STAFF PAPER

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Project	**FASB/IASB Joint Transition Resource Group for Revenue Recognition**		
Paper topic	Application of the Series Provision and Allocation of Variable Consideration		
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Purpose

1. The staff has received questions about the guidance in 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'), regarding the applicability of the series provision in paragraph 606-10-25-14(b) [22(b)] to service arrangements and the allocation of variable consideration to a distinct good or service within the single performance obligation (that is, the series).

2. The TRG previously discussed questions related to the series provision at its March 30, 2105 meeting. More specifically, they discussed (a) whether or not the goods needed to be delivered consecutively and (b) whether the accounting result needed to be the same as if the underlying distinct goods and services each were accounted for as a separate performance obligation to apply the series provision.

3. This paper addresses the application of the series provision to service contracts and the allocation of variable consideration to distinct services in the series. The staff will seek input from members of the FASB-IASB Joint Transition Resource Group for Revenue Recognition on those topics.

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Background

4. The series provision is a concept that was introduced by the new revenue standard and does not exist in current GAAP or IFRS revenue guidance.[1] As described in paragraph BC113 of the new revenue standard, the purpose of the series guidance is to *simplify* the application of the revenue model and to promote consistency in identifying performance obligations. For example, the series provision prevents an entity from having to allocate the transaction price on a relative standalone selling price basis to each increment of a distinct service in repetitive service contracts. In some cases, variable consideration should be allocated directly to the distinct good or service within the series.

5. Stakeholders have indicated that Step 3, Determining the Transaction Price, Step 4, Allocating the Transaction Price, and Step 5, Recognizing Revenue When (or As) the Entity Satisfies a Performance Obligation, will be challenging for entities that enter into long-term contracts with variable consideration if those transactions do not qualify for the series provision or the practical expedient for measuring progress based on the right to invoice the customer in paragraph 606-10-55-18 [B16] (refer to TRG Paper 40 for the July 13, 2015 TRG meeting regarding that practical expedient). They further indicated that attributing the variable consideration across the entire performance obligation may not accurately depict the entity's performance. Examples include IT outsourcing, transaction processing, and hotel management.

6. The staff think that appropriately identifying whether a service is considered a series could help alleviate some of these stakeholders' concerns. Specifically, if a service is considered a series and the requirements to allocate variable consideration to a distinct service within the series are met, an entity would allocate and recognize variable consideration in the period it has the contractual right to the fee, rather than recognizing the fee over the entire performance obligation. Stakeholders have questions regarding how broadly this guidance applies.

[1] In the FASB's Proposed Accounting Standards Update, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, the FASB asked respondents whether the series provision should be an optional practical expedient.

Accounting Guidance

7. The new revenue standard defines a performance obligation and a series as follows:

> **606-10-25-14 [22]** 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]).

8. The new revenue standard also provides criteria for determining the applicability of the series provision as follows:

> **606-10-25-15 [23]** 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 [39] through 25-32 [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.

9. Paragraphs BC113 and BC114 provide the Boards' rationale for the series provision and state:

BC113 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].

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 the 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 single measure of progress to that performance obligation.

10. Paragraph BC115 states that if the criterion in 606-10-25-14(b) [22(b)] is met, "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." As such, the Boards required variable consideration to be allocated to a distinct good or service that forms part of the series when 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) [22(b)] 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.

11. Paragraph BC285 explains the rationale for allocating variable consideration to distinct goods or services that form part of a single performance obligation:

> **BC285** The Boards clarified in paragraph 606-10-32-39(b) [84(b)] that variable consideration can be allocated to distinct goods or services even if those goods or services form a single performance obligation. The Boards made this clarification to ensure that an entity can, in some cases, attribute the reassessment of variable consideration to only the satisfied portion of a performance obligation when that performance obligation meets the criterion in paragraph 606-10-25-14(b) [22(b)]. Consider the example of a contract to provide hotel management services for one year (that is, a single performance obligation in accordance with paragraph 606-10-25-14(b) [22(b)]) in which the consideration is variable and determined based on two percent of occupancy rates. The entity provides a daily service of management that is distinct, and the uncertainty related to the consideration also is resolved on a daily basis when the occupancy occurs. In those circumstances, the Boards did not intend for an entity to allocate the variable consideration determined on a daily basis to the entire performance obligation (that is, the promise to provide management services over a one-year period). Instead, the variable consideration should be allocated to the distinct service to which the variable consideration relates, which is the daily management service.

