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Project	**Revenue recognition**		
Paper topic	Allocating the transaction price		
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Purpose of this paper

1. This paper considers possible refinements and clarifications to the proposed requirements in the 2011 Exposure Draft, *Revenue from Contracts with Customers* ('the 2011 ED') for allocating the transaction price (ie Step 4).

Staff recommendations

2. The staff recommend that the Boards retain the residual approach outlined in paragraph 73(c) of the 2011 ED as an appropriate estimation technique (when the standalone selling price of a good or service is highly variable or uncertain) and clarify that:

    (a) it may be used when there are two or more separate performance obligations and the promised goods or services underlying such performance obligations have standalone selling prices that are highly variable or uncertain; and

    (b) in those circumstances, an entity could use a combination of techniques to estimate the standalone selling prices of those promised goods or services. Specifically, an entity could estimate the standalone selling prices by:

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(i) first, applying the residual approach to estimate an aggregate standalone selling price for the group of promised goods or services that individually have highly variable or uncertain standalone selling prices; and

(ii) next, using another method to estimate the standalone selling prices of the goods or services that underlies each separate performance obligation relative to the aggregate standalone selling price estimated in paragraph (i) above.

3. The staff also recommend the Boards retain the criteria in paragraph 75 of the 2011 ED which determine whether an entity can allocate a discount to one (or some) performance obligation(s) in the contract and the criteria in paragraph 76 of the 2011 ED which determine whether an entity can allocate contingent consideration to a distinct good or service. Additionally, the staff recommend some clarifications to these paragraphs as follows:

(a) an entity should consider the application of paragraph 75 (ie allocation of a discount) before using a residual approach to estimate a standalone selling price; and

(b) paragraph 76 (ie allocation of contingent consideration) can apply to more than one or less than all performance obligations in the contract.

Structure of this paper

4. The remainder of this paper is structured as follows:

(a) Background information (paragraphs 5 – 7);

(b) The proposed basis for allocating the transaction price (paragraphs 8 – 10);

(c) Estimating the standalone selling price (paragraphs 11 – 23);

(i) Applying the residual approach (paragraphs 16 – 23);

(d) Allocating the discount and contingent consideration (paragraphs 24 – 36)

(e) Appendix A - Examples

(f) Appendix B - Proposed changes to the wording in the 2011 ED

Background

5. The allocation objective stated in paragraph 70 of the 2011 ED requires an entity to allocate the transaction price to each separate performance obligation identified in the contract at an amount that depicts the consideration to which the entity expects to be entitled in exchange for satisfying each of those performance obligations. To meet this objective, an entity allocates the transaction price on the basis of the relative standalone selling prices of the promised goods or services underlying those performance obligations. In paragraph BC176 of the 2011 ED, the Boards stated that allocating the transaction price based on the relative standalone selling price would faithfully depict the different margins that may apply to the goods or services promised in the contract.

6. Paragraph 72 of the 2011 ED specifies that the best evidence of a standalone selling price is the observable price of a good or service, when that good or service is sold separately. Acknowledging that a standalone selling price might not always be directly observable, paragraph 73 of the 2011 ED states that, in those cases, an entity should estimate the standalone selling price of the promised good or service. Paragraph 73 of the 2011 ED also states that the entity should estimate the standalone selling price using an approach that maximizes the use of observable inputs and considers all information that is reasonably available to the entity.

7. A consequence of allocating the transaction price on the basis of the relative standalone selling prices of the promised goods or services is that any discount or contingent consideration would be allocated proportionately across each separate performance obligation in the contract. However, if the criteria specified in paragraphs 75 or 76 of the 2011 ED are met, an entity would:

   (a) allocate a discount specifically to one (or some) performance obligations (refer to paragraph 75 of the 2011 ED); or

(b) allocate contingent consideration entirely to a distinct good or service (refer to paragraph 76 of the 2011 ED).

