

FASB Emerging Issues Task Force

Issue No. 06-1

Title: Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider

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Date previously discussed: March 16, 2006; June 15, 2006

Previously distributed EITF materials: Issue Summary No. 1, dated March 1, 2006; Issue Summary Supplement No.1, dated May 31, 2006

References:

EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" (Issue 99-19)

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" (Issue 00-21)

EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" (Issue 01-9)

* The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.

Background

1. At the June 15, 2006 EITF meeting, the Task Force reached a tentative conclusion on this Issue and directed the staff to pursue the issuance of a draft abstract for public comment. The draft abstract was posted to the FASB website on July 6, 2006, for a 30-day comment period that ended August 4, 2006. The Task Force specifically requested that constituents provide comments on:

- a. Whether the service provider should treat the consideration given to a third-party manufacturer or reseller as "other than cash" consideration when applying Issue 01-9 unless the incentive provided to the service provider's customer exceeds the price paid by the end-customer to purchase the equipment and, if so, whether the model is operational.
- b. Whether a service provider should interpret the term "contractual arrangement" explicitly in applying the guidance in the draft abstract or whether a service provider can have a contractual arrangement based on a "mutual understanding."

2. Comment letters received on the draft abstract have been distributed to Task Force members and have been analyzed by the FASB staff. At the September 7, 2006 EITF meeting, the Task Force will have the opportunity to consider these comment letters as it redeliberates the tentative conclusion in the draft abstract and addresses the issues raised in this Supplement. The Task Force will then be asked to affirm its tentative conclusion on this Issue as a consensus.

Summary of Comment Letters

3. Two comment letters were received on the draft abstract, one from a state accountancy society and one from a preparer. In addressing the questions raised by the Task Force, one respondent was supportive of treating *all* consideration (regardless of its form) given by a service provider to a third party that ultimately benefits the service provider's customer as "other than cash" consideration when applying Issue 01-9 except in circumstances in which the consideration exceeds the price paid by the customer for the equipment. In that circumstance, the portion of the consideration that exceeds the price paid for the equipment should be reflected as "cash" consideration in applying Issue 01-9. That same respondent also believed that a

contractual arrangement should include those arrangements that may be based on a "mutual understanding." There was a concern expressed, however, on the operability of the model and whether a service provider would be able to track the consideration given between the third-party manufacturer or reseller and the service provider's customer.

4. The other respondent was supportive of the Task Force's tentative conclusion presented in the draft abstract concerning the applicability of Issue 01-9 to these types of arrangements, but disagreed, however, with the recognition of consideration when the benefit received by the service provider's customer (as directed by the service provider) was in the form of a reduction on the purchase price of the equipment. The respondent argued that this treatment was inconsistent with Issue 01-9 and could result in vendors funneling incentives through intermediaries in order to apply what is perceived to be the more favorable treatment.

5. Upon the Board's ratification of the tentative conclusion reached on this Issue, the Board requested that the staff discuss the tentative conclusion with analysts in the industry, including buy-side analysts. There were differing views among the analysts. One analyst disagreed with the tentative conclusion and highlighted their concern that its application may result in a lack of comparability between entities purely based on the form of the consideration since, in their opinion, the substance and intent of the consideration was the same. Other analysts were generally in agreement with the tentative conclusion and felt that in most instances, service providers providing these types of incentives directed that the consideration be used to benefit the service provider's customer by reducing the price paid on the equipment, which would be classified as "other than cash" consideration and, therefore, there would be little change to current practice. In addition, these analysts were not concerned about comparability among entities, however, because they felt that entities that had incentives that would qualify as "cash consideration" under the draft abstract would likely adjust the nature of their incentive programs. The analysts were also supportive of the requirement for additional financial statement disclosures that they believe will provide an added level of transparency about the nature and the costs associated with these types of programs as well as their financial statement classification.