12. In addition to cleaning, transaction processing, electricity, and hotel management transactions that were mentioned as examples of a series, the new revenue standard also provides the following examples of a service that is a series (see Appendix A):

(a) Example 13: Monthly payroll processing services for one year

(b) Example 25: A five year asset management contract.

Examples

13. Throughout the rest of this paper, the staff will refer to the following examples:

> **Example A:** Information technology (IT) Seller and IT Buyer execute a 10 year IT Outsourcing arrangement in which IT Seller provides continuous delivery of outsourced activities over the contract term. For example, the vendor will provide server capacity, manage the customer's software portfolio, and run an IT help desk. The total monthly invoice is calculated based on different units consumed for the respective activities. For example, the billings might be based on millions of instructions per second of computing power (MIPs), number of software applications used, or number of employees supported, and the price per unit differs for each type of activity.
>
> Prior to the delivery of the service, IT Seller performs certain initial set-up activities to be in a position to provide the other services in the contract. IT Seller charges the IT Buyer a non-refundable upfront fee related to the transition activities. IT Seller concludes that the set up activities do not transfer services to the customer.
>
> The per unit price charged by IT Seller declines over the life of the contract. The agreed upon pricing at the onset of the contract is considered to reflect market pricing. The pricing decreases to reflect the associated costs decreasing over the term of the contract as the level of effort to complete the tasks decreases. Initially, the tasks are performed by more expensive personnel for activities that require more effort. Later in the contract, the level of effort for the activities decreases, and the tasks are performed by less expensive personnel. The contract includes a price benchmarking clause whereby the IT Buyer engages a third party benchmarking firm to compare the contract pricing to current market rates at certain points in the contract term. There is an automatic prospective price adjustment if the benchmark is significantly below IT Seller's price.
>
> Assume IT Seller concludes that there is a single performance obligation that is satisfied over time because the customer simultaneously receives and consumes the benefits provided by its services as it performs.
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> **Example B:** Transaction Processer (TP) enters into a 10 year agreement with a customer. Over the 10 year period, TP will provide continuous access to its system and process all transactions on behalf of the customer. The customer is obligated to use TP's system to process all of its transactions; however, the ultimate quantity

of transactions is not known. TP concludes that the customer simultaneously receives and consumes the benefits as it performs.

TP charges the customer on a per transaction basis. For each transaction, the customer is charged a contractual rate per transaction and a percentage of the total dollars processed. TP also charges the customer a fixed upfront fee at the beginning of the contract.

Example C: Hotel manager (HM) enters into a 20 year agreement to manage properties on the behalf of the customer. HM receives monthly consideration based on 1 percent of monthly rental revenue, reimbursement of labor costs incurred to perform the service, and an annual incentive payment based upon 8 percent of gross operating profit. HM concludes that the customer simultaneously receives and consumes the benefits provided by its services as it performs.

Example D: Franchisor grants franchisee a license that provides franchisee with the right to use franchisor's trade name and sell its products for 10 years. Franchisor will receive a sales-based royalty of 5 percent of the franchisee's sales for the term of the license as well as a fixed fee. Franchisor concludes that the nature of its promise is to provide a right to access the intellectual property throughout the license period, and the performance obligation is satisfied over time because franchisee simultaneously will receive and consume the benefit from franchisor's performance of providing access to its intellectual property.

Issue 1- In order to apply the series provision, how should entities consider whether the performance obligation consists of distinct goods or services that are substantially the same?

14. In order to be considered a series, there must be two or more goods or services that are distinct, and each distinct good or service must also be considered substantially the same. Since there is little guidance on how to consider whether more than one good or service is considered substantially the same, some stakeholders have questions on how broadly or narrowly this should be interpreted. That is, they question whether all the tasks in each increment of service need to be substantially the same. For example, some stakeholders think that a time increment (each day/month/quarter or other time period) of the outsourcing services in Example A could be considered distinct and substantially the same. However, other stakeholders take a more narrow view and think that the individual tasks need to be substantially the same throughout the performance obligation to be considered a series.