The proposed basis for allocating the transaction price

8. The allocation methodology in the 2011 ED is broadly the same as that proposed in the 2010 ED. Although the Boards did not specifically invite comments on the revised proposals for allocating the transaction price, most respondents to the 2011 ED generally supported the relative standalone selling price allocation methodology. (Similar feedback was received on the 2010 ED.) However, some respondents requested further clarification of the application of some aspects of the allocation requirements proposed in the 2011 ED—specifically:

    (a) the mechanics for estimating the standalone selling price, particularly for when the residual approach can be used;

    (b) the allocation of a discount in accordance with paragraph 75; and

    (c) the allocation of contingent consideration in accordance with paragraph 76.

9. This paper focuses primarily on those clarifications. The examples to support the clarifications described in this paper are illustrated in Appendix A.

10. In addition, similar to comments received on the 2010 ED, most respondents from the telecommunications industry disagreed with the allocation proposals in the 2011 ED. The application of the allocation proposals to the telecommunications industry is considered separately in Agenda Paper 7C/165C.

Estimating the standalone selling price

Proposals in the 2011 ED

11. Paragraph 73 of the 2011 ED requires that, in estimating the standalone selling price of a good or service, an entity should consider all information (including market conditions, entity specific-factors, and information about the customer or

class of customers) that is reasonably available to the entity. Furthermore, paragraph 73 states that the entity should maximize the use of observable inputs and apply estimation methods consistently in similar circumstances.

12. The proposals state that the following methods (or other methods if they would provide a faithful representation of the standalone selling price) would be suitable for estimating the standalone selling price of a good or service:

    (a) *Adjusted market assessment approach:* An entity evaluates the market in which it sells the goods or services and estimates the price that customers in that market would be willing to pay for those goods or services (adjusted for an entity's costs and margins, as relevant).

    (b) *Expected cost plus a margin approach:* An entity forecasts its expected costs of satisfying the performance obligation and then adds an appropriate margin for that good or service.

    (c) *Residual approach:* In the case where the standalone selling price of a good or service is highly variable or uncertain, an entity may estimate the standalone selling price by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services in the contract.

Respondent feedback

13. Some respondents requested that the Boards clarify or provide additional guidance about how an entity should estimate the standalone selling price. Issues raised by respondents include the following:

    (a) ***Application of the residual approach.*** Some respondents (mostly from the software industry) requested clarification about accounting for arrangements in which more than one good or service has a standalone selling price that is highly variable or uncertain. Specifically, those respondents requested that the Boards clarify whether the residual approach can be used in accounting for those arrangements and, if so, how the residual amount should be allocated amongst those goods or

services that have highly variable or uncertain standalone selling prices. Those concerns are addressed in paragraphs 16-23 of this paper. Examples 2, 5, and 6 in Appendix A of this paper illustrate the application of the residual approach.

(b) ***Determining the standalone selling price of some homogeneous items that transfer to the customer repeatedly over the contract.*** A few respondents from the energy and utilities industry requested clarification about how the revenue proposals would apply to contracts to supply homogeneous goods or discrete increments of service (eg units of electricity) to the customer repeatedly for a fixed term and for a fixed price per unit. For those contracts, they queried whether they would be required to determine the standalone selling prices for those individual units of electricity by reference to market prices or forward pricing curves. The staff think that, consistent with the July 2012 decision on identifying separate performance obligations, the electricity supply contract would be expected to be a single performance obligation because the promise to transfer each unit of electricity is part of the overall promise to supply electricity to the customer over a period of time (which would be a performance obligation satisfied over time). The staff think that a measure of progress based on units of electricity delivered might provide an appropriate depiction of the entity's performance in satisfying that performance obligation. Consequently, the entity would not be required under the revenue model to determine the standalone selling price of each individual increment of service. Therefore, this issue is not considered further in this paper.

14. Limited specific feedback was received from users on the proposals for allocating the transaction price and, thus, the staff conducted targeted outreach with users from those industries that would be most significantly affected by the proposals.

(a) *Software industry:* Users in the software industry had mixed views about the allocation proposals, predominantly about the removal of the

vendor-specific objective evidence ('VSOE') requirements in Topic 605-25, *Multiple Element Arrangements*.