FASB Staff Analysis

6. The FASB staff believes that an approach whereby *all* consideration (regardless of its form) given by a service provider to a third-party that ultimately benefits the service provider's customer as "other than cash" consideration when applying Issue 01-9 except in circumstances in which the consideration exceeds the price paid by the customer for the equipment, would add an undue level of administrative burden for a service provider to be able to substantiate whether the consideration given to the third-party manufacturer or reseller did not exceed the price paid for the equipment that was purchased by the end customer. In addition, the FASB staff questions whether the service provider would in all circumstances have the ability to obtain this information to make that evaluation. The FASB staff also believes that some resellers may have incentive programs (unrelated to the service provider) that operate concurrent with the service provider's incentive programs. In those instances, it may be difficult to determine which entity's consideration exceeded the price of the equipment purchased by the service provider's customer. The FASB staff believes that the tentative conclusion reached in the draft abstract eliminates this burden by only requiring the consideration to be "cash consideration" when the service provider has a contractual arrangement that stipulates that the service provider's customer must receive a benefit in the form of cash. In all other circumstances, the consideration is considered to be "other than cash" consideration for purposes of applying Issue 01-9.

7. Secondly, while the FASB staff believes that a contractual arrangement could include an arrangement based on a "mutual understanding," since the substance of the arrangement is intended to be the same, the staff believes that this approach would be too difficult to operationalize since the service provider may not have the ability to produce evidence supporting the "mutual understanding."

8. The FASB staff noted that the other comments raised by the respondents who disagreed with the draft abstract were previously considered by the Task Force during its initial deliberations. Therefore, the FASB staff believes that there are no additional comments that warrant consideration by the Task Force at the September 7, 2006 EITF meeting and recommends that the Task Force affirm the tentative conclusion as a consensus.

Other Changes to the Draft Abstract

9. Suggested changes to the wording in the draft abstract that the staff has determined are not significant enough to warrant specific consideration are indicated in the marked draft abstract included as Exhibit 06-1A along with the FASB staff's recommendations to address the comments that have been brought to the Task Force for consideration by this Supplement.

EITF ABSTRACTS (DRAFT)

Issue No. 06-1

Title: Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider

Dates Discussed: March 16, 2006; June 15, 2006; [September 7, 2006]

References: EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"

ISSUE

1. Certain companies provide services to their customers that require the customers to purchase equipment in order to utilize those services. The equipment required is often manufactured and distributed by third-parties and sold to end-customers through resellers without the direct involvement of the service provider. Accordingly, a service provider may provide certain incentives to third-party manufacturers or resellers of the equipment to reduce the selling price of the equipment in order to stimulate end-customer demand and, inherently, increase the demand for the service provider's service.

2. Issue 01-9 provides guidance on the accounting for consideration given by a vendor to a customer. While some diversity exists, the incentives given by service providers to third-party manufacturers or resellers have generally been considered outside the scope of Issue 01-9 because the third-party manufacturers and resellers are believed to be outside of the service provider's distribution chain.

3. The issues are:

Issue 1— Whether the consideration given by a service provider to a manufacturer or reseller (that is not a customer of the service provider) that in turn provides a benefit to the service provider's customer should be characterized as "cash consideration" or "other than cash" consideration for purposes of applying Issue 01-9

Issue 2— Whether the consideration given by a service provider to a manufacturer or a reseller of equipment that benefits a customer of both the service provider and the equipment manufacturer or reseller and where the equipment is necessary for a customer to receive a service from the service provider is, in substance, the same as the service provider giving the consideration directly to the end-customer

Issue 3— Whether the consideration given by a service provider to a manufacturer or a reseller (that is not a customer of the service provider) of equipment, when the equipment is necessary for an end-customer to receive a service from the service provider, and

where the consideration can be linked to the benefit received by the service provider's customer, should be accounted for in accordance with the model used in Issue 01-9.

EITF DISCUSSION

4. The Task Force reached a [consensus] on Issues 1–3 that if the consideration given by a service provider to a manufacturer or reseller (that is not a customer of the service provider) can be linked contractually to the benefit received by the service provider's customer, a service provider should account for the consideration in accordance with Issue 01-9. The service provider should characterize the consideration given to a third-party manufacturer or reseller based on the form of consideration directed by the service provider to be provided to the service provider's customer. If the form of the consideration is stipulated to be anything other than "cash consideration" (as defined in Issue 01-9), then the form of the consideration should be characterized as "other than cash" consideration for purposes of applying Issue 01-9. If the service provider does not control the form of the consideration provided to the service provider's customer, the consideration should be characterized as "other than cash" consideration for purposes of applying Issue 01-9. In reaching this conclusion, Task Force members observed that consideration paid by a service provider that results in a customer receiving a reduced price on equipment purchased from a manufacturer or reseller should be characterized as "other than cash" consideration for purposes of applying Issue 01-9. Examples of the application of the tentative conclusion reached on this Issue are provided in Exhibit 06-1A.

