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Retail and consumer

IFRS 15 solutions

IFRS15

The new revenue recognition standard

Beyond theory to practical application

June 2018

Foreword

We first published 'Issues and Solutions for the Retail and Consumer Goods Industries' in 2008 to provide perspectives on a range of financial reporting issues specific to the retail and consumer goods (R&C) sector. This publication was refreshed in 2011 and was well received thanks largely due to the Q&A format addressing real everyday questions from preparers.

The issuance of IFRS 15, «Revenue from Contracts with Customers», by the IASB has required R&C preparers to consider all of their revenue and promotion models using the new five step model detailed in the standard. At the same time, our old publication has been rendered obsolete for many of the revenue cycle-related solutions.

This publication deals solely with the revenue cycle-related questions requiring analysis under the new guidance. Again, the questions and solutions are derived from the partners in the global PwC network who provide services to some of the world's largest R&C companies. We have combined this knowledge with that of our accounting consulting services network to prepare an extensive set of accounting solutions to help you understand and debate the issues and explain some of the approaches often seen in practice. We hope that this will encourage consistent treatment of similar issues across the sector.

Our framework focuses on generic issues rather than specific facts and circumstances, and it does not necessarily address the exact situations that might arise in practice. Each situation should be considered on the basis of the specific facts; and, in most cases, the accounting treatment adopted should reflect the commercial substance of the arrangements.

We encourage you to discuss the facts and circumstances of your specific situations with your local PwC R&C contact.

We hope that you find the publication useful in addressing your own reporting challenges.

Christine Bouvry

Chair, Retail & Consumer

Industry Accounting Group

David Mason

Retail & Consumer Leader

Global Accounting Consulting Services

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I. Product sales from consumer products companies to retailers

I.1 Transfer of control

Background

- CosmeticsCo, a consumer products company, uses a CostCo, a supermarket chain, to supply its products to the end-customers.
- CostCo receives legal title and is required to pay for the products on receipt.
- CostCo has no right of return to CosmeticsCo.

When does the consumer products company recognise revenue in accordance with IFRS 15?

Relevant guidance

Paragraph 31 of IFRS 15: "*an entity shall recognize revenue when the entity satisfies the performance obligation by transferring a promised good or service (that is, an asset) to a customer. An asset is transferred when the customer obtains control of that asset.*"

Paragraph 33 of IFRS 15: "*Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways.*"

Paragraph 38 of IFRS 15 requires an entity to consider indicators of the transfer of control, which include, but are not limited to, the following:

a. "the customer has a present right to payment……

b. the customer has legal title to the asset……

c. the customer has obtained physical possession of the asset…

d. the customer has the significant risks and rewards of ownership…..

e. the customer has accepted the asset…..

Solution

Revenue is recognised by CosmeticsCo when control of the products is transferred. CostCo has physical possession, legal title and a present obligation to pay for the asset at the time of receipt of the products. These are all indicators that control is transferred when the products are delivered to the retailer.

I.2 Right of return

Background

- WatchCo uses a wholesale network to supply its products to end-customers.
- WatchCo sells 100 watches to a retailer for €50 each. The cost of each watch is €10.
- WatchCo estimates, based on the expected value method, that 6% of watches sold will be returned, and it is highly probable that returns will not be higher than 6%.
- WatchCo has no further obligations after transferring control of the watches.

Situation A – Retailer has a contractual right to return the watches for a full refund for a contractually defined period.
Situation B – Retailer has no contractual right, but WatchCo has a customary business practice where returns have been made and accepted.

How should WatchCo recognise revenue in accordance with IFRS15?

Relevant guidance

Paragraph 10 of IFRS 15: "*A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities […]. An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations.*"

A right of return is not a separate performance obligation, but it affects the estimated transaction price for transferred goods. Revenue is only recognised for those goods that are not expected to be returned.
The estimate of expected returns should be calculated in the same way as other variable consideration.

a) The estimate should reflect the amount that the entity expects to repay or credit customers, using either the expected value method or the most likely amount method.
b) The transaction price should include amounts subject to return only if it is highly probable that there will not be a significant reversal of cumulative revenue if the estimate of expected returns change.

Paragraph B21 of IFRS 15 requires entities to account for sales with a right of return recognising all of the following:

a) *"Revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognized for the products expected to be returned)*
b) *A refund liability*
c) *An asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability."*

I.2 Right of return *(cont'd)*

Solution

Situation A

Revenue is recognised when the watches are delivered and a liability deducted from revenue for expected returns. Simultaneously, an asset is recognised for the watches expected to be returned, reducing the cost of sales. Recognition occurs on transfer of control to the wholesaler.

The returns asset will be presented and assessed for impairment separately from the refund liability. WatchCo will need to assess the returns asset for impairment, and adjust the value of the asset if it is impaired.

<u>Revenue</u>: Sales price per unit × units (excluding those expected to be returned) €50 × 100*(1 – 0.06) watches = €4,700

<u>Cost of sales</u>: Cost × units (excluding those expected to be returned) €10 × 94 watches = €940
<u>Asset</u>: Former carrying amount x units expected to be returned €10 × 6 watches = €60

<u>Liability</u>: Return ratio x units sold x sales price per unit
6% x 100 watches × €50 = €300 for the refund obligation.

Situation B

WatchCo has a customary business practice of accepting returns which should be considered part of the terms of the contracts with its customers.
The right of return is accounted for in the same manner as in situation A.

I.3 Consignment arrangements

Background

- GardenfurnishingsCo provides teak furniture to a garden centre on a consignment basis. The products are immediately proposed for sale in the garden centre.
- GardenfurnishingsCo retains title to the products until they are sold to the end-customer.
- The garden centre does not have an obligation to pay GardenfurnishingsCo until a sale occurs, and any unsold products can be returned to GardenfurnishingsCo.
- GardenfurnishingsCo also retains the right to take back any unsold products, or to transfer unsold products to another retailer.
- Once the garden centre sells the products to the end-customer, GardenfurnishingsCo has no further obligations, and the retailer has no further return rights.

When does GardenfurnishingsCo recognise revenue in accordance with IFRS 15?

Relevant guidance

Consignment arrangements are where an entity ships goods to a distributor but retains control of the goods until a predetermined event occurs. Revenue is not recognised on delivery of the goods to another party if the delivered products are held on consignment.