(i) Some users welcomed those proposed changes because they think that, under current software accounting requirements in US GAAP, it is difficult to determine to which performance obligation revenue is attributable (eg license, the ongoing service, or the support). Those users think the proposals would provide more clarity about the various revenue streams of an entity and better visibility into what affects the contract liability balance. The users in favor of the proposed changes were satisfied with removal of the VSOE requirements as long as preparers apply the revenue model consistently from year to year and auditors can audit this information.

(ii) Other users opposed the allocation proposals in the 2011 ED because of increased subjectivity that may be introduced into the revenue line. Those users think the removal of the VSOE requirements could lead to an entity manipulating the standalone selling prices to achieve a desired pattern of revenue recognition. Those users were concerned that the allocation methodology proposed creates additional complexity and suggested retaining rateable revenue recognition guidance when an entity does not have VSOE to effectively limit management's ability to manipulate estimates to influence the timing of revenue recognition.

(b) *Telecommunications industry*: the views expressed by analysts of the telecommunications industry are reflected in Agenda Paper 7C/165C.

15. Paragraph BC185 of the 2011 ED explains that the primacy given to VSOE in US GAAP is similar to the 2011 ED's proposal that an entity should use observable prices when a good or service is sold separately by the entity. However, in contrast to existing US GAAP on software, the 2011 ED would require an entity to estimate the standalone selling price when a good or service is not sold separately by an entity. That proposal to estimate the standalone selling

price of a promised good or service forms part of the basic building blocks of the revenue model that were initially proposed in the Boards' 2008 Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers*. Paragraph 5.47 of the Discussion Paper states:

> The boards acknowledge that estimating a stand-alone selling price for a promised good or service can be difficult. Nevertheless, if an entity was not required to estimate a price, then the entity would have to account for that performance obligation together with other performance obligations. That could result in an entity accounting for a satisfied performance obligation as if it was unsatisfied (in other words, accounting for a delivered good or service as if it was undelivered). Failing to account for the satisfaction of a performance obligation would impair the depiction of an entity's financial position and performance in a contract with a customer. Consequently, the boards propose that estimated prices should be used when observable prices are not available.

Applying the residual approach

16. Many respondents requested clarification about how to apply the residual approach for estimating the standalone selling price in arrangements that contain more than one performance obligation for which the goods or services underlying those performance obligations have standalone selling prices that are highly variable or uncertain. The 2011 ED, as drafted, contemplates the residual approach applying when the price of one good or service is highly variable or uncertain, but it does not specifically address situations in which *more than one* good or service has a highly variable or uncertain price.

17. In those situations in which more than one good or service has a highly variable or uncertain price, some respondents requested clarification on the following:

(a) whether the residual approach could be applied to estimate the standalone selling price and, therefore, determine the amount of the transaction price that should be allocated to that identifiable group of performance obligations in which the underlying goods or services have selling prices that are highly variable or uncertain; and

(b) if so, how an entity should estimate the standalone selling prices for each underlying distinct good or service in order to allocate that amount of transaction price to the individual performance obligations in that group.

Staff analysis

18. The staff think that the rationale for using a residual approach to estimate a standalone selling price is the same regardless of whether one good or service has a highly variable or uncertain selling price or whether two or more goods or services have highly variable or uncertain selling prices. That rationale was explained in paragraph BC182 of the 2011 ED, which states:

> ...paragraph 73(c) of the proposed requirements specifies the circumstances in which a residual approach would be a suitable method to estimate a standalone selling price. In specifying those circumstances, the Boards were particularly mindful of the challenges in determining standalone selling prices in contracts for intellectual property and other intangible products, in which the pricing can be highly variable because there is little or no incremental cost to the entity in providing those goods or services to a customer. In those circumstances, the most reliable way of determining the standalone selling price in the contract will often be to use a residual approach. For the same reason, the Boards noted that the residual approach might be appropriate in situations in which an

entity has not yet established the selling price for a good or service that has not been previously sold.

