

## EITF ABSTRACTS

Issue No. 02-16

**Title:** Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor

**Dates Discussed:** September 11–12, 2002; November 21, 2002; January 23, 2003; March 20, 2003

**References:** FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*  
FASB Statement No. 5, *Accounting for Contingencies*  
FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*  
FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*  
FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*  
FASB Concepts Statement No. 6, *Elements of Financial Statements*  
APB Opinion No. 20, *Accounting Changes*  
APB Opinion No. 29, *Accounting for Nonmonetary Transactions*  
AICPA Audit and Accounting Guide, *Agricultural Producers and Agricultural Cooperatives*  
International Accounting Standard 20, *Accounting for Government Grants and Disclosure of Government Assistance*

### ISSUE

1. Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)," addresses the accounting by a **vendor**<sup>1</sup> for consideration given to a **customer**, including both a **reseller** of the vendor's products and an entity that purchases the vendor's products from a reseller. That Issue provided accounting guidance on how a vendor should characterize consideration given to a customer and when to recognize and how to measure that consideration in its income statement.

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<sup>1</sup>Terms defined in Exhibit 02-16B, the glossary, are set forth in **boldface type** the first time they appear.

2. Questions have arisen regarding how a reseller of a vendor's products should account for **cash consideration** (as that term is defined in Issue 01-9) received from a vendor.

3. The issues are:

Issue 1—The circumstances under which cash consideration received from a vendor by a reseller should be considered (a) an adjustment of the prices of the vendor's products or services and, therefore, characterized as a reduction of cost of sales when recognized in the reseller's income statement, (b) an adjustment to a cost incurred by the reseller and, therefore, characterized as a reduction of that cost when recognized in the reseller's income statement, or (c) a payment for assets or services delivered to the vendor and, therefore, characterized as revenue when recognized in the reseller's income statement

Issue 2—If a vendor offers a customer a rebate or refund of a specified amount of cash consideration that is payable only if the customer completes a specified cumulative level of purchases or remains a customer for a specified time period, when the customer should recognize the rebate and how the customer should measure the amount of the offer

Issue 3—Under what circumstances up-front nonrefundable cash consideration given by a vendor to a customer should be recognized immediately in the customer's income statement rather than as a liability

Issue 4—How to measure and when to recognize the reduction of a liability incurred upon receipt of up-front nonrefundable cash consideration in the customer's income statement.

## **EITF DISCUSSION**

4. At the November 21, 2002 meeting, the Task Force reached a consensus on Issue 1 that cash consideration received by a customer from a vendor is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the customer's income statement. However, that presumption is overcome when the consideration is either (a) a payment for assets or services delivered to the vendor, in which case the cash consideration should be characterized as revenue (or other income, as appropriate) when recognized in the customer's income statement, or (b) a reimbursement of costs incurred by the customer to sell the vendor's products, in which case the cash consideration should be characterized as a reduction of that cost when recognized in the customer's income statement.

5. The Task Force reached a consensus that cash consideration represents a payment for assets or services delivered to the vendor and should be characterized as revenue (or other income, as appropriate) when recognized in the customer's income statement if the vendor receives, or will receive, an identifiable benefit (goods or services) in exchange for the consideration. In order to meet that condition the identified benefit must be sufficiently separable from the customer's purchase of the vendor's products such that the *customer* would have entered into an exchange transaction with a party other than the

vendor in order to *provide* that benefit, and the customer can reasonably estimate the fair value of the benefit provided. If the amount of cash consideration paid by the vendor exceeds the estimated fair value of the benefit received, that excess amount should be characterized as a reduction of cost of sales when recognized in the customer's income statement.

6. The Task Force reached a consensus that cash consideration represents a reimbursement of costs incurred by the customer to sell the vendor's products and should be characterized as a reduction of that cost when recognized in the customer's income statement if the cash consideration represents a reimbursement of a specific, incremental, identifiable cost incurred by the customer in selling the vendor's products or services. If the amount of cash consideration paid by the vendor exceeds the cost being reimbursed, that excess amount should be characterized in the customer's income statement as a reduction of cost of sales when recognized in the customer's income statement.

