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The New Revenue Recognition Standard
Customer Options for Additional Goods or Services & Material Rights

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We continue our revenue recognition series on implementation issues from FASB Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. The new revenue recognition standard in ASU 2014-09 is primarily codified in FASB *Accounting Standards Codification* (FASB ASC) 606, with the same title. This report addresses how an entity should account for customer options to acquire additional goods or services, including contract renewal options and customer loyalty programs.

When businesses enter into contracts with customers, they commonly offer them options for additional goods or services. Such options are offered along the full spectrum of business transactions, from simple retail sales with no written contract to complex business-to-business dealings involving long-term, lengthy, complicated agreements. A question arises about how these customer options are accounted for under the new revenue recognition guidance (FASB ASC 606). Is the option a performance obligation (separate unit of account) within the contract? Are these options for additional goods or services marketing or promotional offers? What about contract renewal options and loyalty programs through which a customer earns points, miles, or some status level? Are they considered options to purchase additional goods or services?

Customer options for additional goods or services are within the scope of FASB ASC 606. Specifically, FASB ASC 606-10-55-41 through 55-45 provides the relevant guidance. In addition, The Basis for Conclusions of ASU 2014-09 (BC 386 through BC 395) elaborates on that guidance. The FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) also addressed the topic (see TRG Paper Nos. 6, 18, 32, 34, 48 and 54).

The CPEA Revenue Recognition Series — Fortune Favors the Prepared	
Part I:	Key concepts, including the minimum requirements to recognize revenue, long-term contracts, variable consideration, and other topics.
Part II:	Key concepts, including application of the terms “Distinct” and “Separately Identifiable,” methods for measuring progress on contracts, and significant financing component.
Part III:	Contract costs, warranties, and bill and hold arrangements.
Part IV:	Accounting for licenses.
Part V:	Principal versus agent considerations
ASU 2016-10:	Identifying performance obligations, and licensing implementation guidance.
ASU 2016-20:	FASB ASC 606 Technical Corrections & Improvements – Implementation Issues on New Revenue Recognition Standard
Sales of nonfinancial assets:	Scope of the new revenue recognition standard as it relates to sales of nonfinancial assets, as well as the accounting for such transfers.
Disclosure of impact:	CPEA recommendation that non-SEC registrants consider making disclosures about the impact of the Big Three new accounting standards (revenue recognition, leases, financial instruments credit losses)
Auditing Implementation of ASU 2014-09:	Addresses some of the risks associated with pre-adoption date activities and requirements, and identifies procedures that are or could be responsive to those risks.
NFP Entities - Part I:	General implementation issues in the not-for-profit sector.
NFP Entities - Part II:	Higher education sector implementation issues.
Real Estate Industry:	General implementation issues in the real estate sector.

Customer Options for Additional Goods or Services

Options in contracts for customers to acquire additional goods or services are many and various. Some offer the additional goods or services for free, others offer them at a discount, and others offer them at normal standalone selling prices. These customer options include discounts on future goods or services, sales incentives, customer award credits (or points, or miles), and contract renewals. Note that FASB ASC 606 does not define the term “customer option.”

Examples of Customer Options for Additional Goods or Services

Discount Voucher

- A voucher for a discount on future purchases made within a specified time period. The voucher is received only after a customer makes an initial purchase

Loyalty Program

- A loyalty program that allows an entity’s customers to accumulate points (miles) for every dollar spent (completed flight). Those points (miles) may then be used to obtain free goods or services when enough points (miles) have been earned through future purchases.

Renewal Option

- A renewal option that allows an entity’s customers to renew a contract at the end of the contract term by paying a renewal amount that is less than what the entity would charge its new customers for similar services.

But X, Get X Free

- Buy x amount and get x amount free programs, in which customers who have purchased a certain amount of products over a given period of time may receive additional products for free.

Volume Discount

- Volume discounts, in which the price of products or services in a subsequent year is dependent on the volume of purchases made in the current year.

Tier Status

- Tier status programs that categorize customers according to their purchasing history and provides different levels of future benefits (i.e., goods or services offered to customers for free or at a discounted price) to those customers based on the tier level.

Termination Option

- An option that allows the customer to terminate a contract.

When reviewing contracts, identifying customer options for additional goods or services is important because such options may give rise to performance obligations in the contracts if the options provide material rights to the customers that they would not receive without entering into those contracts.