Transition

5. The Task Force reached a [consensus] that this Issue should be effective for the first annual reporting period beginning after June 15, 2007. Earlier adoption is permitted for financial statements that have not yet been issued. Entities should recognize the effects of applying the [consensus] on this Issue as a change in accounting principle through retrospective application to all prior periods unless it is impracticable to do so. This should include the recognition of:

- a. The cumulative effect of the change to the new accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented
- b. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position
- c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the new accounting principle.

6. If the cumulative effect of applying the change in accounting principle to all prior periods can be determined but it is impracticable to determine the period-specific effects of that change on all prior periods presented, the cumulative effect of the change to the new accounting principle shall be applied to the carrying amounts of assets and liabilities as of the beginning of the earliest period to which the new accounting principle can be applied. An offsetting adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period.

7. Upon application of this [consensus], the following should be disclosed:

- a. A description of the prior-period information that has been retrospectively adjusted
- b. The effect of the change on revenue, cost of sales, income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for any prior periods retrospectively adjusted
- c. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented
- d. A description of the nature of these programs including the amounts recognized in the statement of operations and their related classification for each period presented, where significant
- e. If retrospective application to all prior periods is impracticable, disclosure of the reasons therefor, and a description of the method used to report the change should be made.

Board Ratification

8. At its [September 20, 2006] meeting, the Board ratified the [consensuses] reached by the Task Force in this Issue.

Status

9. No further EITF discussion is planned.

Exhibit 06-1B

EXAMPLES OF THE APPLICATION OF THE [CONSENSUS] ON ISSUE 06-1

The following examples are provided to illustrate the application of the [consensus] in Issue 06-1. The application of this [consensus] depends on the relative facts and circumstances and requires significant judgment. The application of that judgment in a given fact pattern is based on the assumed facts; accordingly, judgment will vary in differing fact patterns.

1. Service provider gives a cash incentive to a third-party manufacturer that results in a rebate to the service provider's customer.

Scenario: A service provider of satellite radio services has a contractual arrangement with a third-party that manufactures the equipment that is necessary for customers to receive its programming. The contractual arrangement stipulates that the service provider will give a \$50 incentive to the third-party manufacturer for each unit produced if the end-customer who purchases the equipment enters into a contract for satellite radio service from the service provider. The contractual arrangement between the service provider and the third-party manufacturer requires that the third-party manufacturer must pass this incentive along to the end-customer in the form of a mail-in rebate honored by the third-party manufacturer.

Evaluation: The service provider should characterize the incentive as "cash consideration" for purposes of applying Issue 01-9 because the service provider has directed through a contractual arrangement that the benefit received by the service provider's customer must be in the form of cash (through a mail-in rebate).

2. Service provider gives a cash incentive to a third-party manufacturer that results in a price reduction on equipment sold to the service provider's customers.

Scenario: A service provider of satellite radio services has a contractual arrangement with a third-party that manufactures the equipment that is necessary for customers to receive its programming. The contractual arrangement directs that the service provider will give a \$50 incentive to the third-party manufacturer for each unit produced if the end-customer who purchases the equipment enters into a contract for satellite radio service from the service provider. The contractual arrangement between the service provider and the third-party manufacturer requires that the third-party manufacturer must pass this incentive along to the end-customer in the form of a price reduction on the equipment sold by the third-party manufacturer to the end-customer. (Assume for purposes of this example that the manufacturer sells directly to the end-customer.)

Evaluation: The service provider should characterize the incentive paid to the third-party manufacturer as "other than cash" consideration for purposes of applying Issue 01-9 because the service provider has directed through a contractual arrangement that the benefit received by the service provider's customer must be in the form of a price reduction on equipment purchases.