15. The staff think the first step is to determine the nature of the entity's promise in providing the services to the customer. In some cases, an entity would need to determine if the nature of the promise is the actual delivery of a specified quantity of service or the act of standing ready to perform (refer to TRG Paper 16 for the January 26, 2015 TRG meeting regarding stand ready obligations). If the nature of the promise is the delivery of a specified quantity of a service, then the evaluation should consider whether each service is distinct and substantially the same. If the nature of the entity's promise is the act of standing ready or providing a single service for a period of time (that is, because there is an unspecified quantity to be delivered), the evaluation would likely focus on whether each time increment, rather than the underlying activities, are distinct and substantially the same.

16. The staff think that making this evaluation based on the nature of the promise is consistent with the examples throughout the new revenue standard. That is, the Boards intended that a series could consist of distinct time increments (an hour of cleaning) or the good or service delivered (each unit of electricity), depending on the nature of the promise. For example, paragraph BC285 discusses a hotel management performance obligation that is a series of distinct days of service. In that example, the nature of the promise is to provide a daily management service, and not a specified amount of services, which could include management of the hotel employees, accounting services, training, procurement, etc. The staff notes that the underlying activities could significantly vary within a day and from day to day; however, that would not be relevant to the evaluation of the nature of the promise. In contrast, Example 13 describes an annual contract to provide monthly payroll processing services that is considered a series. In this contract, the nature of the promise is to deliver twelve distinct instances of the service, rather than a promise to stand ready to perform an undefined number of tasks.

17. When considering the nature of the entity's promise and the applicability of the series guidance, the staff also thinks it could be helpful to consider the reason why the entity concluded that a performance obligation is satisfied over time. If a performance obligation is satisfied over time because the customer simultaneously receives and consumes the benefits provided by its services as it performs (paragraph 606-10-25-27(a) [35(a)]), that might indicate that each increment of service being performed is

capable of being distinct (paragraph 606-10-25-19(a) [27(a)]). That is because the customer can benefit on its own from each increment of service. The entity would then need to evaluate whether each increment was separately identifiable (paragraph 606-10-25-19(b) [27(b)]) and substantially the same, as described above.

18. If a promise is satisfied over time based on the other criteria in paragraph 606-10-25-27 [35], the nature of that promise might be the delivery of a single specified good or service. For example, a contract to construct a single piece of equipment might meet the criteria to be recognized over time in paragraph 606-10-25-27(b) [35(b)]. The nature of the promise is to provide the piece of equipment and not a daily construction or manufacturing service. As such, the staff does not think this performance obligation is a series since the individual goods or services within that performance obligation are not distinct, and the evaluation of a time increment is not relevant due to the nature of the promise. However, a contract for two pieces of equipment that each meet the criteria to be recognized over time could be a series comprised of two pieces of equipment if they are substantially the same.

19. A contract to provide professional services that results in a professional opinion might be recognized over time if it meets the criteria in paragraph 606-10-25-27(c) [35(c)]. In this arrangement, the nature of the promise is providing the professional opinion and not a daily service. As such, the staff does not think this service would be a series. That is because there is no increment of the service that could be a separate performance obligation because each of the activities are inputs to provide the combined output of the professional opinion and, therefore, are not distinct within the context of the contract. Similarly, due to the nature of the promise, a time based increment of the service would not be relevant.

Example A

20. The entity first considers the nature of its promise to the customer in this contract (that is, whether the entity's promise is to provide an integrated outsourcing service or, instead, to provide defined items or activities that are distinct from each other). Because IT Seller has promised to provide an unspecified quantity of activities, rather than a defined number of services, the staff thinks it would be reasonable to conclude

that the nature of the promise is an obligation to stand ready to provide the integrated outsourcing service each day.

21. If the nature of the entity's promise is the overall IT outsourcing service, the staff think that each day of service could be considered distinct because the customer can benefit from each day of service on its own and each day of service is separately identifiable. Put another way, each day could be separately identifiable because the entity does not provide an integration service between the days (that is, while the activities are generally coordinated and inputs to the combined service, each day those combined activities are provided is not an input to a combined output), each day does not modify or customize another day, and the days of service are generally not highly interdependent or interrelated because the entity can fulfil its obligations each day independent of fulfilling its obligations for the other days.