Paragraph B77 of IFRS 15: "*When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end-customers, the entity shall evaluate whether that other party has obtained control of the product at that point in time. A product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, an entity shall not recognise revenue upon delivery of the product to another party if the delivered product is held on consignment.*"

Paragraph B78 of IFRS 15: "*Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:*

a) the product is controlled by the entity until a specified event occurs, such as the sale of the products to a customer of the dealer or until a specified period expires;

b) the entity is able to require the return of the products or transfer the products to a third party (such as another dealer); and

c) the dealer does not have an unconditional obligation to pay for the products (although it might be required to pay a deposit)."

Solution

GardenfurnishingsCo should recognise revenue once the garden centre sells the product to the end-customer. Although the garden centre has physical possession of the products, it does not take title, only a right to sell, and it does not have an unconditional obligation to pay GardenfurnishingsCo. GardenfurnishingsCo retains the right to call back the products. Therefore, revenue is not recognised when the goods are delivered to the garden centre in accordance with the guidance in paragraphs B77 and B78 of IFRS 15.

GardenfurnishingsCo should also assess whether it is the principal to the transaction with the end-customer. If this is the case, it would recognise revenue in the amount that was received from the end-customer, and the amount retained by the garden centre would be recognised as commission expense (see also Section VI).

I.4 Volume discount

Background

TellieCo, an electronics manufacturer, enters into an arrangement with one of its major retailers, under which the retailer will receive a 5% discount on all purchases if the purchases by the retailer exceed € 100,000 for the annual period ending 31 December.

At 30 June, purchases by the retailer from TellieCo amount to €30,000. TellieCo forecasts that, due to the historic seasonality of the revenues (which peak prior to December in the run-up to the year-end holidays) and the launch of new products, the annual sales to the retailer will be in the range of €110,000 – 120,000.

How should TellieCo measure the revenue at 30 June ?

Relevant guidance

Paragraph 50 of IFRS 15 states: "*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.*"

Paragraph 51 of IFRS 15: "*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 can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a products was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.*"

According to paragraph 53 of IFRS 15, an entity should estimate an amount of variable consideration by using one of two methods - "the expected value" and "the most likely amount" – whichever method is a better prediction of the final outcome.

According to paragraph 56 of IFRS 15, the transaction price should include some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

Solution

The transaction price of the goods sold to date includes an element of consideration which is variable or contingent on future events. TellieCo must estimate and recognise a liability at 30 June for the amount that it is expected to pay for the volume discount, and it recognises revenue only to the extent that it is highly probable that a significant reversal will not occur. TellieCo recognises a provision for the most likely amount that will be payable to the retailer of €1,500 (€30,000 × 5%).

I.5 Bill-and-hold arrangements

Background

- Consoles AG, a video game company, enters into a contract to supply 100,000 video game consoles to a retailer, Durbin, branded with Durbin's logo, to be delivered by the end of the year.
- The contract contains specific instructions from the retailer about where the consoles should be delivered.
- The retailer expects to have sufficient shelf space at the time of delivery.
- As of year-end, Consoles AG has shipped 60,000 units and the remaining 40,000 inventory of Durbin-branded consoles have been produced, packed and are ready for transport. However, the retailer asks for the shipment to be held, due to lack of shelf space.

When should Consoles AG recognise revenue for the 100,000 units to be delivered to the retailer?

Relevant guidance

Bill-and-hold arrangements arise when a customer is billed for goods that are ready for delivery, but the entity does not ship the goods to the customer until a later date. Entities must assess in these cases whether control has transferred to the customer, even though the customer does not have physical possession of the goods. Revenue is recognized when control of the goods transfers to the customer.

Paragraph B81 of IFRS 15 presents the following additional criteria that **all** need to be met in order for the customer to have obtained control in a bill-and-hold arrangement:

a) *the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);*
b) *products must be identified separately as belonging to the customer;*
c) *products currently must be ready for physical transfer to the customer; and*
d) *products cannot be used or directed to another customer.*

Solution

At the year-end, Consoles AG should recognise revenue for all 100,000 units, because all of the criteria exist for the control of the units to have transferred to Durbin. Since the goods are branded, they can not be directed to another customer, they are clearly identified as belonging to Durbin, and the reason for entering into the transaction is substantive (that is, lack of shelf space).

I.6 Shipping terms

Background

- Screens Inc, an electronics manufacturer has an arrangement with a retailer to sell televisions and arrange for the shipping.
- The delivery terms state that legal title and risk of loss passes to the retailer when the televisions are provided to the carrier.
- The retailer does not have physical possession of the televisions during transit, but has legal title at shipment and therefore can redirect the televisions to another party.
- Screens is also precluded from selling the televisions to another customer once the televisions have been picked up by the carrier at Screens' shipping dock.

How many performance obligations does Screens have and when should it recognize revenue?

Relevant guidance

A performance obligation is a promise to provide a distinct good or service or a series of distinct goods or services as defined by the revenue standard.
IFRS15.22 states that *"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."*

When there are multiple promises in a contract the company must determine whether goods or services are distinct and therefore separate performance obligations exist.

IFRS15.27 states "*that a good or service that is promised to a customer is distinct if* ***both*** *of the following criteria are met:*
a) Customer can benefit from good/service on its own or with other resources readily available to the customer (good/service is capable of being distinct)
b) Promise to transfer good/service to customer is separately identifiable from other promises in the contract (promise to transfer good/service is distinct within the context of the contract)."

IFRS15.33 and IFRS15.35 provide useful guidance on transfer of control in general and on over time revenue recognition for services.

Solution

There are two performance obligations: (1) sale of the televisions and (2) if not de-minimos, shipping services.

Revenue recognition for sale of televisions:
- When control transfers to the retailer : in this fact pattern when goods are provided to the carrier
- Retailer can benefit from the televisions on their own
- No impact of the shipping service as it is a distinct service

Revenue recognition for shipping services:
- When performance occurs, usually over the shipping period
- Retailer can benefit from the shipping together with the TV that it has already obtained

In many cases, a third-party carrier will be used to deliver the products. An entity will need to evaluate whether they are the principal or agent for the shipping services. If they are the agent, revenue should be recognised net of the payment to the third party carrier (ie. revenue will be the commission income).

II. Contractual arrangements between consumer products companies and retailers other than product sales

II.1 Slotting fees

Background

- ShampooCo, a consumer products company, has a policy of paying 'slotting fees' to retailers, in order to have the products allocated to advantageous spaces in the retailers' premises for a defined period of time. For example, the products are placed near the checkout counter, to be more noticeable for customers.
- ShampooCo sells products to CheapCo, a retailer, for €100,000. Simultaneously, it is invoiced €5,000 for a specific placement in the store which will generate additional sales.

How should the retailer account for slotting fees paid by the consumer products entity?