19. The staff note that a consequence of using a residual approach to estimate standalone selling prices is that any discount in the arrangement would be allocated to the residual item or items. For the reasons outlined in paragraph BC182, the staff think that outcome generally would be consistent with the 2011 ED's objective of allocating the transaction price in an amount to which the entity expects to be entitled in exchange for satisfying each separate performance obligation. (This situation is illustrated in Example 2 of Appendix A.) However, the residual approach would not be a suitable approach for estimating standalone selling prices if it would result in the standalone selling price of a good or service being estimated to be nil or a negligible amount and that amount does not faithfully represent the standalone selling price of the good or service. (Example 3 of Appendix A illustrates that situation.) Accordingly, in those situations in which the residual approach would result in the estimated standalone selling price for the promised goods or services being inconsistent with the objective of allocation, an entity should use a different method to estimate the standalone selling prices of those goods or services.

20. If an entity uses the residual approach to determine the aggregate transaction price that relates to a group of performance obligations in which the underlying goods or services have highly variable or uncertain selling prices, that aggregate amount should be allocated to those individual performance obligations using standalone selling prices that have been estimated using another method (eg an adjusted market assessment approach or an expected cost plus margin approach). Consistent with the requirements in paragraph 73 of the 2011 ED, the estimation method used should consider all available information that is reasonably available and that maximizes the use of observable inputs. (This process is illustrated in Example 6 of Appendix A.)

21. If an entity has difficulty in estimating the standalone selling price of a promised good or service within the group of performance obligations to which the residual approach is applied, the entity should first assess whether:

(a) those promised goods or services are distinct in the context of the contract and, therefore, would be accounted for as separate performance obligations; and

(b) the promised goods or services transfer to the customer at the same time or over the same period of time and, therefore, in practice would not need to be accounted for separately.

22. If after those assessments, an entity still has not determined the standalone selling price of those goods or services, an entity must estimate the standalone selling price. That estimate may be more subjective than other estimated selling prices, but this will be mitigated because the application of the residual approach means that the aggregate transaction price allocated to that group of promised goods or services ensures that any discount in the arrangement would typically be allocated to those performance obligations. In addition, the staff notes that estimates are part of the underlying principles of the revenue model and paragraph BC180 of the 2011 ED acknowledges that "many entities may already have robust processes for determining standalone selling prices on the basis of reasonably available data points and the effects of market considerations and entity-specific factors." Therefore, the staff think that the overall allocation objective would be met and an entity would recognize revenue at an amount that depicts the amount of consideration to which the entity expects to be entitled.

Staff recommendation

23. The staff recommend that the Boards retain the residual approach outlined in paragraph 73(c) of the 2011 ED as an appropriate estimation technique (when the standalone selling price of a good or service is highly variable or uncertain) and clarify that:

(a) it may be used when there are two or more separate performance obligations and the promised goods or services underlying such performance obligations have standalone selling prices that are highly variable or uncertain; and

(b) in those circumstances, an entity could use a combination of techniques to estimate the standalone selling prices of those promised goods or services. Specifically, an entity could estimate the standalone selling prices by:

(i) first, applying the residual approach to estimate an aggregate standalone selling price for the group of promised goods or services that individually have highly variable or uncertain standalone selling prices; and

(ii) next, using another method to estimate the standalone selling prices of the goods or services that underlies each separate performance obligation relative to the aggregate standalone selling price estimated in paragraph (i) above.

Question 1 – application of the residual approach

Do the Boards agree with the staff recommendation to retain the residual approach and clarify that:

a) it may be used when there are two or more separate performance obligations and the promised goods or services underlying such performance obligations have standalone selling prices that are highly variable or uncertain; and

b) in those circumstances, an entity could estimate the standalone selling prices by:

(i) first, applying the residual approach to estimate an aggregate standalone selling price for the group of promised goods or services; and

(ii) next, using another method to estimate the standalone selling prices of the goods or services that underlies each separate performance obligation relative to the aggregate standalone selling price estimated in paragraph (i) above.

