

# STAFF PAPER

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<b>Project</b>	<b>FASB/IASB Joint Transition Resource Group for Revenue Recognition</b>		
<b>Paper topic</b>	Allocation of the Transaction Price for Discounts and Variable Consideration		
CONTACT(S)	Sean May	<a href="mailto:srmay@fasb.org">srmay@fasb.org</a>	+1 203 956 5305
	Scott A. Muir	<a href="mailto:samuir@fasb.org">samuir@fasb.org</a>	+1 203 956 3478
	Stuart Leadill	<a href="mailto:sleadill@ifrs.org">sleadill@ifrs.org</a>	+44 207 246 6410

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## Purpose

- Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, and IFRS 15 *Revenue from Contracts with Customers* (collectively, the “new revenue standard”), includes guidance on how to allocate the transaction price to performance obligations. The guidance on allocating discounts to only one or some, but not all, performance obligations in a contract is different from the guidance on allocating variable consideration to only one or some, but not all, performance obligations (or distinct goods or services that comprise a single performance obligation in accordance with paragraph 606-10-25-14(b) [22(b)]). Because a discount can be variable consideration, some stakeholders have raised questions as to whether an entity should account for such a discount by applying:
  - the guidance for allocating discounts; or
  - the guidance for allocating variable consideration.
- 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 on these potential implementation issues.

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## Background and Accounting Guidance

3. Paragraphs 606-10-32-28 [73] through 606-10-32-41 [86] provide guidance on allocating the transaction price to performance obligations (Step 4 of the revenue model). A contract with a customer includes a discount if the “sum of the standalone selling prices of those promised good or services in the contract exceeds the promised consideration in a contract.”<sup>1</sup> Unless a contract meets the following criteria, the discount is allocated proportionately to all performance obligations:

**606-10-32-37 [82]** An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

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

b. The entity also regularly sells on a standalone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the standalone selling prices of the goods or services in each bundle.

c. The discount attributable to each bundle of goods or services described in (b) is substantially the same as the discount in the contract, and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.

4. The new revenue standard includes separate guidance for allocating variable consideration to performance obligations. Examples of variable consideration included in 606-10-32-6 [51] are discounts, rebates, and price concessions. An entity is required to estimate variable consideration and determine whether the variable consideration should be included in the transaction price.

5. Variable consideration is attributable to only one or some, but not all, of the performance obligations (or distinct goods or services that comprise a single

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<sup>1</sup> Paragraph 606-10-32-36 [81]

performance obligation in accordance with paragraph 606-10-25-14(b) [22(b)]) in the contract if the following criteria are met:

**606-10-32-40 [85]** An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 606-10-25-14(b) [22b] if both of the following criteria are met:

a. The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).

b. Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 606-10-32-28 [73] when considering all of the performance obligations and payment terms in the contract.

6. Variable consideration that does not meet the criteria in paragraph 606-10-32-40 [85] is allocated to performance obligations based on the remainder of the guidance in Step 4 of the revenue model:

**606-10-32-41 [86]** The allocation requirements in paragraphs 606-10-32-28 [73] through 32-38 [83] shall be applied to allocate the remaining amount of the transaction price that does not meet the criteria in paragraph 606-10-32-40 [85].

**Implementation question: What is the interaction between the guidance on allocating discounts and allocating variable consideration?**

7. Stakeholders have different views about whether the guidance on allocating discounts or the guidance on allocating variable consideration should be applied in certain circumstances. The staff are aware of the following interpretations of different stakeholders:
- (a) *View A* – Variable consideration is first subject to the guidance on allocating variable consideration. Only if the criteria in paragraph 606-10-32-40 [85] are not met, would an entity further consider the remaining allocation guidance in paragraphs 606-10-32-28 [73] through 32-38 [83].
  - (b) *View B* – A discount, whether fixed or variable, is subject to the guidance on allocating a discount. Accordingly, a discount should be allocated to one or some, but not all, of the performance obligations in the contract only if the criteria in paragraph 606-10-32-37 [82] are met.
  - (c) *View C* – An entity should apply judgment to determine whether it should apply the guidance on allocating a discount or the guidance on allocating variable consideration. In making that judgment, an entity would consider the specific facts and circumstances in the context of the overall objective for allocating the transaction price.<sup>2</sup>
8. The staff think that paragraph 606-10-32-41 [86] establishes a hierarchy for allocating variable consideration such that when a contract includes variable consideration, an entity should first apply the guidance on allocating variable consideration before considering the guidance on allocating discounts. Therefore, the staff think that only View A is consistent with the new revenue standard.
9. The staff note that, in accordance with paragraph 606-10-32-41 [86], only *after* the entity considers whether all or a portion of the variable consideration in the contract relates to a specific part(s) of the contract should the entity consider the remaining

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<sup>2</sup> Paragraph 606-10-32-28 [73]: “The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.”

paragraphs on allocating the transaction price to the performance obligations in the contract (that is, paragraphs 606-10-32-28 [73] through 606-10-32-38 [83]). Those remaining paragraphs *include* the specific guidance on allocating a discount. The staff think that guidance is clear that an entity first considers the allocation of variable consideration because the guidance states that the other paragraphs “shall be applied to allocate the *remaining* amount of the transaction price.”<sup>3</sup> Because an entity is first required to identify variable consideration and determine whether it should allocate variable consideration to one or some, but not all, performance obligations (or distinct goods or services that comprise a single performance obligation in accordance with paragraph 606-10-25-14(b) [22(b)]) based on the guidance above, the entity would consider the requirements for allocating a discount only if the discount is not variable consideration or the entity does not meet the criteria to allocate variable consideration to a specific part of the contract.

10. The staff think it is important to emphasize that the guidance on allocating variable consideration in paragraphs 606-10-32-39 [84] and 32-40 [85] does not apply to consideration that is not variable consideration. The mere use of the words “discount” or “rebate” in paragraph 606-10-32-6 [51] does not mean any contract that contains a discount or a rebate contains variable consideration. If the amount of a discount or a rebate in a contract is fixed and not contingent (for example, a CU100 discount or rebate received solely as a consequence of entering into the contract), that discount or rebate is not variable consideration.

**Question for the TRG Members**

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

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<sup>3</sup> Paragraph 606-10-32-41 [86]