7. The Task Force reached a consensus on Issue 2 that a rebate or refund of a specified amount of cash consideration that is payable pursuant to a binding arrangement only if the customer completes a specified cumulative level of purchases or remains a customer for a specified time period should be recognized as a reduction of the cost of sales based on a systematic and rational allocation of the cash consideration offered to each of the underlying transactions that results in progress by the customer toward earning the rebate or refund provided the amounts are probable and reasonably estimable. If the rebate or refund is not probable and reasonably estimable, it should be recognized as the milestones are achieved.

8. The Task Force observed that the ability to make a reasonable estimate of the amount of future cash rebates or refunds depends on many factors and circumstances that will vary from case to case. However, the Task Force reached a consensus that the following factors may impair a customer's ability to determine whether the rebate or refund is probable and reasonably estimable:

- a. The rebate or refund relates to purchases that will occur over a relatively long period.
- b. There is an absence of historical experience with similar products or the inability to apply such experience because of changing circumstances.
- c. Significant adjustments to expected cash rebates or refunds have been necessary in the past.
- d. The product is susceptible to significant external factors (for example, technological obsolescence or changes in demand).

9. The Task Force reached a consensus that changes in the estimated amount of cash rebates or refunds and retroactive changes by a vendor to a previous offer (an increase or a decrease in the rebate amount that is applied retroactively) are changes in estimate that should be recognized using a cumulative catch-up adjustment. That is, the customer would adjust the cumulative balance of its rebate recognized to the revised cumulative estimate immediately. The Task Force observed that entities should consider whether any portion of the cumulative-effect adjustment impacts, for example, inventory, in which case only a portion of that adjustment would be reflected in the income statement.

10. The Task Force agreed to discontinue consideration of Issues 3 and 4 regarding whether up-front nonrefundable cash consideration given by a vendor to a customer results in a liability or should be recognized immediately in the customer's income statement due to the broad, general nature of related questions.

11. The SEC Observer commented that, until further guidance is issued, resellers that provide goods or services to a vendor from which they also purchase goods or services should consider whether certain transactions between the two parties (for example, a reseller providing goods or services to a vendor with a contemporaneous agreement to purchase an equal amount of that vendor's goods or services) are subject to the guidance contained in paragraph 21 of Opinion 29.

12. The examples in Exhibit 02-16A illustrate the consensuses reached in this Issue.

## **Transition**

### **Issue 1**

13. The consensus on Issue 1 should be applied to new arrangements, including modifications of existing arrangements, entered into after December 31, 2002. If determinable, pro forma disclosure of the impact of the consensus on prior periods presented is encouraged. Early application of the consensus is permitted as of the beginning of periods for which financial statements have not been issued. Recasting of prior-period financial statements for comparative purposes is permitted provided that previously reported net income would not change as a result of applying the consensus.

14. An entity that has not issued financial statements also is permitted to report the change in accounting as a cumulative-effect adjustment in accordance with Opinion 20 and Statement 3 when the effect of applying the consensus on prior-period financial statements results in a change to previously reported net income. For example, an entity with a calendar year-end that has not issued financial statements for the year ended December 31, 2002, may adopt the consensus as a cumulative-effect adjustment as of

either January 1, 2002, or January 1, 2003. However, an entity with a January 31 fiscal year-end that has not issued financial statements for the fiscal year ended January 31, 2003, could only adopt the consensus as a cumulative-effect adjustment as of February 1, 2002. An entity should disclose the selected method of adopting the consensus on Issue 1.

15. The SEC Observer reminded registrants to consider the MD&A disclosure requirements regarding the comparability of financial statement information.

## **Issue 2**

16. The consensus on Issue 2 is effective for arrangements entered into after November 21, 2002.

## **STATUS**

17. No further EITF discussion is planned.

## Exhibit 02-16A

### EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS ON ISSUE 02-16

#### Example 1

Vendor manufactures toys that are sold by Retailer. Vendor offers a **cooperative advertising** arrangement through which Retailer receives an allowance for qualifying advertising costs of up to 2 percent of the total purchases from Vendor if certain qualitative criteria are met. Retailer must maintain documentation of advertising performed and related costs.

