the glossary of the new revenue standard. A customer is a “party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration” and note that paragraph 606-10-10-4[4] states that the new revenue standard “specifies the accounting for an individual contract with a customer.” Those stakeholders assert that, just as each revenue contract (that is not combined) is accounted for separately, the determination of which entities are customers for application of the consideration payable to a customer guidance is a contract-by-contract determination. These stakeholders cannot take that view under existing GAAP, because the existing definition of a customer is explicitly broader than the new definition. Existing GAAP defines the customer, in part, as “a group of entities known to a reporting entity to be under common control shall be considered as a single customer,” (this definition is superseded under the new revenue standard).
22. Opponents of this interpretation point out that, in order to parse which payments relate to the purchase of goods and services within the distribution chain, an entity has to consider the nature of the purchase. The standard requires an entity to assess whether it purchases a distinct good or service at an amount that does not exceed fair value. There is no language in the standard that indicates an entity would only consider the nature of the payment for some payments made to customers.

Staff View

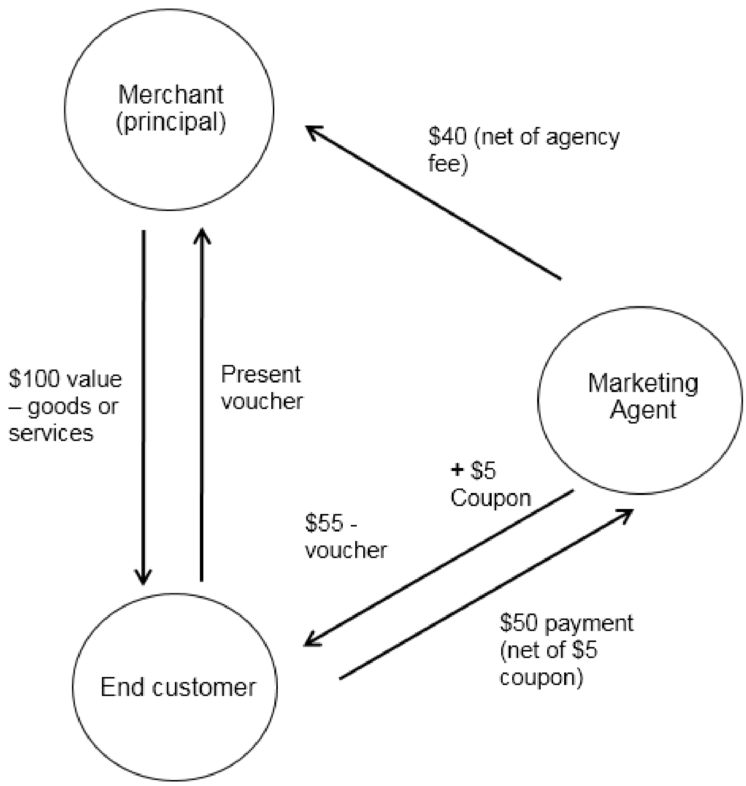
23. The staff thinks that Interpretation A is the only view supported by the new revenue standard. The Boards acknowledged that consideration received from a customer and consideration paid to a customer could be linked even if they are separate events. The

only way to determine if consideration paid to the customer is linked to a revenue contract with a customer is to assess whether the consideration paid to the customer was for distinct goods or services acquired at an amount that does not exceed fair value. Both View B and View C eliminate this assessment for some payments to a customer, and therefore, are not supported by the language in the new revenue standard.

Question 2: Does the guidance on consideration payable to a customer relate to customers in the distribution chain or more broadly to any customer of an entity's customer?