Relevant guidance

An entity should account for consideration payable to a customer as a reduction of the transaction, unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

A good or service that is promised to a customer is distinct if both of the following criteria are met (by virtue of paragraph 27 of IFRS 15):

a) *Customer* ***can benefit from good/service on its own or with other resources readily available*** *to the customer (ie the good/service is distinct).*
b) *The entity's promise to* ***transfer good/service to customer is separately identifiable*** *from other promises in the contract (promise to transfer good/service is distinct).*

Furthermore, paragraph 71 of IFRS 15 requires that, if an entity cannot reasonably estimate the fair value of the good or service received from the customer, it sshould account for all of the consideration payable to the customer as a reduction of the transaction price.

Solution

Slotting fees would not occur without the purchase of goods from the consumer products company, and they are therefore highly dependent on the purchase of the products. Thus, slotting fees are not distinct and should be accounted for as a reduction of the selling price. ShampooCo recognises the slotting fees as a reduction of revenue.

II.2 Waste disposal payments

Background

In some countries, consumer products companies are obliged to take back or dispose of the transport packaging when selling goods to their retailers. In practice, retailers usually take over the responsibility for disposing of the transport packaging. In return, they receive a refund from the consumer products company as compensation (waste disposal payment).

How should the consumer products company recognise the payment made to the retailer for the disposal of the transport packaging?

Relevant guidance

An entity should account for consideration payable to a customer as a reduction of the transaction, unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

A good or service that is promised to a customer is distinct if both of the following criteria are met (by virtue of paragraph 27 of IFRS 15):

a) *Customer* ***can benefit from good/service on its own or with other resources readily available*** *to the customer (ie the good/service is distinct).*
b) *The entity's promise to* ***transfer good/service to customer is separately identifiable*** *from other promises in the contract (promise to transfer good/service is distinct).*

If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, the entity should account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it should account for all of the consideration payable to the customer as a reduction of the transaction price (under paragraph 71 of IFRS 15).

Solution

Consumer products companies could dispose of the transport packaging themselves, or they could engage a third party to provide the service. Therefore, the disposal service provided by the retailer is distinct and separately identifiable.

The payment should be accounted for in the same way that the consumer products company accounts for other purchases or services provided by suppliers. The amount paid will be recognised as an expense by the consumer products company.
However, if the amount paid for the service does not reflect its fair value, the portion of the cost above the fair value should be accounted for as a reduction of the revenue generated from sales to the retailer.

II.3 Trade incentives *– Co-advertising services*

Background

Hiccup plc, a beverage producer, has entered into agreements with two of its customers (Retailer A and Retailer B) in relation to product advertising and promotion.

Retailer A

Hiccup plc has entered into an advertising arrangement with Retailer A, under which advertisements are to be published in a local newspaper. Hiccup plc has had arrangements in the past directly with the local newspaper and, absent the arrangement with the retailer, would advertise locally.

Retailer A will contract directly with the local newspaper and pay for the full cost of the campaign. Under a separate contractual arrangement with Retailer A, Hiccup plc has committed to reimburse 50% of the advertising costs. In order for Hiccup plc to reimburse Retailer A, it requires Retailer A to place adverts and provide the associated proof of placement in the local newspaper.

Retailer B

Hiccup plc also enters into a contract with Retailer B, under which Retailer B is entitled to an advertising allowance of €10m if it advertises Hiccup plc's goods on advertising boards and in its publicity mailings with certain regularity throughout the year. Retailer B only advertises brands that it lists/sells.

How should these transactions be recorded?

Relevant guidance

An entity should account for consideration payable to a customer as a reduction of the transaction, unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

A good or service that is promised to a customer is distinct if both of the following criteria are met (by virtue of paragraph 27 of IFRS):

- Customer can benefit from good/service on its own or with other resources readily available to the customer (ie the good/service is distinct)
- The entity's promise to transfer good/service to customer is separately identifiable from other promises in the contract (promise to transfer good/service is distinct)

- *If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, the entity should account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it should account for all of the consideration payable to the customer as a reduction of the transaction price (under paragraph 71 of IFRS 15).*

II.3 Trade incentives *– Co-advertising services (cont'd)*

Solution

Arrangement with Retailer A

The payment to Retailer A is for a distinct service. Hiccup plc has previously purchased similar advertising at similar pricing, and Hiccup plc could have entered into this arrangement whether or not Retailer A is a customer.

The fair value of the advertising services can be reasonably estimated, and Hiccup plc is paying Retailer A fair value for such services. Hiccup plc recognises the advertising costs as an expense in the income statement.

Arrangement with Retailer B

Hiccup plc is unable to identify a distinct service and/or separate the arrangement from the underlying customer relationship and sales/purchase arrangement. Therefore the amounts due by Hiccup plc to Retailer B would be recognised as a reduction of Hiccup plc's revenue.

Case-by-case assessment

In many circumstances, trade incentives might vary depending on local practices between consumer products companies and retailers. It might often be difficult to determine if a service can be considered as distinct or not.

II.4 Trade incentives – *Scan deals*

Background

Scan deals are agreements that involve a joint promotional campaign between consumer goods companies and retailers. The agreements generally specify that the seller grants reduced prices to retailers who, at the same time, offer promotional prices to consumers.

- Showergel, a consumer goods company, and a retailer agree that, for a period of two months, all sales of certain products will be subject to a special promotional price. The promotional period of two months will coincide with Showergel's media campaign for the products.
- Showergel does not have an established practice of scan deals.
- Showergel's normal selling price to the retailer is €80; the selling price from the retailer to consumers is €100.
- Showergel and the retailer agree that both of their respective prices will be reduced by 20%. The reductions in price apply only to goods sold in the promotional period.
- The retailer reports unsold discounted products to Showergel at the end of the promotional period, and it reimburses any unearned discount.

How does Showergel account for the discount arising from scan deals?

Relevant guidance

Paragraph 47 of IFRS 15: "An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both."

Solution

- Showergel should consider the discount in determining the transaction price. The entity will need to estimate the number of products that will be sold by the retailer at a discount during the promotional period. The discount of € 16 (20% off the regular price of € 80) per unit expected to be sold during the period is applied as a reduction of the transaction price and, therefore, as a reduction of revenue. This can be either a reduction relating to inventory already held by the retailer or a deduction from sales to the retailer during the scan deal period, as appropriate.
- Revenue must only be recognised to the extent that it is highly probable that a significant reversal will not occur once the number of products that qualify for the discount is finally determined. At this point, the amount of revenue recognised will be adjusted to reflect the total discount granted.