Allocating the discount and contingent consideration

24. This section considers possible clarifications on the application of the proposals in paragraphs 75-76 of the 2011 ED, related to allocating a discount and allocating contingent consideration.

Allocating a discount

25. Paragraphs 74, 75, and IG68/IE7 in the 2011 ED provide guidance about how the entity should allocate a discount to the separate performance obligations in a contract. Paragraph 74 of the 2011 ED specifies the general principle that a discount should be allocated to all separate performance obligations on a relative standalone selling price basis. However, in developing the 2011 ED, the Boards acknowledged that there may be cases where allocating a discount to all of the separate performance obligations in a contract would not be consistent with the allocation objective in paragraph 70. For that reason, paragraph 75 proposes that an entity should allocate a discount entirely to one (or some) separate performance obligation(s) in the contract if both of the following criteria are met:

    (a) the entity regularly sells each good or service (or each bundle of goods or services) in the contract on a standalone basis; and

    (b) the observable selling prices from those standalone sales provide evidence of the performance obligation(s) to which the entire discount in the contract belongs.

26. Those proposals for allocating the discount to only one or some performance obligations are intentionally strict. That is because, as noted in paragraph BC189 of the 2011 ED the use of a relative standalone selling price basis brings rigor and discipline to the allocation process, thereby enhancing comparability within and across entities.

Respondent feedback

27. Some respondents disagreed with the proposals in paragraph 75 of the 2011 ED for allocating the discount in a contract specifically to one (or some) performance obligations. Those respondents commented that the proposals are too restrictive and would not yield an outcome that reflects the economics of their transactions. A few of those respondents suggested the entity should be allowed to allocate the discount specifically to a performance obligation if it is able to demonstrate where the discount belongs. For instance, one respondent suggested:

> Paragraph 75 restricts the ability to allocate a discount entirely to one (or some) separate performance obligation(s), so that it is only available if the entity regularly sells each good or service (or each bundle of goods or services). We suggest that this is unnecessarily restrictive, and that the focus should instead be on the quality of evidence that supports the stand-alone selling prices. Paragraph 81 [of the 2011 Exposure Draft] envisages that the experience of other entities may be relevant when assessing whether variable amounts are reasonably assured. In our view, evidence based on the experience of other parties could also be sufficient to justify the allocation of a discount entirely to one (or some) separate performance obligations under paragraph 75. (CL#75 Deloitte Touche Tohmatsu)

28. In addition, one respondent requested that the Boards explicitly state that an entity should consider the application of paragraph 75 before using the residual approach to estimate a standalone selling price. The respondent commented that, if an entity used the residual approach to estimate a standalone selling price before considering whether the arrangement included a discount that should be allocated in accordance with paragraph 75, the 'residual' performance obligation(s) would inappropriately be allocated all of the discount in the arrangement. (Example 5 in the Appendix A illustrates this issue.)

Staff analysis and recommendation

29. The staff observe that the criteria in paragraph 75 of the 2011 ED was largely based on the concept of price independence and the proposals for contract segmentation originally proposed in the 2010 ED. These concepts were generally supported by respondents to the 2010 ED. Those concepts lend rigor and discipline to the allocation process and appropriately restrict the situation in which the discount should not be allocated pro rata to all performance obligations in the contract. This rigor is explained in paragraph BC190 which states:"the Boards

have largely carried forward into the proposed guidance the notion that an entity should allocate a discount to one or more separate performance obligations, rather than to all the performance obligations, if the entity has observable sales prices for parts of the contract that establish that the entire discount in the contract is attributable only to one or more separate performance obligations." The staff think that any proposal to expand those criteria creates a risk of unintended consequences and raises a question of how that expanded criteria can be appropriately limited, so as to not diminish the rigor of the allocation process. Therefore, the staff recommend no change to the criteria in paragraph 75 of the 2011 ED.