24. The staff notes that the new revenue standard is clear that consideration payable to a customer guidance applies to entities within the distribution chain (that is, it applies to the customer and other parties that purchase the entity's goods or services from the customer). However, some question whether the guidance applies more broadly. They note that paragraph BC255 refers to payments an entity makes to "its customers or to its customer's customer (for example, an entity may sell a product to a dealer or distributor and subsequently pay amounts to or provide a cash incentive to a customer of that dealer or distributor)." These stakeholder think that the words "for example" indicates that the guidance on consideration payable to a customer applies to other examples of customer's customers that are not in the distribution chain.
25. These stakeholders commonly reference principal-agent relationships to illustrate when a customer's customer may extend beyond the distribution chain. The following example illustrates a typical principal-agent relationship that stakeholders have described:

Issue 2: Application of the Model to Agency Transactions



26. In this example, the marketing agent (the intermediary or agent) arranges for a voucher that can be redeemed for $100 worth of goods or services from the merchant (the principal) to be delivered to the end customer for $50 ($55 voucher price less $5 coupon). The agent facilitates the end customer's purchase of the goods or services from the principal. The agent may provide incentives to the end customer, such as in the form of a coupon, discount, or rebate, to entice the customer to make the purchase, because total agency fees are based on the number of purchases made by end customers. Merchants may not be aware that its customers are offered incentives from the agent. In the context of this example, some stakeholders are interpreting that the "customer's customer" language would apply because the end customer would be the agent's "customer's [principal's] customer". Therefore, some stakeholders have questioned whether the agency fee would have to be reduced for the consideration paid by the agent to the end customer even though the agent's customer is the principal.

27. Paragraph 606-10-32-25[70] of the new revenue standard states that the customer would not only include direct customers but "other parties that purchase the entities goods or services from the customer." This language is consistent with viewing an entity's customers as entities in the distribution chain. Paragraph BC255 does not conflict with the standard. Those in the distribution chain are the customer's customers. Instead the phrase customer's customer is a plain English way to describe the concept. The staff thinks the use of the term "for example" was not intended to imply that there are other customer's customers that should be considered beyond the distribution chain.

Question 3: Timing of recognition of consideration payable to a customer

28. The guidance on consideration payable to a customer states that such amounts should be recognized as a reduction of revenue at the later of when the related revenue is recognized or the entity pays or promises to pay such consideration (promises could be implied by customary business practices). Some think this recognition guidance could in some cases be viewed as inconsistent with guidance on variable consideration. The description of variable consideration in paragraph 606-10-32-6[51] is broad and includes price concessions, refunds, incentives, and other payments to a customer. That is, the variable consideration guidance would require an entity to estimate amounts and reduce the transaction price before the entity "promises to pay" the consideration in some fact patterns.
29. The staff does not think the guidance is inconsistent because not all consideration payable to a customer is variable consideration. If the consideration payable to a customer is not variable, then the recognition timing in paragraph 606-10-32-27[72] on consideration payable to a customer applies.[6] However, if the consideration payable to a customer is variable consideration, then paragraph 606-10-32-25[70] requires an entity to "estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 606-10-32-5[50] through 32-13[58]." To illustrate, consider the following example:

[6] For example, a fixed discount of $100 received by the customer solely as a consequence of entering into a contact is not variable consideration.

> An entity that manufactures consumer goods enters into a contract to sell a new product to a customer (a retail store chain) on December 15th. Before delivering any of the new products to the retail store chain, the entity's marketing department assesses whether the entity should offer CU1-off coupons in newspapers to encourage consumers to buy the new product at the retail store chain. The entity will reimburse the retail store chain for any coupons that are redeemed by consumers. The entity has not historically entered into similar coupon offerings in the past.
>
> The entity delivers the new consumer goods (1,000 units at CU10/unit) to the retail store chain on December 28th. On December 31st, the entity decides to make the coupon offering. On January 2nd, the entity communicates to its customer that it will reimburse the retail store chain on March 30th for any coupons redeemed by the retail store's customers. Assume the entity prepares its financial statements based on a calendar year end.

30. The CU1-off coupon in the example is consideration payable to a customer, but it may not be variable consideration, as that notion applies to estimating the transaction price in the new revenue standard. Paragraph 606-10-32-6[51] provides examples of consideration that **could** be considered variable:

> **606-10-32-6[51]** An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, or other similar items. The promised consideration also can vary if an entity's entitlement to the consideration is contingent on the occurrence or nonoccurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.

