

Question:

Street Dog, Inc., a publicly-traded company, operates hot dog carts on the streets of major cities. Street Dog is considering an incentive plan to increase the hot dog sales of its street vendors. The plan will give customers a free hot dog if they buy five street hot dogs at regular prices. Customers will be issued a card that will be punched each time a hot dog is purchased. After five punches, the card can be turned in for a free hot dog. Justin Case, the company's CFO, is not sure how to characterize the cost of the incentive plan – a reduction of revenue or an increase in cost of sales.

Answer:

The cost of the free hot dog should be recognized by Street Dog, Inc. as an increase to cost of sales. Street Dog, Inc. is considering the following incentive plan to its customers: When the card issued to a customer is punched for the purchase of five street hot dogs, the customer will receive a free hot dog. The cost of the free hot dog should be recognized as an expense (FASB ASC 605-50-45-3). And that expense should be classified as cost of sales (605-50-S99-1S99-1).

Excerpts:

605 Revenue Recognition

50 Customer Payments and Incentives

45 Other Presentation Matters

605-50-45-3 If the consideration consists of a free product or service (for example, a gift certificate from the vendor or a free airline ticket that will be honored by another, unrelated entity), or anything other than cash (including credits that the customer can apply against trade amounts owed to the vendor) or equity instruments (see Example 9 [paragraph 605-50-55-43]), the cost of the consideration shall be characterized as an expense (as opposed to a reduction of revenue) when recognized in the vendor's income statement. That is, the free item is a deliverable in the exchange transaction and not a refund or rebate of a portion of the amount charged to the customer.

> SEC Staff Guidance

>> Comments Made by SEC Observer at Emerging Issues Task Force (EITF) Meetings

>>> SEC Observer Comment: Accounting for Consideration Given by a Vendor to a Customer (Including Reseller of the Vendor's Products)

605-50-S99-1S99-1 The following is the text of SEC Observer Comment: Accounting for Consideration Given by a Vendor to a Customer (Including Reseller of the Vendor's Products).

- As it relates to consideration given by a vendor to a customer the SEC staff believes that the expense associated with a "free" product or service delivered at the time of sale of another product or service should be classified as cost of sales.