Determining If the Option Provides a Material Right

As just indicated, an option for additional goods or services gives rise to a performance obligation in the contract if the option provides a *material right* to the customer that it would not receive without entering into that contract. FASB ASC 606 does not provide bright lines for determining if an option provides a material right. An entity will need to apply judgment based on its facts and circumstances to determine whether a contract with a customer includes a material right.

Would the customer receive the option without entering into the contract?

The key question to answer in determining if the option for additional goods or services provides a material right to the customer is whether the customer could receive the option without entering into the contract. If the customer could receive the option to acquire the additional goods or services without entering into the contract, then the option does not give rise to a material right and performance obligation within the contract. The objective of answering this question is to evaluate whether a customer option would exist independently of the current contract. When an option is independent, it is a marketing offer and not a material right. Therefore, it is not a separate performance obligation and unit of account.

In answering the question about whether the customer would receive the option without entering into the contract, consider whether the discount offered in the option to acquire additional goods or services is incremental to the range of discounts typically given by the entity for those goods or services to that class of customer in that geographical area or market. In other words, consider whether the discount exceeds the range of discounts typically given.

Example

Acme Company includes in its animal delivery service contract with a customer an option to purchase additional services at a 25% discount. That same discount is offered to other customers in that same class and market independent of a prior contract with the entity. In this case, the discount option offered to the customer is not incremental to the range of discounts typically given and would, therefore, not provide a material right.

Example

Acme Company sells rocket sleds for $299. As part of the contract, Acme gives the customer a 25% discount voucher for any future purchases in the next 30 days. Acme intends to offer a 5% discount on all sales during the next 30 days as part of a marketing promotion. The 5% discount cannot be used in addition to the 25% discount voucher. In this case, the 25% discount option offered to customers who enter into a contract to purchase the rocket sled is incremental to the range of discounts (5%) typically given and would, therefore, provide a material right. However, because all customers will receive a 5% discount on purchases during the next 30 days, the only discount that provides the customer with a material right is the discount that is incremental to that 5% (that is, the additional 20% discount).

Discount Should Be Significant to the Customer

The FASB indicates in BC 387 of FASB ASU 2014-09 that the discount offered on the option to acquire additional goods or services should be “significant” to the customer as well as “incremental.” Entities will need to apply judgment in determining what is significant to the customer. At the individual transaction level, the determination of significance is from the customer’s perspective and not based on the entity’s materiality model.

CPEA Observation. The notions of an option being “incremental” and “significant,” as indicated in BC 387 of ASU 2014-09, are derived from legacy U.S. Generally Accepted Accounting Principles (U.S. GAAP) developed for the software industry (FASB ASC 985-605-15-3(d)) and applied broadly, by analogy, across all industries. However, unlike legacy U.S. GAAP, under FASB ASC 606, even if a discount is not incremental to the range of discounts reflected in the pricing of other elements *in the contract*, it could give rise to a material right to the customer. In other words, unlike legacy U.S. GAAP the discount does not need to be incremental to the range of discounts reflected in the pricing of the other elements (other goods or services) in the contract. This difference with legacy U.S. GAAP could cause more customer options to be evaluated as providing material rights.

Example

Acme Company enters into a contract to sell super speed vitamins to a customer for $60, which represents a 40% discount off its list price of $100. In the same contract, it also gives the customer a 25% discount voucher for any future purchase of its giant rubber bands in the next 30 days. The 25% discount option offered to the customer is clearly not incremental to the 40% discount offered in the contract on the super speed vitamins. However, that fact is not a relevant consideration under FASB ASC 606 with regard to the determination of a material right. What is relevant is whether the 25% discount option is incremental to the range of discounts typically given by the entity for those giant rubber bands to that class of customer in that geographical area or market.

Right to Purchase Additional Goods or Services at Their Standalone Selling Prices

If a customer has the option to acquire an additional good or service at a price that would reflect the standalone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In other words, a customer option to acquire additional goods or services would not give rise to a material right if a customer could execute a separate contract to obtain the same goods or services at the same price. In those cases, the entity has made a marketing offer that it should account for in accordance with the guidance in FASB ASC 606 only when the customer exercises the option to purchase the additional goods or services.