30. The staff agree with those respondents that suggested an entity consider the application of paragraph 75 of the 2011 ED before using the residual approach to estimate the standalone selling price for promised goods or services with a highly variable and uncertain selling price. The staff think that the resulting allocation from making this clarification would be more consistent with the core allocation principle described in paragraph 71 of the 2011 ED (ie allocate the transaction price in an amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation). The staff recommend the Boards clarify this through the use of an example.

Question 2 – Discount allocation clarifications

Do the Boards agree with the staff recommendation to retain paragraph 75 of the 2011 ED and clarify that an entity would consider the application of paragraph 75 (ie allocation of a discount) before using a residual approach to estimate a standalone selling price for a highly variable or uncertain performance obligation?

Allocating contingent consideration (paragraph 76 of the 2011 ED)

34. Paragraph 76 requires contingent consideration be allocated entirely to a distinct good or service if both of the following criteria are met:

    (a) the contingent payment terms for the distinct good or service relate specifically to the entity's efforts to transfer that good or service (or to a specific outcome from transferring that good or service); and

    (b) allocating the contingent amount of consideration entirely to the distinct good or service is consistent with the allocation principle in paragraph 70 when considering all of the performance obligations and payment terms in the contract.

35. Some respondents requested clarification of the proposal in paragraph 76 of the 2011 ED for allocating contingent consideration. Those respondents interpreted paragraph 76 to mean that the contingent amount could be allocated either to one distinct good or service or allocated proportionately to all of the distinct goods or services promised in the contract, but not to any combination in between. For example, if an entity promises to transfer four goods to a customer, some read the proposal to require that, in allocating the transaction price, any contingent consideration could only be allocated to one distinct good (if the criteria in paragraph 76 were met) or would be required to be allocated to all four goods on the basis of their relative standalone selling prices. Those respondents requested that the drafting in paragraph 76 be amended to allow the contingent amount to be allocated entirely to the *goods and services* to which it relates and not just to the *good or service* to which it relates. For instance, one comment letter respondent stated:

    > Paragraph 76 refers to a 'distinct good or service' but we believe that in practice these could also be plural - i.e. 'distinct goods and/or services'. For example if an entity contracts to deliver A, B and C, which are all distinct, under a contract which states that a bonus will be payable if both A and B are delivered a week early, then the bonus

arguably relates to both A and B. (CL#344 The Institute of Chartered Accountants in England and Wales)

Staff analysis and recommendation

36. The staff think that those respondents have interpreted the wording of paragraph 76 of the 2011 ED too narrowly because the proposal was intended to apply to, among other things, repetitive services contracts in which each increment of service would have been distinct (as defined in the 2011 ED). The staff plan to clarify this in the final standard.

Question 4 – allocation of contingent consideration
Do the Boards agree to retain paragraph 76 of the 2011 ED and clarify that an entity can apply to more than one but less than all distinct goods and services in a contract?

Appendix A – Examples

The following examples illustrate how the allocation proposals would apply to some common fact patterns.

A1. **Example 1 -** An entity enters into a contract with a customer to sell Products A, B, and C for a total transaction price of CU100. Each promise to deliver a product is a performance obligation satisfied at a point in time and will be provided at a different point in time from the other items. The entity regularly sells Product A separately. The selling prices for Products B and C are not directly observable and, therefore, the entity estimates the prices of B and C using an adjusted market assessment approach and an expected cost plus margin approach, respectively. These estimates maximize the use of observable inputs. The standalone selling prices are as follows:

Product	Price Method	Standalone selling price
Product A	Directly observable (paragraph 72)	50
Product B	Adjusted market assessment (paragraph 73a)	25
Product C	Expected cost plus a margin (paragraph 73b)	75
	Total	150
	Allocation	
Product A	50/150 x 100	33*
Product B	25/150 x 100	17
Product C	75/150 x 100	50
	Total	100
*Note that the discount is allocated proportionately across Products A, B, and C (ie this number is not 50).		