22. If IT Seller concluded that the nature of its promise is one overall service, the staff also think it would be reasonable to conclude each day of service is substantially the same. That is, even if the individual activities that comprise the performance obligation vary from day to day, the nature of the overall promise is the same from day to day. Therefore, the entity has promised the daily IT outsourcing service.

23. The staff note that some stakeholders think a more narrow view would be appropriate. In this example, each individual activity within the performance obligation is priced separately, and, therefore, these stakeholders think this is indicative that the activities need to be the same each day. Since many different types of tasks that comprise the performance obligation are being performed, these stakeholders would not conclude that each distinct service is substantially the same. This view would result in few transactions meeting the conditions to apply the series guidance.

24. The staff note that stakeholders having this narrow view also, in general, identify the nature of the overall promise as the delivery of the specified services rather than an integrated outsourcing service. The staff think the narrow view is inconsistent with the conclusion that there is a single performance obligation that consists of multiple activities. That is, the conclusion that there is a single performance obligation indicates the substance of the arrangement is a single integrated outsourcing service.

25. The staff notes that if the nature of the promise was to provide multiple distinct services, this might imply that the arrangement should have multiple performance obligations, and the entity could have multiple series in a single contract. Additionally, the staff does not think the payment terms dictate the analysis and identification of the distinct goods or services.

26. The staff would not consider the set up activities in the assessment of whether or not the distinct services are the same. That is because those activities do not transfer goods or services to the customer and would not be considered part of the performance obligation, as stated in paragraph 606-10-25-17 [25].

Example B

27. If TP concludes that the nature of its promise to the customer is one of providing continuous access to its system, rather than one of processing a particular quantity of transactions, then TP might conclude that there is a single performance obligation to stand ready to process as many transactions as the customer requires. If that is the case, the staff think it would be reasonable to determine if there are multiple distinct time increments of that service. The staff think that each day of service could be considered distinct because the customer benefits each day from the access to its system (capable of being distinct) and each day is separately identifiable. That is, each day of service could be separately identifiable because there is no significant integration service, each day does not modify or customize another day, and each day is not highly interdependent or interrelated.

28. The staff think that each day of access (the distinct service) provided to the customer could be considered substantially the same since the customer is deriving a consistent benefit from the access over each day of the service period even if the number of transactions processed in a given day differs from the next. That is, if the nature of what could be considered daily performance obligations is the stand ready service to provide access, the nature of each day would be similar.

29. If TP concludes that the nature of the promise is the processing of each transaction, then TP would need to evaluate whether or not a series of distinct transactions was present. The staff notes that this view of the performance obligation raises additional questions when there is an undefined quantity of transactions and if each transaction

should be considered an optional purchase that is accounted for separately. Regardless, the staff think each transaction processed could be considered substantially the same even if there are multiple types of transactions that generate different payments. Furthermore, the staff think that each transaction could be a distinct service because the customer benefits from each transaction and each transaction could be distinct in the context of the contract.

Example C

30. HM must first consider the nature of its promise to the customer in this contract (that is, whether the entity's promise is to provide a single integrated management service or, instead, to provide defined items or activities that are distinct from each other). If the nature of HM's promise is the overall management service because the underlying activities are not distinct from each other, the staff think that each day of service could be considered distinct because the customer can benefit from each day of service on its own and each day of service is separately identifiable.

31. Example C is similar to the hotel management example in paragraph BC285 where the Boards concluded that each time increment of service is distinct and substantially the same. Therefore, assuming the nature of the promise is the overall management service, the staff think the service performed each day could be considered distinct and substantially the same.

Example D

32. The staff think that the single performance obligation (the right to access the entity's intellectual property for a period of time) could be considered to have multiple distinct services of providing access each day, week, month, etc. However, this would only be the case because the entity had first concluded that the nature of the license is the right to access over time (**note**: if the nature of the license is a right to use the intellectual property, the entity's performance (its singular act) is complete when it makes the intellectual property available for the customer's use). The staff think the customer benefits from the right of access (capable of being distinct) each day on its own, and each day could be separately identifiable because there is no integration service provided between the days of access provided, no day modifies or customizes another, and the days of access are not highly interdependent or highly

interrelated. Similar to the other examples, the staff think that the nature of each distinct daily service is the same since the customer consumes and receives a consistent benefit each day (that is, the right to access the intellectual property).