Example

Acme Company enters into a contract with a customer to provide airdrop services for its goods for one year. The airdrop service includes up to 5 airdrops each month for a fixed monthly fee of $4,000. The contract specifies the price for any additional airdrops that the customer may choose to purchase in any month at $1,000. Standalone selling prices for airdrops are $1,000. In this case, Acme determines that the option to purchase the additional airdrops does not provide a material right that the customer would not receive without entering into the contract.

This is because the prices of the additional airdrops reflect the standalone selling prices for those services (the customer could execute a separate contract to obtain the same goods or services at the same price). Because the option for additional airdrops does not grant the customer a material right, Acme concludes it is not a performance obligation in the contract. Consequently, Acme does not allocate any of the transaction price to the option for additional airdrops. Acme will recognize revenue for the additional airdrops when they provide those services.

For a customer option to provide a material right, the customer would not have received the option without entering into the contract.

- The discount offered under the option exceeds the range of discounts typically given to that class of customer in that geographical area or market.
- The option does not simply provide the customer with a right to purchase additional goods or services at their standalone selling prices.

When the option to purchase additional goods or services provides a material right to the customer, the customer in effect pays the entity in advance for future goods and services, and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

Evaluating the Existence of Material Rights

For some contracts, determining whether a contract includes an option that provides a material right will be clear. However, in other cases, the determination will require significant judgment. In evaluating whether an option for additional goods or services provides a material right to the customer, consider:

- Relevant transactions with the customer, including current, past, and future transactions
- Quantitative and qualitative factors, including whether the right accumulates (for example, loyalty points)

Some options are given to customers as part of an entity's marketing efforts (that is, efforts to obtain future contracts with customers) while others are granted to customers (often implicitly) as part of a present contract and give those customers a right to acquire additional goods or services at a discount. Distinguishing between the two kinds of options can be challenging sometimes. A customer option to purchase additional goods or services is either a material right that is paid for by the customer as part of the existing contract or a marketing offer that is not part of the contract.

Accounting for a Material Right

If an option to acquire additional goods or services provides the customer with a material right that the customer would not receive without entering into the contract, that option gives rise to a performance obligation in the contract. The performance obligation is the option given to the customer, not the underlying goods or services the customer may purchase. The entity should allocate part of the contract transaction price to the performance obligation and recognize revenue related to the option when those future goods or services are transferred or when the option expires.

If the option does not provide the customer with a material right that the customer would not receive without entering into the contract, that option does not represent a performance obligation within the contract. In effect, the option is a marketing offer. A customer option for additional goods or services that is essentially a marketing offer (no material right provided) is accounted for separately from the current contract as an independent transaction when the customer exercises the option.

Practice Note: As indicated previously, the customer in effect pays the entity in advance for future goods and services when it is granted an option with a material right that the customer would not receive without entering into the contract.

FSB ASC 606-10-32-29 requires an entity to allocate the transaction price to performance obligations on a relative standalone selling price basis. If the standalone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity should estimate it. That estimate should reflect the discount that the customer would obtain when exercising the option, adjusted for both the following:

- Any discount that the customer could receive without exercising the option (the standalone selling price for a customer option that provides a material right includes only the incremental discount provided through the current purchase)
- The likelihood that the option will be exercised (The estimate of the option's standalone selling price is adjusted for breakage)

Illustration of Allocating Transaction Price to a Material Right and Recognizing Revenue

Acme Company enters into a contract with a customer to provide a jet-propelled unicycle for $15,000 and one year of maintenance service for $2,000. Both prices are equal to their standalone selling prices. The standalone selling price of the maintenance service for the second year is also $2,000 due to the nature of the product. The contract provides the customer with the option to renew the maintenance service for $1,000 for one additional year (the second year). Acme concludes that the option to renew the maintenance service (i.e., customer option to purchase an additional service) provides a material right to the customer that the customer would not receive without entering into the contract because the discount is incremental to the range of discounts offered to similar customers and is significant. As such, the option to renew the maintenance service is a performance obligation within the contract and a portion of the transaction price should be allocated to it based on its relative standalone selling price.

To estimate the standalone selling price of the renewal option, Acme estimates a 60% likelihood that the customer will renew the maintenance service. It estimates the standalone selling price of the option as $600 ($2,000 standalone selling price X 50% discount X 60% likelihood of renewal). Acme then allocates the transaction price on a relative standalone selling price basis as follows:

Performance Obligation	**Standalone Selling Price**	**Selling Price Ratio**	**Price Allocation**
Jet-propelled unicycle	$15,000	85.2%	$14,484
Maintenance year 1	$2,000	11.4%	$1,938
Material right renewal option	$600	3.4%	$578
Total	$17,600	100%	$17,000

Acme allocates $14,484 to the jet-propelled unicycle and recognizes revenue for the unicycle when control transfers. Acme allocates $1,938 to the maintenance service and recognizes revenue for the service as the performance obligation is satisfied over the year. Acme allocates $578 to the maintenance renewal option and recognizes revenue when the customer renews the maintenance service or when the option expires.