31. Paragraph 606-10-32-7[52] provides guidance on instances in which those examples of consideration are **actually** variable consideration:

> **606-10-32-7[52]**The variability relating to the consideration promised by a customer may be explicitly stated in the contract. In addition to the terms of the contract, the

promised consideration is variable if either of the following circumstances exist:

(a) The customer has a valid expectation arising from an entity's customary business practices, published policies, or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry, or customer this offer may be referred to as a discount, rebate, refund, or credit.

(b) Other facts and circumstances indicate that the entity's intention, when entering into the contract with the customer, is to offer a price concession to the customer.

32. The staff reviewed the guidance in the preceding paragraph to determine if the CU1-off coupon represents variable consideration in the contract entered into on December 15th. The coupon was not explicitly stated in the contract between the manufacturer and the retail store. The manufacturer cannot have a valid expectation that the retail store would accept an amount of consideration that is less than the price stated in the contract, because the entity has no history of providing coupons in the past. The example does not indicate any facts and circumstances that would indicate that the manufacturer intended to offer a price concession when *entering into the contract.*
33. Based on an assessment of paragraph 606-10-32-7[52], the staff thinks the CU1-off coupon is not variable consideration in this example and, therefore, would not be estimated it as part of the transaction price. Rather, the coupon would be accounted for under the consideration payable to a customer guidance, and the coupon would be recognized as a reduction to revenue at the later of when the revenue is recognized (December 28th) or the consideration was promised to the customer (January 2nd). In this case, the promise to provide consideration occurred after the revenue was recognized. However, assume the same fact pattern above except the manufacturer starts a practice of regularly issuing CU1-off coupons as part of a weekly newspaper advertisement. Consequently, the manufacturer might conclude, depending on the facts and circumstances, that the customer has a valid expectation on the basis of customary business practices that it will provide a price concession in the form of a

coupon to the retail store's customers. If the manufacturer concludes that the customer has a valid expectation of a price concession, it would estimate the transaction price in accordance with the variable consideration guidance. The manufacturer would need to apply judgment in making this assessment.

34. Assume that the first fact pattern above (that is, the one in which the entity does not have a past practice of offering coupons) changes such that the 1,000 units are delivered in two separate shipments as follows:

> An entity that manufactures consumer goods enters into a contract to sell a new product to a customer (a retail store chain) on December 15th. Before delivering any of the new products to the retail store chain, the entity's marketing department assesses whether the entity should offer CU1-off coupons in newspapers to encourage consumers to buy the new product. The entity will reimburse the retail store chain for any coupons that are redeemed. The entity has not historically entered into similar coupon offerings in the past.
>
> The entity delivers 500 units of the new consumer goods (500 units at CU10/unit) to the retail store chain on December 28th and another 500 units on April 15th (500 units at CU10/unit). On December 31st, the entity decides to make the coupon offering. On January 2nd, the entity communicates to its customer that it will reimburse the retail store chain on March 30th for any coupons redeemed by the retail store's customers by that date. Assume the entity prepares its financial statements on a quarterly and annual basis (calendar year end).

35. The staff thinks that at the time of delivering the initial 500 units on December 28th, the customer would not have a valid expectation that the entity will accept a price concession and would recognize revenue based on the CU10/unit price. However, in the first quarter when the entity communicates the coupon offering (January 2nd), the entity would recognize a reduction in revenue for the coupons that are expected to be redeemed related to the 500 units sold to the retailer in December.

36. If every two weeks after January 2nd the entity communicates to its customer a new CU1-off coupon offering, the entity would need to apply judgement to determine whether the estimated transaction price associated with the delivery of 500 units on April 15th is CU10/unit or CU 9/unit. If the manufacturer has a history of providing CU1-off coupons, it might conclude that the customer has a valid expectation that there will be a price concession and, therefore, the coupon represents variable

consideration. Based on that judgement, the manufacturer would follow the guidance on estimating variable consideration in 606-10-32-5[50].

Questions for the TRG Members
1. What are your views about the staff's interpretations for the issues discussed in this paper? 2. Are there any related potential interpretation issues not included in this paper?