II.5 Retail fixture compensation

Background

- SmoothLines, a consumer products company, gives a retailer compensation to cover their cost for retail store renovation to meet the standard required by SmoothLines. The contract has a minimum purchase requirement.
- The compensation will be paid partly as a lump sum on completion of the renovation, with an additional discount offered to the retailer in relation to future sales which exceed the minimum purchase requirements.

How should the retailer and SmoothLines account for the arrangement?

Relevant guidance

An entity should account for consideration payable to a customer as a reduction of the transaction, unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

A good or service that is promised to a customer is distinct if both of the following criteria are met (by virtue of paragraph 27 of IFRS 15):

a) *Customer **can benefit from good/service on its own or with other resources readily available** to the customer (ie the good/service is distinct)*

b) *The entity's promise to **transfer good/service to customer is separately identifiable** from other promises in the contract (promise to transfer good/service is distinct)*

Solution

- SmoothLines does not receive a distinct good or service in exchange for the compensation paid to the customer. SmoothLines should recognise the compensation as a reduction of revenue for the related goods. The goods to which the reduction of revenue is attributable will depend on the contractual arrangements.
- The retailer should record the amounts received as a reduction in the cost of inventory acquired under this contract, with the lump sum being allocated pro-rata to the minimum purchase requirement.

II.6 Retail markdown compensation

Background

Markdown compensation (also known as price protection) is an arrangement between a consumer goods company and a retailer, under which the consumer goods company pays compensation to the retailer for losses as a result of reduction in the market price.

(a) DeNimes is a well-known clothing producer. In order to prevent obsolete products from accumulating in the distribution channel and to maintain relationships with the retailers, DeNimes has a well-established practice of providing retail markdown compensation on outgoing collections two weeks before the launch of a new collection.

(b) Capsules is a newcomer to the coffee machine market. Its first model has been highly successful over the past three years but, as a result of the launch of the next model, Capsules has decided to provide retail markdown compensation, to eliminate the first model inventory from the retail channel. The second model will be sold directly through Capsules's website.

How and when do these consumer goods companies account for the markdown compensation that they grant to retailers?

Relevant guidance

Paragraph 50 of IFRS 15: "*Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 50–58.*"

IFRS15.72 "*Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognise the reduction of revenue when (or as) the later of either of the following events occurs:*

(a) the entity recognises revenue for the transfer of the related goods or services to the customer; and

(b) the entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices."

II.6 Retail markdown compensation *(cont'd)*

Solution

The consumer goods companies should recognise revenue when control of the products is transferred to the customer. Revenue will be reduced by the amount of the markdown compensation that the company pays, or expects to pay, to the retailer.

DeNimes should reduce the transaction price for estimated markdown compensation when it recognises revenue on shipment of the original collection. Although DeNimes has not yet offered the compensation, it has a customary business practice of providing compensation and, it intends and expects to provide compensation related to the original collections. Therefore, DeNimes
should account for the compensation following the guidance on variable consideration.

As Capsules had no past practice of markdown compensation; it accrues the markdown compensation as a reduction of revenue as soon as it has offered the payment, based upon the amount of inventory in the channel.

III. Transactions between end-customers and retailers

III.1 Customer incentives *– Buy three, get coupon for one free*

Background

- Death By Chocolate Ltd, a high street chain, is offering a promotion whereby a customer who purchases three boxes of chocolates at €20 per box in a single transaction in a store receives an offer for one free box of chocolates if the customer fills out a request form and mails it to them before a set expiration date.
- Death By Chocolate estimates, based on recent experience with similar promotions, that 80% of the customers will complete the mail-in rebate required to receive the free box of chocolates.

How is a 'buy three, get one free' transaction accounted for and presented by Death By Chocolate?

Relevant guidance

Paragraph 22 of IFRS 15 states: *"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; or

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 23)."

Paragraph 26 of IFRS 15 *provides examples of distinct goods and services, including "granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs B39–B43)".*

Paragraph B40 of IFRS 15: "*If, in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires".*

***III.1 Customer incentives** – Buy three, get coupon for one free (cont'd)*

Solution

- The purchase of three boxes of chocolates gives the customer the right to the fourth box for free. This is a material right which is accounted for as a separate performance obligation. An element of the transaction price would be allocated to the material right using the relative stand-alone selling price, which considers estimated redemptions. The value of the option would be €16 (€20 × 100% discount × 80% expected redemption). Management would allocate €12.63 (€60 (transaction price for three boxes at € 20 each) × (€16 / (€16 + €60))) of the transaction price to the mail-in rebate.

- Death By Chocolate would recognise revenue of €47.37 when control of the three boxes of chocolates transfers. Management would allocate € 12.63 to the undelivered box and recognise revenue on delivery.. The expected breakage amount is recognised as revenue in proportion to the pattern of rights exercised by the customer. If Death by Chocolate is unable to determine the number of mail-in rebates that will be used, management might assume 100% redemption, to ensure that it is not highly probable that there will be a significant reversal of revenue.

III.2 Customer incentives – Discount coupons

Background

LA, a clothing retailer, has launched a promotional campaign whereby a coupon is published in a national newspaper giving a discount of 5% off for any purchase over €50 in any of LA's stores.

LA's margin on similar transactions, prior to the impact of the coupons, is between 30% and 40%. Therefore, there is no risk of creating an onerous arrangement between the retailer and the customer.

How does a retailer account for these coupons?

Relevant guidance

Paragraph 9 of IFRS 15 states: *"An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:*

a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations…"

Paragraph 10 of IFRS 15: *"A contract is an agreement between two or more parties that creates enforceable rights and obligations."*

Solution

The simple issuance of the coupons does not create a binding contract with a customer. This only occurs once the customer makes the purchase exceeding €50. LA should not recognise a liability in its financial statements for the distribution of coupons.

LA should account for discount coupons as an adjustment to the transaction price only when the customers redeem them.

***III.3 Customer incentives** – Discount coupons / free products rebate*

Background

DressCo is a high street retailer and has launched a promotional campaign with the following elements:

- discount coupons are provided to any customers that purchase goods with a total value of over €5,000. The discount coupons entitle the customer to an additional 50% till discount on selected items during the 90 days immediately following the campaign;
- DressCo has issued 60 of the 50% coupons to high-spending consumers and took from them €100,000 at the till during the campaign; and
- based on historical trends, management expects that:
  - ✓ 75% of the end-consumers receiving 50% discount coupons will use the coupon;
  - ✓ customers using the coupons will spend on average €1,000 at the till; and
  - ✓ It will still make a positive margin on the transactions when the coupons are used.