A2. **Example 2** - Assume the same facts as Example 1, however, the contract price is now CU200 and there is an additional product D sold with products A, B, and C. The selling price for product D is not directly observable and the entity concludes the standalone selling price of Product D is highly variable or uncertain, therefore, the entity uses the residual approach to estimate the standalone selling price. The standalone selling prices for the products are as follows:

Product	Price Method	Standalone selling price
Product A	Directly observable (paragraph 72)	50
Product B	Adjusted market assessment (paragraph 73a)	25
Product C	Expected cost plus a margin (paragraph 73b)	75
Product D	Residual approach (paragraph 73c)	50*
	Total	200
*Price for product D calculated by taking the contract price and subtracting the other observable standalone selling prices (200-50-25-75 = 50). Note that any discount is allocated to Product D using the residual approach.		

	Allocation	
Product A	50/200 x 200	50
Product B	25/200 x 200	25
Product C	75/200 x 200	75
Product D	50/200 x 200	50
	Total	200

A3. **Example 3** Assume the entity has the same fact pattern as Example 2 but, in this case, the transaction price is CU150 and not CU200. In this case, the residual approach would result in a standalone selling price of CU0 for Product D (CU150 less Product A [50] less Product B [25] less Product C [75]). Because CU0 is unlikely to be a faithful representation of the standalone selling price of Product D the entity should use a different technique to estimate the standalone selling price for purposes of allocating the standalone selling price.

A4. **Example 4** - An entity enters into a contract to sell Products X, Y, and Z for CU100. The entity regularly sells product X, Y, and Z for the following prices:

	Standalone Selling Price
Product X	40
Product Y	80
Product Z	20
Total	140

The contract results in a discount of CU20 on the overall transaction that generally would be allocated proportionately to all three products in the contract. However, the entity regularly sells Products Y and Z together for CU60 and regularly sells Product X for CU40. Therefore, in accordance with paragraph 75

of the 2011 ED, the CU40 discount in the contract should be allocated only to Products Y and Z. Hence, the entity allocates the transaction price of CU100 as follows:

	Allocation	
Product X	40/140 x 140	40
Product Y	80/100 x 60	48
Product Z	20/100 x 60	12
	Total	100

A5. **Example 5 -** Assume the same facts as Example 4, however, the contract price is now CU130 and there is an additional product W sold along with products X, Y, and Z. The selling price for product W is not directly observable and the entity concludes in determining the estimation of the standalone selling price that the price is highly variable or uncertain, therefore, the estimation method for product W is determined to be the residual approach. The entity determines that it needs to apply paragraph 75 (allocating the discount in the contract) before applying the residual approach for determining the standalone selling price of product W.

Product	**Price Method**	**Standalone selling price**
Product X	Directly observable (paragraph 72)	40
Product Y and Z	Directly observable with discount (paragraph 72 and 75)	60
Product W	Residual approach (paragraph 73c)	30*
	Total	130
*Price for product W calculated by taking the contract price and subtracting the other observable standalone selling prices (130-40-60 = 30). Note that the full discount is allocated to Product D using the residual approach.		
	Allocation	
Product X	40/130 x 130	40
Product Y and Z	60/130 x 130	60*
Product W	30/130 x 130	30
	Total	130
*Consistent with Example 4, the standalone selling prices of Y and Z are 48 and 12.		

A6. **Example 6 -** An entity enters into a contract with a customer to sell Service A along with Products B, C, and D, for a total transaction price of CU120. The entity regularly sells Service A separately for a directly observable standalone selling price of CU20. The selling prices for Products B, C, and D are not directly observable, and, in fact, are determined to be highly variable or uncertain thus the entity determines the residual approach to be the best technique for estimating the standalone selling price of products B, C, and D. The standalone selling prices are as follows:

Product	**Price Method**	**Standalone selling price**
Service A	Directly observable (paragraph 72)	20
Products B, C, and D	Residual approach (paragraph 73c)	100*
	Total	120
*Standalone selling price for bundle of products B, C, and D calculated by taking the contract price and subtracting the other observable standalone selling prices (120-20 = 100). Note that the full discount is allocated to the products in the residual approach.		
	Allocation	
Service A	20/120 x 120	20
Products B, C, and D	100/120 x 120	100
	Total	120