Acme records the following journal entries, assuming the customer exercises the renewal option:

	Debit	**Credit**
Cash/trade receivables	$17,000	
Revenue		$14,484
Contract liability		$2,516
To recognize revenue on transfer of control of jet-propelled unicycle.		
Contract liability	$1,938	
Revenue		$1,938
To recognize revenue ratably as maintenance service performance obligation is satisfied over one year.		
Cash/trade receivables	$1,000	
Contract liability	$578	
Revenue		$1,578
To recognize revenue when the renewal option for additional maintenance service is exercised.		

Illustration of a Material Right with a Low Probability of Exercise

Acme Company enters into a contract to sell two instant icicle makers to a customer, with an option for a third icicle maker with a discount of 20% off the selling price, which is not offered to similar customers for similar products. The customer has never owned and operated more than two instant icicle makers at one time due to operational needs and budgetary constraints. Further, Acme believes it is unlikely that the customer will exercise the option for the third icicle maker. In this example, the low probability of the exercise does not eliminate the customer's material right. The option to purchase the third instant icicle maker at a discount represents a material right because paying the full price for the first two icicle makers results in the customer effectively paying in advance for the discounted third icicle maker.

In accordance with FASB ASC 606-10-55-44, the low probability that the customer will exercise the option should be factored into the determination of the amount to be allocated to the material right related to the option. In other words, the low probability of the option's exercise should result in a much lower allocation of the transaction price to the material right.

Practical Alternative to Estimating the Standalone Selling Price of the Option

If a customer has a material right to acquire future goods or services and those goods or services are 1) similar to the original goods or services in the contract and 2) are provided in accordance with the terms of the original contract, then an entity may, as a practical alternative to estimating the standalone selling price of the option, allocate the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration.

Typically, the practical expedient will apply to options that are for contract renewals (see the Contract Renewal Options section in this report). That is because use of the practical expedient requires that two criteria be met, as indicated in the paragraph above. Firstly, the additional goods or services provided under the option must be similar to those provided under the initial contract (i.e., an entity continues to provide what it was already providing). Secondly, use of the practical expedient requires that the additional goods or services must be provided in accordance with the terms of the original contract. Consequently, these criteria substantially restrict the use of the practical expedient because the entity cannot change the terms and conditions (e.g., pricing) of providing the additional goods or services under the customer option beyond the parameters specified in the original contract and it must continue to provide products or services similar to those provided under the original contract. Such restrictions will greatly limit an entity's ability to use the practical expedient for customer options that are not renewal options, such as discount vouchers and loyalty programs. In fact, the FASB provided the practical expedient with renewal options in mind.

Accounting for the Customer's Exercise of a Material Right

In accordance with FASB ASC 606-10-25-23, an entity recognizes revenue as the amount allocated to the material right when the future goods or services are transferred or when the option expires. A questions arises about how an entity follows that principle and accounts for the customer's exercise of a material right. Based on FASB TRG discussions (see TRG Paper No. 34), two approaches are acceptable, depending on the facts and circumstances:

- *Continuation of the Original Contract*. At the time a customer exercises a material right, an entity should update the transaction price of the contract to include any consideration to which the entity expects to be entitled as a result of the exercise. The additional consideration should be allocated to the performance obligation underlying the material right and should be recognized when or as the performance obligation underlying the material right is satisfied.
- *Contract Modification*. The exercise of a material right should be accounted for as a contract modification. That is, the additional consideration received and/or the additional goods or services provided when a customer exercises a material right represent a change in the scope and/or price of a contract. An entity should apply the modification guidance in FASB ASC 606-10-25-10 through 25-13.

Most TRG members leaned toward the first approach, continuation of the original contract. That approach appears to be the method that more often would be used in practice. TRG members observed that in most, but not all, cases the financial reporting outcome of applying either approach would be similar. Only in cases in which the optional goods or services are determined to be not distinct from the original promised goods or services, would the results appear to differ. FASB staff think that an entity typically would conclude that an optional good or service is distinct.