How should DressCo account for the discount coupon issued to customers?

Relevant guidance

Paragraph26 of IFRS 15: "*Depending on the contract, promised goods or services may include, but are not limited to, the following:*

...

j) granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs B39–B43)."

According to paragraphs B40, B41 and B42 of IFRS 15:

"B40 If, in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.

B41 If a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone 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 those cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services.

B42 Paragraph 74 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it. That estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:

- *any discount that the customer could receive without exercising the option; and*
- *the likelihood that the option will be exercised."*

III.3 Customer incentives – *Discount coupons / free products rebate (cont'd)*

Solution

DressCo has sold dresses for a total amount of €100,000, and it has simultaneously granted to its customers 50% off coupons, that will be used in future purchases by an estimated 75% of customers. The discount coupons represent a material right to the end-customers. Hence, these are two separate performance obligations.

DressCo has decided to use the portfolio approach, on the basis that it reasonably expects that the effects on the financial statements would not differ materially from applying IFRS 15to the individual contracts.

<u>Determination of the stand-alone selling price of the options as a portfolio:</u>
50% discount coupons = net price of additional products × discount ×"likelihood
= €1,000 × 60 × 50% × 75%
= €15,000

<u>Allocation of the transaction price:</u>
Total value of the transactions = price of initial purchase + option value granted
= €100,000 + €15,000
= €115,000

The transaction price is allocated to the material right, based on the relative stand-alone selling price.

Transaction price	= €100,000
Transaction price allocated to the discount coupons	= €15,000/€115,000 × €100,000
	= €13,040
Accounting entries at initial purchase:	
Dr. Cash (B/S)	€100,000
Cr. Product sales (P/L)	€86,960
Cr. Contract liability – discount coupons (B/S)	€13,040
Accounting entries at redemption/2nd purchase of coupons:	
Dr. Cash (B/S) (50% of €1,000 × 45)	€22,500
Cr. Products sales (P/L)	€35,540
Dr. Contract liability – discount coupons (B/S)	€13,040

If Dress Co is unable to determine the number of coupons that will be exercised, management would assume 100% redemption (as opposed to 75% illustrated above), to ensure that it is not highly probable that there will be a significant reversal of revenue.

Breakage estimates would usually be updated at each period-end, and adjustments would be made where necessary.

If Dress Co expects to be entitled to a breakage, it should also recognise breakage revenue in proportion to the pattern of rights exercised by the customer (that is, redemption of the coupons). If Dress Co is unable to determine the number of coupons that will be exeiercised, management would assume 100% redemption, and it would recognise the breakage amount as revenue when the likelihood of the coupon redemption becomes remote. Breakage estimates would usually be updated at each period-end, and adjustments would be made where necessary. .

III.4 Loyalty programs

Background

- FabricKs operates retail stores and a website where customers can buy dresses.
- There is a customer loyalty program in place, awarding customers 1 point for every €1 spent on buying dresses.
- Points are only redeemable for €0.10 off future purchases and cannot be redeemed for cash.
- FabricKs expects 5% of points to expire unredeemed, based on historical trends.
- FabricKs has sold dresses for €1,000 during the period.

How should FabricKs account for the loyalty program?

Relevant guidance

Paragraph 26 of IFRS 15: "*Depending on the contract, promised goods or services may include, but are not limited to, the following: …*

(i) granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs B39–B43)."

An option gives rise to a material performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (paragraph B40 of IFRS 15).

The allocation of transaction price to performance obligations is to be undertaken on a relative stand-alone selling price basis (paragraph 74 of IFRS 15).

See also example 52 in Appendix B to IFRS 15 – Customer loyalty programme.

III.4 Loyalty programs *(cont'd)*

Solution

The transaction involves the retailer committing to two performance obligations: the good purchased; and the rights related to the loyalty points. FabricKs has decided to use the portfolio approach, on the basis that it reasonably expects that the effects on the financial statements would not differ materially from applying IFRS 15 to the individual contracts.

Determination of the stand-alone selling price of the option:
Total discount on future purchases = discount × loyalty points awarded
= €0.1 × 1,000 = €100
Stand-alone selling price = total discount on future purchases – expected breakage of points
= €100 – (5% × 1,000 x €0.10) = €95

Allocation of the transaction price:
FabricKs has to allocate customer payments of €1,000 between products sales and loyalty points, based on their relative stand-alone selling prices.

Total transaction value = price of initial purchase + option value granted
= €1,000 + € 95 = €1,095

Customer payment allocated to the loyalty program	= €1,000 × €95 / €1,095 = €87
Customer payment allocated to the products sales	= €1,000 × €1,000 / €1,095 = €913

Accounting entries at initial purchase:

Dr. Cash (B/S)	€1,000
Cr. Products Sales (P/L)	€913
Cr. Contract Liability – Loyalty points (B/S)	€87

If management can reasonably estimate breakage, it would recognise revenue for the breakage in the same pattern that it recognises revenue for the points redeemed. If FabricKs is unable to determine the number of points that will be used, management might assume 100% redemption, to ensure that it is not highly probable that there will be a significant reversal of revenue. In this case, management would recognise the revenue allocated to the points on redemption, on expiration of the rebate or when it is able to true up its estimate of breakage.

III.5 Gift cards

Background

Woolly has launched a campaign of selling gift cards for the upcoming holiday season:

- Gift cards are valid for up to one year from the date of purchase and only at Woolly outlets; furthermore, the customer cannot obtain a cash reimbursement for unspent amounts or unused cards. Unspent amounts after a year are kept by the company.
- Woolly expects 10% of the gift card's value to expire unused, based on historical trends.
- Woolly has no obligation to remit unused gift card amounts to end-customers or to a third party (for example, government).

60 end-consumers purchase €100 gift cards on 30 August.

Should Woolly recognise revenue on the sale of gift cards or on their redemption? How should "breakage" be accounted for?

Relevant guidance

A customer's non-refundable prepayment to an entity gives them a right to receive a good or service in the future. However, customers might not exercise all of their contractual rights, which are often referred to as "breakage" (paragraph B45 of IFRS 15).

The entity should recognise a contract liability (and not revenue) for any consideration received that is attributable to a customer's unexercised rights. Additionally, if the entity expects to be entitled to a breakage amount, it recognises the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customers (paragraph B46 and B47 of IFRS 15).