The next step in allocating the transaction price is to further allocate the residual amount of CU100 to Products B, C, and D. The entity determines, after first applying the residual approach, an estimate of the individual standalone selling prices for Products B, C, and D using a technique that maximizes the use of observable inputs an considers all reasonably available information. The entity's estimate determines the relative value of each of the individual products using this technique and the standalone selling prices are as follows:

Product	**Price Method**	**Standalone selling price**
Product B	Relative value	80
Product C	Relative value	70
Product D	Relative value	50
	Total	200
	Allocation	
Product B	80/200 x 100	40
Products C	70/200 x 100	35
Product D	30/200 x 100	15
	Total	100

Appendix B – Proposed changes to the wording in the 2011 ED

The following table lists the proposed requirements from the 2011 ED that relate to the allocation of the transaction price and identifies which of those proposals might change as a result of the staff recommendations in this paper.

Proposals from the 2011 exposure draft		Anticipated change?
	Allocating the transaction price to separate performance obligations (see paragraphs IG68 and IG69)	No material change is anticipated.
70	For a contract that has more than one separate performance obligation, an entity shall allocate the transaction price to each separate performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.	
71	To allocate an appropriate amount of consideration to each separate performance obligation, an entity shall determine the standalone selling price at contract inception of the good or service underlying each separate performance obligation and allocate the transaction price on a relative standalone selling price basis. The standalone selling price is the price at which an entity would sell a promised good or service separately to a customer.	No material change is anticipated.
72	The best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the standalone selling price of that good or service.	No material change is anticipated.
73	If a standalone selling price is not directly observable, an entity shall estimate it. When estimating a standalone selling price, an entity shall consider all information (including market conditions, entity-specific factors, and information about the customer or class of customer) that is reasonably available to the entity. In addition, an entity shall maximize the use of observable inputs and shall apply estimation methods consistently in similar circumstances. Suitable estimation methods include, but are not limited to, the following: a) Adjusted market assessment approach – An entity could evaluate the market in which it sells goods or services an estimate the price that customers in that market would be willing to pay for those goods or services. That approach also might include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins. b) Expected cost plus a margin approach – An entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service c) Residual approach – if the standalone selling price of a good or service is highly variable or uncertain, then an entity may estimate the standalone selling price by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services promised in the contract. A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. A selling price is uncertain when an entity has not yet	No material change is anticipated, however, additional implementation guidance and clarification proposed in paragraph 23.

established a price for a good or service and the good or service has not previously been sold.	
74 If the sum of the standalone selling prices of the promised goods or services in the contract exceeds the transaction price (that is, if a customer receives a discount for purchasing a bundle of goods or services), an entity shall allocate that discount to all separate performance obligations on a relative standalone selling price basis except as specified in paragraphs 75 and 76.	No material change is anticipated.
75 An entity shall allocate a discount entirely to one (or some) separate performance obligation(s) in the contract if both of the following criteria are met: a) The entity regularly sells the good or service (or each bundle of the goods or services) in the contract on a standalone basis. b) The observable selling prices from those standalone sales provide evidence of the performance obligation(s) to which the entire discount in the contract belongs.	No material change is anticipated, however, clarification is suggested in paragraph 29-30.
76 If the transaction price includes an amount of consideration that is contingent on a future event or circumstance (for example, an entity's performance or a specific outcome of the entity's performance), the entity shall allocate that contingent amount (and subsequent changes to the amount) entirely to a distinct good or service if both of the following criteria are met: a) The contractual payment terms for the distinct good or service relate specifically to the entity's efforts to transfer that good or service (or to a specific outcome from transferring that good or service). b) Allocating the contingent amount of consideration entirely to a distinct good or service is consistent with the allocation principle in paragraph 70 when considering all of the performance obligations and payment terms in the contract.	No material change is anticipated, however, clarification is suggested in paragraph 36.