Issue 2- If there is an undefined quantity of outputs but the contractual rate per unit of output is fixed, is the consideration variable?

33. The staff is aware that some stakeholders have questioned whether a contract includes variable consideration if the contract includes an undefined quantity of outputs, but the contractual rate per unit of output is fixed. For example, a transaction processor has a contract with a customer where the price per transaction is $0.001 per transaction, but the quantity of transactions is not fixed.

34. The new revenue standard includes the following guidance on variable consideration:

> **606-10-32-5 [50]** If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.
>
> **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. ***[Emphasis added.]***

35. If a contract has variable consideration, it would be subject to the following guidance:

> **606-10-32-8 [53]** An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to

better predict the amount of consideration to which it will be entitled:

> a. The expected value—The expected value is the sum of probability-weighted amounts in a ***range of possible consideration amounts***. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.
>
> b. The most likely amount—The most likely amount is the single most likely amount in a ***range of possible consideration amounts*** (that is, the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not). ***[Emphasis added.]***

36. The staff think the determination of whether an arrangement includes variable consideration based on the guidance above is dependent upon the evaluation of the entity's promise. If the nature of the promise is to perform an unknown quantity of tasks throughout the contract period and the consideration received is contingent upon the quantity completed, the total transaction price would be variable since it is based upon the occurrence or nonoccurence of events outside the entity's control (for example, the customer's usage or other events) and the contract has a range of possible transaction prices. In contrast, if the nature of the promise is to perform a defined number of distinct services at a fixed price per unit, then the consideration would be fixed since the total transaction price is known. The staff also note that an entity would need to consider all substantive terms of the contract, which could include contractual minimums or other clauses that would make some or all of the consideration fixed.

Example A, B and D

37. The staff think that if the nature of the promise is a daily integrated service or a promise to stand ready to perform, rather than to provide a defined number of transactions, then the consideration would be variable since the consideration to be paid is unknown. In Example A, the entity would have the right to bill based upon the units consumed of the various tasks that day. Since the number of units are not defined each day (or for the entire contract), the consideration would vary each day based upon the level of activity. For example, IT Seller may earn CU100 for its activities during one distinct day of service and CU200 in the next day but not earn a known *fixed amount of consideration*. Similarly, in Examples B and D, since there is not a defined quantity of transactions in the contract, the transaction price would be variable.

Example C

38. In Example C, the staff think it is clear that the monthly fee based on a percentage of sales and the annual incentive fee are variable. If the nature of the entity's promise is to provide the daily management service and not a specified amount of labor hours at a rate per hour, the staff and other stakeholders in the hospitality industry also think that the cost reimbursements are variable since the amount is not known at the beginning of the contract and the amount that the entity will be entitled to changes based upon the requirements to fulfil the contract for each day of distinct service.

Issue 3 - In order to meet the requirements in paragraph 606-10-32-40(b) [85(b)], is the allocation to be made on a relative standalone selling price basis?

39. Paragraph 606-10-32-40(b) [85(b)] requires the allocation of variable consideration to a distinct service consistent with the allocation objective in paragraph 606-10-32-28 [73] which states:

> 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 to exchange for transferring the promised goods or services to the customer.

40. The staff has become aware that some stakeholders think the allocation of variable consideration to a distinct good or service in a series is required to be based on standalone selling prices. This could limit the number of transactions that qualify under this guidance since it might imply that each distinct service that is substantially the same would need to be allocated the same amount (absolute value) of variable consideration.

41. Paragraph 606-10-32-29 [74] states that to meet the allocation objective, an entity shall allocate the transaction price to each performance obligation on a standalone selling price basis. However, that paragraph specifically excludes paragraphs 606-10-32-39 through 32-41 [84-86] on allocating variable consideration to a distinct service in a series from this requirement. Furthermore, paragraph 606-10-32-30 [75] states that the guidance in paragraphs 606-10-32-31 through 32-41 [76-86] on the standalone selling price allocation do not apply to the allocation of variable consideration. Paragraph BC280 describes that while standalone selling price is the default method for determining whether the allocation objective is met, the Boards decided that other methods could be used in certain instances and, therefore, included the guidance on allocating variable consideration.