III.5 Gift cards (cont'd)

Solution

Revenue recognition occurs on redemption of gift cards by a consumer in relation to products sold. Woolly also expects to be entitled to breakage revenue. In estimating breakage, Woolly has assessed that it has adequate historical information to recognise breakage revenue in proportion to the pattern of rights exercised by the customer. In making this assessment it has determined that recognising 10% breakage would result in recognition of only that amount of revenue that is not highly probable of a significant reversal. Woolly has decided to use the portfolio approach on the basis that it reasonably expects that the effects on the financial statements would not differ materially from applying IFRS 15 to the individual contracts.

For €6,000 worth of gift cards, the total breakage estimate is €600. The expected value to be used is €5,400. Before the 31 December year-end, end-customers purchase €3,600 of product using the gift cards. Woolly should recognise the following:
Sales = €3,600 (reflecting the product's selling price)
Breakage revenue = Gift card used value / Gift card expected value to be used × Total breakage revenue
= (€3,600 / €5,400 * €600) = €400

Accounting entries at time of gift card purchase:

Dr. Cash (B/S)	€6,000
Cr. Contract Liability - Gift Card (B/S)	€6,000

Accounting entries at 31 December (€3,600):

Dr. Contract Liability – Gift Card (B/S)	€4,000
Cr. Products Sales (P/L)	€3,600
Cr. Breakage Revenue (P/L)	€400

Note: *breakage estimates would usually be updated at each period-end, and adjustments would be made where necessary.*

This solution is applicable for prepaid cards with an expiry date. For prepaid cards with no expiry date, an element of the breakage might need to be deferred for a longer period.

III.6 Right of return

Background

All sales made by Stripeys include a right of return.

- Stripeys sells 100 shirts for €100 each.
- The shirts cost Stripeys €50 each to buy.
- End-customers can return the shirts, as new and in original packaging, within 28 days from the date of purchase for a full refund, provided that they are unused and saleable as new.
- Based on historical patterns, Stripeys has estimated that the probability-weighted expected value of returns is 10% of revenues.
- Stripeys does not expect to incur any costs to accept the return of the shirts, because the end-consumer will return shirts directly to the store.

How should Stripeys record revenue and expected returns associated with this transaction?

Relevant guidance

The guidance on «Sale with a right of return» is covered in paragraphs B20+B27 of IFRS 15.

Paragraph B20 of IFSR 15: *" In some contracts, an entity transfers control of a product to a customer and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product) and receive any combination of the following:*

a. a full or partial refund of any consideration paid;

b. a credit that can be applied against amounts owed, or that will be owed, to the entity; and

c. another product in exchange."

Paragraph B25 of IFSR 15: "*An asset recognised for an entity's right to recover products from a customer on settling a refund liability shall initially be measured by reference to the former carrying amount of the products (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). At the end of each reporting period, an entity shall update the measurement of the asset arising from changes in expectations about products to be returned. An entity shall present the asset separately from the refund liability."*

In addition, it is important to take into consideration the guidance in paragraph B26 of IFRS 15: "E*xchanges by customers of one product for another of the same type, quality, condition and price (for example, one colour or size for another) are not considered returns for the purposes of applying this Standard"*.

Moreover, paragraph B27 of IFRS 15 confirms that "C*ontracts in which a customer may return a defective product in exchange for a functioning product shall be evaluated in accordance with the guidance on warranties in paragraphs B28–B33."*

III.6 Right of return *(cont'd)*

Solution

Stripeys estimates that 10 shirts will be returned. Furthermore, Stripeys has concluded that it is highly probable that there will not be a significant reversal of revenue recognized, based on this estimate, when the uncertainty is resolved (that is, once the return period has expired).

a) At the time of sale, Stripeys should recognise the following:

products sales	= (Total shirts sold – expected returns) × Selling price = (100-10) × €100 = €9,000
Cost of sales	= €4,500 {(100-10) × €50}
Asset for anticipated return	= Cost of shirts x expected return = € 500 (€50 ×10)
Liability for customer refund	= Selling price of shirts x expected return = € 1,000 (€100 × 10)

b) Accounting entries

At the time the sale occurs:

Dr. Cash (B/S)	€10,000
Cr. Products Sales (P/L)	€10,000
Dr. Products Sales (P/L)	€1,000
Cr. Liability – Customer refund (B/S)	€1,000
Dr. Cost of sales (P/L)	€5,000
Cr. Inventory (B/S)	€5,000
Dr. Asset for anticipated return (B/S)	€500
Cr. Cost of sales (P/L)	€500

On return of the products:

Dr. Liability - Customer refund (B/S)	€1,000
Cr. Cash	€1,000
Dr. Inventory (B/S)	€500
Cr. Asset for anticipated return (B/S)	€500

Note: *Estimate of return probability is to be evaluated at each period-end. Any change is to be adjusted against asset and liability, with these being recognised against cost of sales and revenue respectively.*

III.7 Price protection

Background

Skirtz Ltd has a price protection policy in place for all sales:

- Reimbursement is for the difference between the purchase price and the lower price offered by direct competitors.
- The reimbursement is restricted to the three-month period following date of sale.
- Skirtz Ltd has used the expected value approach to estimate that the reimbursement is expected to be an average of 5% of sales.

Skirtz Ltd made sales of €1,000.

How should Skirtz Ltd account for the potential refund?

Relevant guidance

Paragraph 50 of IFRS 15: "*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.*"

Paragraph 51 of IFRS 15: "*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 can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a products was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.*"

Under paragraph 53 of IFRS 15, an entity should estimate an amount of variable consideration by using either of the two following methods: "the expected value" and "the most likely amount" – whichever method is a better prediction of the final outcome.

According to paragraph 56 of IFRS 15, the transaction price should include variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

III.7 Price protection *(cont'd)*

Solution

The price protection arrangement represents variable consideration. The transaction price should be estimated and constrained to the amount that would result in an amount of revenue that is highly probably of not reversing. Skirtz Ltd recognises revenue for sales to the retailer at a transaction price that is reduced by the estimated potential refund to the customer. The difference between the cash selling price and the transaction price is recorded as a liability for cash consideration expected to be paid to the end-customer.

Assuming sales of €1,000 and a probable refund percentage of 5%, the following should be recognised by Skirtz Ltd:

Sales	= €950 (€1,000 – €50 refund liability)
Refund liability	= €50 (€1,000 × 5% probable customer refund)

Accounting entries

At the time of the sale

Dr. Cash (B/S)	€1,000
Cr. Products Sales (P/L)	€950
Cr. Liability – Refund (B/S)	€50

At the time of the cash reimbursement

Dr. Liability – Refund (B/S)	€50
Cr. Cash (B/S)	€50

Skirtz Ltd will update its estimate at each reporting period until the refund is made or the three-month period has passed.

