



Staff Paper

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| Project | Revenue Recognition |
| Topic | Accounting for product warranties - addendum |

Purpose

1. At the January 28, 2011 Education Session, the FASB asked the staff to clarify their recommendation for determining which warranties should be accounted for as a cost accrual in accordance with other standards.
2. Paragraph 20 of Agenda Paper 1A (Memo 136A) lists two alternatives for determining which warranties should be accounted for as a cost accrual:
 - (a) Warranties that are not separately priced; or
 - (b) Warranties that the entity deems to be “quality assurance” rather than insurance.
3. The first alternative would be straightforward to apply in practice and is consistent with existing requirements in U.S. GAAP. The second alternative often would result in the same accounting as the first alternative, but it would remove the bright line of existing requirements and would require an entity to use more judgment when evaluating the objective of a warranty.
4. The staff is recommending the second alternative because sometimes an entity clearly provides a warranty service (that is, an insurance service in addition to the promised product) even though that service is not separately priced. The first

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alternative would result in an entity recognizing all of the revenue before satisfying its performance obligation for the warranty service. The example in paragraph 21 of Agenda Paper 1A (Memo 136A) highlights that scenario.

5. At the January 28, 2011 Education Session, some FASB members questioned how an entity would apply the second alternative. They thought that when using judgment to determine the objective of the warranty, an entity should consider whether the warranty was priced separately or sold separately by other entities (that is, whether the customer had the option to purchase the warranty separately). The staff agrees and proposes the following clarification of the staff's recommendations in Agenda Paper 1A (Memo 136A):
 - (a) If a customer has the option to purchase a product warranty separately, the entity should account for the warranty as a separate performance obligation in accordance with the revenue standard. Hence, the entity would allocate revenue to both the product and to the warranty service.
 - (b) If a customer does not have the option to purchase a product warranty separately, the entity should account for the warranty as a cost accrual unless the warranty provides a service to the customer in addition to assurance that the delivered product is as specified in the contract (in which case the entity would account for the warranty service as a separate performance obligation in accordance with the revenue standard).