**Evaluation:** The cash consideration received for cooperative advertising, to the extent that it represents a reimbursement of specific, incremental, identifiable costs incurred by the customer to sell Vendor's products, should be characterized as a reduction of those costs when recognized in the customer's income statement, provided that the cash consideration received does not exceed such costs incurred. If the amount of cash consideration paid by Vendor exceeds the costs being reimbursed, that excess amount should be characterized as a reduction of cost of sales when recognized in Retailer's income statement.

#### Example 2

Retailer enters into an agreement with Vendor to perform a significant amount of market research for Vendor related to the launch of a new product. Vendor believes that it is paying for the expertise and knowledge available from Retailer. Retailer believes

Vendor is electing to purchase its knowledge of the market rather than internally developing such knowledge. Retailer would offer such services to a nonvendor.

**Evaluation:** The cash consideration received is in return for Retailer providing goods or services that provide an identifiable benefit to Vendor that is sufficiently separable from Retailer's purchase of Vendor's goods. Since Retailer offers those research services to a nonvendor and the fair value of the research services is determinable, the cash consideration received from the vendor represents revenue (or other income, as appropriate) and should be characterized as such when recognized in Retailer's income statement, provided that the cash consideration received does not exceed the estimated fair value of the benefit received by Vendor. If the amount of cash consideration paid by Vendor exceeds the estimated fair value of related benefits received, that excess amount should be characterized as a reduction of cost of sales when recognized in Retailer's income statement.

### **Example 3**

On January 1, 20X1, in a binding arrangement, Vendor offers a cash refund of \$1,000 to Customer if during the calendar year 20X1, Customer purchases 1,000 units. Customer, on average, purchases 1,700 units each year.

**Evaluation:** Since Customer is entitled to the refund offered by Vendor based on the purchase of 1,000 units of inventory, Customer should accrue the refund offer over the purchase of the 1,000 units, provided that it is probable and reasonably estimable that Customer will purchase 1,000 units during 20X1.

## **GLOSSARY**

This exhibit contains definitions of certain terms used in this Issue.

### **Cash consideration**

For purposes of this Issue, cash consideration includes cash payments and "credits" that the customer can apply against trade amounts owed to the vendor. In addition, under the consensus on Issue 2 of Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," consideration in the form of equity instruments is recognized "in the same period(s) and in the same manner (that is, capitalize versus expense) as if the enterprise had paid cash for the goods or services or used cash rebates as a sales discount instead of paying with or using the equity instruments." Accordingly, for purposes of this Issue, guidance with respect to cash consideration is applicable to consideration that consists of equity instruments (regardless of whether a measurement date has been reached). For purposes of this Issue, cash consideration may be referred to by terms such as sales incentives, discounts, coupons, rebates, price reductions, and so forth.

### **Cooperative advertising**

A vendor agrees to reimburse a customer for a portion of the advertising costs incurred by the customer. Cooperative advertising programs generally provide that a vendor will participate in the cost of a customer's advertising. The amount reimbursed to the customer typically is limited to a specified percentage of that customer's purchases from the vendor. The program may or may not require the customer to provide documentation of the actual costs incurred to advertise the vendor's products.

### **Customer**

A reseller or a consumer (either an individual or a business that purchases a vendor's products or services for end use rather than for resale). Customer should be defined consistent with paragraph 39 of Statement 131, which states that "a group of entities known to a reporting enterprise to be under common control shall be considered as a single customer, and the federal government, a state government, a local government (for example, a county or municipality), or a foreign government each shall be considered as a single customer." For purposes of this Issue, customer includes any purchaser of the vendor's products at any point along the distribution chain, regardless of whether the purchaser acquires the vendor's products directly or indirectly (for example, from a distributor) from the vendor. For example, a vendor may sell its products to a distributor who in turn resells the products to a retailer. The retailer in that example is a customer of the vendor as that term is used in this Issue.

**Reseller**

Any entity that purchases another vendor's products for resale, regardless of whether that entity is a distributor or wholesaler, retailer, or other type of reseller.

**Vendor**

For purposes of this Issue, the term vendor is used to represent a service provider or product seller, such as a manufacturer, distributor, or reseller.