The method used to account for the exercise of a material right will depend on the facts and circumstances of the arrangement. The method used should be applied consistently by an entity to similar types of material rights with similar facts and circumstances.

Contract Renewal Options

Renewal options should be viewed and treated similarly to other customer options to provide additional goods or services, such as discount vouchers. However, a renewal option often provides the customer with a series of options. In other words, to exercise any option in the contract, the customer must have exercised all the previous options in the contract. For example, at the end of a contract term, customers may be provided with an option to renew the contract for an additional year and also provided with an option to renew the contract again for a second year. Determining the standalone selling price of a series of options can be complex (e.g., estimating the likelihood that customers will exercise the renewal options in each subsequent period). For that reason, the FASB provided the practical alternative to estimating the standalone selling price of the option described previously in this report.

Loyalty Programs

As indicated previously in this report, a customer loyalty program is an example of a customer option for additional goods or services. Typically, a loyalty program allows an entity's customers to accumulate points (or miles) for dollars spent. These points may then be used to obtain free goods or services when enough points have been earned through future purchases. Customer loyalty programs need to be assessed as other options for additional goods or services are assessed and a determination should be made as to whether the loyalty program provides material rights to customers.

Practice Note: In evaluating whether an option for additional goods or services provides a material right to the customer, one consideration is whether the right accumulates, as with loyalty points.

Illustration of Customer Loyalty Program

Acme Company maintains a customer loyalty program. Customers receive a point for every dollar spent on eligible merchandise. Once a customer accumulates 200 points, he or she will receive $10 toward his or her next purchase.

During Year 1, customers purchase eligible merchandise for $100,000 and earn 100,000 points. The consideration is fixed, and the standalone selling price of the purchased merchandise is $100,000. Based on historical experience, Acme expects 60% of customers' points to be redeemed.

Acme determines that the points provide a material right to customers that they would not receive without entering into a contract. Consequently, Acme concludes that the promise to provide points to the customer is a performance obligation.

Acme estimates a standalone selling price of the points as $3,000 [((100,000 X 60%) ÷ 200) X $10].

Acme allocates the transaction price ($100,000) to the product and the points (material right) on a relative standalone selling price basis as follows:

Performance Obligation	Standalone Selling Price	Selling Price Ratio	Price Allocation
Merchandise	$100,000	97.1%	$97,100
Points (material right)	$3,000	2.9%	$2,900
Total	$103,000	100%	$100,000

At the end of the first year, 24,000 points have been redeemed, and Acme continues to expect 60,000 points in total to be redeemed . Acme recognizes revenue for the loyalty points of $1,160 [(24,000 points ÷ 60,000 points) × $2,900] and recognizes a contract liability of $1,740 ($2,900 – $ 1,160) for the unredeemed points at the end of Year 1.

At the end of Year 2, 38,000 points have been redeemed cumulatively. Acme updates its estimate of the points that will be redeemed and now expects that only 50,000 points will be redeemed. The entity recognizes revenue for the loyalty points of $1,044 [((38,000 total points redeemed ÷ 50,000 total points expected to be redeemed) × $2,900 initial allocation) – $1,160 recognized in the first reporting period]. The contract liability balance is $696 ($2,900 initial allocation – $2,204 of cumulative revenue recognized).

Acme records the following journal entries:

	Debit	**Credit**
Cash/trade receivables	$100,000	
Revenue		$97,100
Contract liability		$2,900
To recognize revenue on sale of merchandise in Year 1		
Contract liability	$1,160	
Revenue		$1,160
To recognize redemption of points in Year 1.		
Contract liability	$1,044	
Revenue		$1,044
To recognize redemption of points in Year 2.		

Change from Legacy U.S. GAAP

Although legacy U.S. GAAP does not explicitly specify how to account for customer loyalty programs, two methods of accounting for such programs are commonly used. The more popular method is the incremental cost method in which an accrual for the expected costs of satisfying the membership or loyalty program is made. Another less popular method treats the issuance of the credit in the membership or loyalty program as a separate unit of account and allocates revenue to that unit of account for each qualifying transaction, similar to multiple-element revenue recognition. Now that FASB ASC 606 specifies how to account for loyalty programs and other customer options for additional goods or services, many entities will need to change their accounting policies.