42. Based upon the above, the staff thinks that a relative standalone selling price allocation is not *required* to meet the allocation objective when it relates to the allocation of variable consideration to a distinct good or service in a series. However, as stated in Example 35 where variable consideration is allocated to different performance obligations, standalone selling prices in some cases might be utilized (but are not required to be utilized) to determine the reasonableness of the allocation.

43. The Boards did not describe other methods that could be used to comply with the allocation objective other than stating in paragraph 606-10-32-40(b) [85(b)] that an entity should consider all the payment terms and performance obligations. As such, the staff think that stakeholders should apply reasonable judgment to determine whether the allocation results in a reasonable outcome. Consider the following examples; however, note that the staff does not think the examples below are all inclusive, and there could be other reasons why a variable fee would or would not meet the allocation objective.

Example A

44. In this example, the events that trigger the variable consideration are the same throughout the contract, but the price per unit decreases each year. The staff think that even with the declining prices, the allocation objective could be met if the pricing is based on market terms or the changes in price are substantive and linked to changes in the entity's cost to fulfil the obligation or value provided to the customer. In this example, the contract contains a price benchmarking clause whereby the IT Buyer engages a third-party benchmarking firm to compare the contract pricing to current market rates, which may help support the allocation objective.

Example B

45. If the nature of the entity's promise is a single service to process as many transactions as the customer requires, the fees based on quantity processed and the fees based on a percentage of dollars processed might be considered variable consideration. The staff think the fees based on quantity processed and percentage of dollars processed could meet the allocation objective for each month of service. For example, the allocation objective could be met if the fees are priced consistently throughout the contract and the rates charged are consistent with the entity's standard pricing practices with similar customers.

Example C

46. Example C is similar to the hotel management example in paragraph BC285 where the Boards noted that variable consideration based upon 2% of daily occupancy rates could be allocated to each day. The staff thinks the base monthly fees could meet the allocation objective for each month because they are similar to the example in paragraph BC285 in that there is a consistent measure throughout the contract period that reflects the value to the customer each month (the % of monthly sales). Similarly, if the cost reimbursements are commensurate with the entity's efforts to fulfil the promise each day, then the allocation objective for those variable fees could also be met. Finally, the staff think that the allocation objective could also be met for the incentive fee if it reflects the value delivered to the customer for the annual period (reflected by the profits earned) and is reasonable compared to the incentive fees that could be earned in other periods.

Example D

47. The staff think that allocating the royalties to the respective day in which it has the right to invoice could be consistent with the allocation objective. In this example, the formula and price are consistent throughout the license term, and the amount allocated to each day reasonably reflects the value/benefit to the customer of its access to the intellectual property for that day (reflected by the sales that access has generated for the customer).

Accounting for the Examples as a Series

48. If Examples A through D meet the series provision and criteria to allocate variable consideration, the staff think an entity would account for each Example as follows:

Example A

49. IT Seller would allocate variable consideration to each day (or for practical reasons, each month) based upon the contractual right to bill in that period. The fixed upfront fee would be recognized over the common measure of progress for the entire performance obligation. IT Seller would still need to consider the requirements to disclose the transaction price allocated to unsatisfied performance obligations at the end of each period.[2]

Example B

50. If TP concluded the nature of the entity's promise is to stand ready to process transactions and each day is a distinct service, TP would allocate the variable fees charged for each transaction to the day in which it has the contractual right to bill under the contract. The fixed upfront fee would be recognized over the common measure of progress for the entire performance obligation. TP would still need to

[2]Paragraph 606-10-50-13 [120] states that an entity must disclose certain information about its remaining performance obligations. That information includes the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied at the end of the period and a quantitative or qualitative explanation of when the entity expects to recognize as revenue the amount disclosed. Under Topic 606, the disclosure in paragraph 606-10-50-13 [120] is only required for a public business entity, a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, or an employee benefit plan that files or furnishes financial statements with or to the SEC. Other entities following Topic 606 may elect to apply this disclosure. IFRS 15 requires the disclosure for all entities.

consider the requirements to disclose the transaction price allocated to unsatisfied performance obligations at the end of each period.