III.8 Internet sales / e-commerce

Background

- An end-consumer decides to buy clothes directly on the website of a high street chain, Bouvry & Co. Full payment is made immediately on-line.
- The website proposes delivery to the end-consumer's home for an additional fee. Alternatively, the end-consumer can collect her purchases from any one of the chain's retail stores.
- Wherever possible, and in this case, the sale is honoured by Bouvry & Co using the store's inventory which is put aside immediately following the sale.

- Customer A opts for store pick-up, and goes to the selected store to pick up the clothes one week after the payment is made. The original purchase and the final pick-up are in different reporting periods of Bouvry & Co.
- Customer B opts for delivery to their home for the additional fee.

When should the revenue be recognised by Bouvry & Co?

Relevant guidance

Bill-and-hold arrangements are discussed in paragraphs B79–B81 of IFRS 15. They arise when a customer is billed for goods that are ready for delivery, but the entity does not ship the goods to the customer until a later date. Entities must assess in these cases whether control has transferred to the customer, even though the customer does not have physical possession of the goods. Revenue is recognised when control of the goods transfers to the customer.

Paragraph B81 of IFRS 15 presents the following additional criteria that **all** need to be met in order for the customer to have obtained control in a bill-and-hold arrangement:

"*a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);*
b) the product must be identified separately as belonging to the customer;
c) the product currently must be ready for physical transfer to the customer; and
d) the entity cannot have the ability to use the product or to direct it to another customer".

Solution

- Customer A – Bouvry & Co is able to recognise revenue, because the product has been set aside, is available at the pick-up location and can not be used for another customer. If goods need to be delivered from the warehouse, the bill-and-hold criteria will not be met until the store has received the products ordered by the end-consumer. Consideration might also need to be given to a "returns" estimate, that could include goods that are never claimed.

- Customer B − Revenue is recognised when control of the products is transferred. Although Customer B has paid for the asset at the time of purchase, they do not have the ability to direct the use of the asset until it is received. The customer does not have the ability to change the shipping destination. They do not have physical possession and have not accepted the asset until it is received. These are all indicators that control is transferred when the products are delivered to Customer B.

IV. Transactions between end-customers and consumer products companies

IV.1 Customer incentives – Coupons with purchase

Background

- Truewhite plc, a detergent manufacturer, sells its best-selling product through retailers at a price of €20 to the retailer. End-customers purchasing the product receive a voucher at the till for a price reduction coupon of €2, redeemable on a subsequent purchase of the same product. The price reduction coupon is only made available to those who have purchased the product, and there are no equivalent coupons available to the general public. At the end of the period, Truewhite plc has sold 1,000 units, as has the retailer.
- The redeemed coupons entitling the end-customers to a €2 discount on their purchases will be reimbursed by the manufacturer to the retailers.
- The manufacturer has historical experience that one coupon is redeemed for every two issued.

How does the soap manufacturer account for the coupons?

Relevant guidance

An entity should account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (paragraph 70 of IFRS 15).

Discounts are allocated to all of the performance obligations, based on their relative stand-alone selling prices. The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer (paragraph 77 of IFRS 15).

Solution

The consideration allocated to the coupon is presented as "refund liability" in the balance sheet, and it is measured at the relative stand-alone selling price of the coupon.

The face value of the coupon to the customer is €2. The face value is adjusted by the proportion of coupons expected to be redeemed (50%), so the relative stand-alone selling price is €1 (€2 × 50%).

A portion of the cash received [20,000 (€20 × 1,000)] is allocated to revenue (20,000/21,000 = €19,048) and a portion to the refund liability (€952).

As the end-customers redeem the coupons, the retailer reclaims cash from the manufacturer, and the refund liability is reduced accordingly.

IV.2 Customer incentives *– Coupons in local paper*

Background

Chez Aurelie, an upmarket boutique, buys all of its inventory of children's dresses from KidCo, a local manufacturer. The following end-customer discount arrangements are made:

- Coupons are issued directly by KidCo to end-customers via a local newspaper; the coupon's face value amounts to €10 and the coupon is valid until the end of the following month.
- Coupons can be redeemed by the end-customer only at Chez Aurelie.
- Chez Aurelie submits redeemed coupons to KidCo for full reimbursement.
- Using the expected value method, KidCo expects the coupons to be used for 40% of sales from the inventory sold to Chez Aurelie.

Chez Aurelie bought 1,000 dresses at a €100 unit price from KidCo, and sold them all to the end-customer during the coupon validity period at €120.

How much revenue should be recognised by KidCo and Chez Aurelie?

Relevant guidance

An entity should account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue, unless the payment to the customer is in exchange for a distinct good or service (paragraph 70 of IFRS 15).

Discounts are allocated to all of the performance obligations, based on their relative stand-alone selling prices. The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer (paragraph 77 of IFRS 15).

IV.2 Customer incentives *– Coupons in local paper (cont'd)*

Solution

a) Revenue recognition

KidCo = €100,000 – €4,000 = €96,000 (total sales to Chez Aurelie, less estimated coupon redemption)

Chez Aurelie = €120,000 (total sales, irrespective of coupon redemption)

The additional consideration paid by KidCo (the consumer products entity) is revenue to the retailer, because the fair value of the total consideration received by the retailer is €120. The cost of sales remains at the original amount paid by the retailer of €100.

b) Accounting entries

At the time of initial sale from KidCo to Chez Aurelie and issue of coupons

KidCo

Dr. Cash - (B/S)	€100,000
Cr. Refund liability	€4,000
Cr. products sales (P/L)	€96,000