CPEA Observation. Entities that currently offer customer loyalty or additional incentive programs will want to review these programs to ensure that they feel comfortable with the accounting under FASB ASC 606 for these arrangements. Some entities might rethink these programs and under what situations they will offer these incentives to customers, as it could be very time consuming to account for these items appropriately under FASB ASC 606. One way of reducing the accounting burden might be to increase minimum amounts for customers to be able to get credit in a customer loyalty program.

Tier Status Programs

Many entities have incentive affinity programs that enable customers to achieve a tier status based on their loyalty or their repeat purchases of goods and services in the ordinary course of business. Affinity programs with tier status require careful evaluation because some programs may have elements similar to point loyalty programs, which are generally considered to reflect material rights that would be separate performance obligations. In other circumstances, such programs are designed to provide marketing incentives on future revenue transactions, which may not be separate performance obligations. Chapter 10, Airlines, and Chapter 6, Gaming Entities, of the AICPA Revenue Recognition Guide provide detailed guidance on assessing whether tier status in an affinity program conveys a material right to goods or services.

Nonrefundable Upfront Fees and Material Rights

In some contracts, an entity charges a customer a nonrefundable upfront fee at or near contract inception. Examples include health club membership fees, activation fees in telecommunication contracts, setup fees in outsourcing contracts, and initial fees in supply contracts. To identify performance obligations in such contracts, an entity should assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a nonrefundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfill the contract, that activity does not usually result in the transfer of a promised good or service to the customer. Rather, the upfront fee is an advance payment for future goods or services and, therefore, would be recognized as revenue when those future goods or services are provided.

The revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right. The FASB TRG indicated that the period over which a nonrefundable fee, such as an activation fee, will be recognized depends on whether the nonrefundable fee provides the customer with a material right. If an entity concludes that the activation fee provides the customer with a material right, the fee would be recognized over the service period during which the customer is expected to benefit from not having to pay an activation fee upon renewal of service. Conversely, if an entity concludes that the activation fee does not provide the customer with a material right, the activation fee is, in effect, an advance payment for the promised goods or services in the contract.

Consideration of Significant Financing Components Associated with Material Rights

FASB ASC 606-10-32-15 makes clear that an entity must consider the effects of the time value of money when determining the transaction price. This evaluation would include consideration of whether a significant financing component exists as a result of a material right (that is, the evaluation would be the same as for any other performance obligation). However, FASB ASC 606-10-31-17(a) indicates that a contract would not have a significant financing component if a customer pays for goods or services in advance, and the timing of the transfer of those goods or services is at the discretion of the customer. In those cases, the purpose of the payment terms is not related to a financing arrangement between the parties. In addition, the FASB decided that the costs of requiring an entity to account for the time value of money in these cases would outweigh any perceived benefit because the entity would need to continually estimate when the goods or services will transfer to the customer.

Although an entity will have to evaluate whether a material right includes a significant financing component, there is likely not a significant financing component if the customer can choose when to exercise the option.

Distinguishing Between Options to Purchase Additional Goods or Services and Variable Consideration

Questions can arise about how to distinguish between a contract that contains an option to purchase additional goods and services and a contract that includes variable consideration based on a variable quantity (such as a usage-based fee). Judgment will be needed to distinguish between the two. A critical step is to appropriately identify the nature of the promises in the contract as well as the rights and obligations of the parties. The following table lists some differences between optional purchases and variable consideration that may be helpful when evaluating a contract.

Options for additional goods or services	• The customer has a right that allows it to choose the amount of additional distinct goods or services (or change the goods or services to be delivered) that are purchased (it's a separate purchasing decision). The entity is not obligated to provide (and does not have a right to consideration for delivering) additional goods or services until the customer exercises that right (option). • The customer's action in an optional purchase results in a new obligation for the entity to transfer additional distinct goods or services.
Variable consideration	• The entity is obligated to transfer all goods or services to the customer under the contract. The future events (including the customer's own actions) that result in additional consideration occur after (or as) control of the goods or services have (or are) transferred. The customer's actions do not obligate the entity to provide additional distinct goods or services (or change the goods or services to be transferred). • Customer actions or events that result in additional payment after (or as) control of the goods or services has transferred would be indicative of variable consideration.

FASB TRG Paper Nos. 48 and 49 provide a discussion about distinguishing between a contract that contains an option to purchase additional goods and services and a contract that includes variable consideration based on a variable quantity.

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