Example C

51. HM would allocate the cost reimbursement to each distinct day of service (or for practical reasons, each month of distinct service). Similarly, the monthly fees based upon a percentage of sales would be allocated to each month. The annual incentive fees would be allocated to each annual period.

52. As each distinct month of service is completed, the variable fees allocated to that month would be recognized. The estimated annual incentive fee (subject to the constraint on variable consideration) would be recognized over the annual period based upon the common measure of progress. HM would still need to consider the disclosure requirements for unsatisfied performance obligations.

Example D

53. Franchisor would allocate the variable consideration to each day of distinct service, and the fixed fee would be allocated to the entire performance obligation. As a result of the allocation to each day of distinct service, the variable fees would be recognized in the month the customer's sales occur, and the fixed upfront fee would be recognized over the entire performance obligation. Franchisor would still need to consider the disclosure requirements for unsatisfied performance obligations.

Summary

54. The resulting accounting when there is fixed and variable consideration for a series might produce a result that some think is similar to using multiple measures of progress. However, the staff notes that this is not multiple attribution (refer to TRG paper 41 on multiple measures of progress). The different patterns of recognition for the different fees are a result of allocation (Step 4) and not attribution (Step 5).

Question for the TRG Members
1. Do the TRG members agree with the staff's views on the application of the series provision to long term service arrangements?

Appendix A: Accounting Guidance

> > > Example 13—Customer Simultaneously Receives and Consumes the Benefits

606-10-55-159 An entity enters into a contract to provide monthly payroll processing services to a customer for one year.

606-10-55-160 The promised payroll processing services are accounted for as a single performance obligation in accordance with paragraph 606-10-25-14(b) [22(b)]. The performance obligation is satisfied over time in accordance with paragraph 606-10-25-27(a) [35(a)] because the customer simultaneously receives and consumes the benefits of the entity's performance in processing each payroll transaction as and when each transaction is processed. The fact that another entity would not need to reperform payroll processing services for the service that the entity has provided to date also demonstrates that the customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs. (The entity disregards any practical limitations on transferring the remaining performance obligation, including setup activities that would need to be undertaken by another entity.) The entity recognizes revenue over time by measuring its progress toward complete satisfaction of that performance obligation in accordance with paragraphs 606-10-25-31 through 25-37 [39-45] and 606-10-55-16 through 55-21 [B14-B19].

> > > Example 25—Management Fees Subject to the Constraint

606-10-55-221 On January 1, 20X8, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a 2 percent quarterly management fee based on the client's assets under management at the end of each quarter. In addition, the entity receives a performance-based incentive fee of 20 percent of the fund's return in excess of the return of an observable market index over the 5-year period. Consequently, both the management fee and the performance fee in the contract are variable consideration.

606-10-55-222 The entity accounts for the services as a single performance obligation in accordance with paragraph 606-10-25-14(b) [22(b)], because it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

606-10-55-223 At contract inception, the entity considers the guidance in paragraphs 606-10-32-5 through 32-9 [50-54] on estimating variable consideration and the guidance in paragraphs 606-10-32-11 through 32-13 [56-58] on constraining estimates of variable consideration, including the factors in paragraph 606-10-32-12 [57]. The entity observes that the promised consideration is dependent on the market and, thus, is highly susceptible to factors outside the entity's influence. In addition, the incentive fee has a large number and a broad range of possible consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is probable that a significant reversal in the cumulative amount of revenue recognized would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

606-10-55-224 At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception—the variability of the fee based on the market index indicates that the entity cannot conclude that it is probable that a significant reversal in the cumulative amount of revenue recognized would not occur if the entity included its estimate of the incentive fee in the transaction price. At March 31, 20X8, the client's assets under management are $100 million. Therefore, the resulting quarterly management fee and the transaction price is $2 million.

606-10-55-225 At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter in accordance with paragraphs 606-10-32-39(b) and 606-10-32-40 [84(b) and 85]. This is because the fee relates specifically to the entity's efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters, and the resulting allocation will be consistent with the allocation objective in paragraph 606-10-32-28 [73]. Consequently, the entity recognizes $2 million as revenue for the quarter ended March 31, 20X8