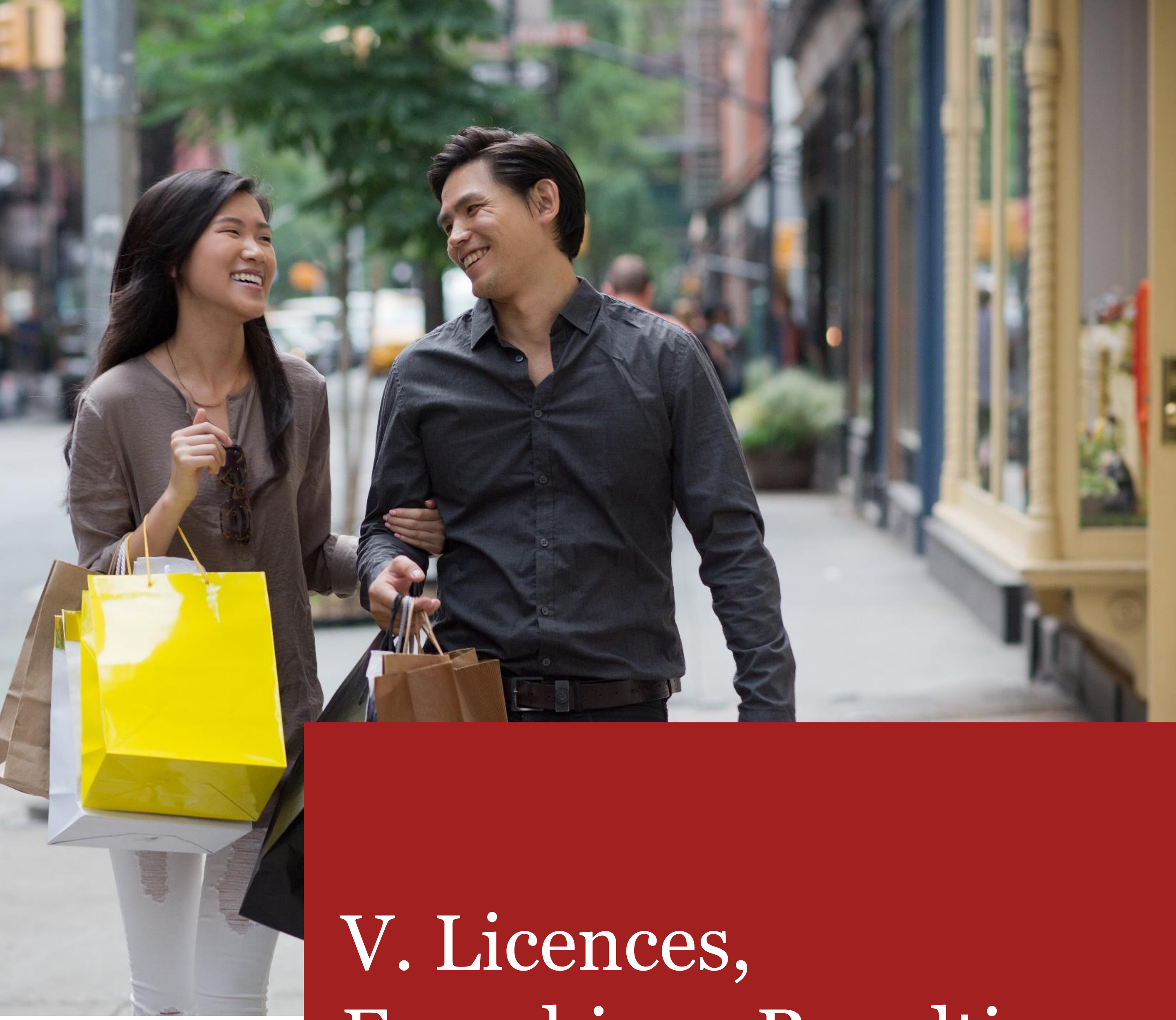
Chez Aurelie

Dr. Inventory	€100,000
Cr. Cash	€100,000

At the time of end-customer purchase

Chez Aurelie

Dr. Receivable from KidCo	€4,000
Dr. Cash (B/S)	€116,000
Cr. Products sales (P/L)	€120,000
Dr. Cost of sales (P/L)	€100,000
Cr. Inventory (B/S)	€100,000



V. Licences, Franchises, Royalties

V.1 Right to use brand name

Background

Allocco is a well-known Italian design house which designs, manufactures, distributes and retails luxury products branded with its famous trademark.

- Allocco enters into a contract with a real estate developer, Colosseum Spa, whose intention is to construct and sell private luxury apartments using a 'stylistic concept' aligned to Allocco's brand. Colosseum Spa agrees to provide Allocco an opportunity to influence the interior design, which is the primary responsibility of Colosseum Spa's internal design team. Allocco grants the licence to use its brand name in connection with the sale of the apartments.
- The term of the agreement is four years.
- Allocco receives a fixed fee of €2,000,000, plus 2% of all proceeds from the sales of the apartments, as compensation for the intellectual property licence.

How should Allocco recognise the payments that it receives from Colosseum Spa as compensation for the right of use of its brand name?

Relevant guidance

Guidance on licensing is provided in paragraphs B52-B63 of IFRS 15.
Where a contract with a customer includes a promise to grant a licence in addition to other promised goods or services, the first step is to paragraph 27 of IFRS 15 determine whether the licence is distinct or should be combined with the other goods or services: "*A good or service is distinct if* ***both*** *of the following criteria are met:*

- *the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and*
- *the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract."*

Paragraph B56 of IFRS 15 identifies two types of licence:

- a right to access, that transfers over time; and
- a right to use, that transfers at a point in time.

Paragraph B58 of IFRS 15: "*the nature of an entity's promise in granting a licence is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:*

a) the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights

b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities

c) those activities do not result in the transfer of a good or a service to the customer as those activities occur."

As stated in paragraph B63 of IFRS 15, "*…an entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:*

a) the subsequent sale or usage occurs; and

b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied)."

V.1 Right to use brand name *(cont'd)*

Solution

Allocco has promised to provide Colosseum Spa with a licence of its brand name, and it has the right to influence the design. It has determined that the brand usage is the predominant element of the arrangement. It has also determined that the design oversight is not a separate performance obligation but rather a protective right to ensure that Colosseum Spa uses the brand in a reasonable manner.

Allocco has also concluded that the licence is a "*right to access the IP*" because the benefit for Colosseum Spa is dependent on the ongoing activities performed by Allocco that support or maintain the value of the brand.

The total of the fixed amounts (€2,000,000) is allocated to the licence, and it is recognised over time during the licence period.

There is also a variable form of consideration, for which Allocco concludes that it is related specifically to the licence. Therefore, the sales-based royalty guidance applies, and revenues are recognised by Allocco when the apartments are sold.

Note: Further guidance on the allocation of variable consideration in the context of licences might provide useful indications. Please refer to paragraphs 84(a) and 85-86 of IFRS 15.

V.2 Franchise agreements

Background

Hollywood Star plc ("HS") operates several restaurants around the world through franchise agreements.

- On 1 January 20x1, HS grants a franchisee the exclusive right to operate a restaurant using the HS brand in Liverpool for three years, and a licence to operate another branded restaurant in Marseilles for three years.

- However, because of an existing arrangement with another franchisee, the right in Marseilles does not begin until 1 January 20x2. The licence fee is equal to €150,000 for each of the two licences.

What are the implications of the contractual provisions that:

i) restrict the use of the brand for a period of three years?
ii) defer the starting period of the licence in Marseilles?

Relevant guidance

According to the paragraph B62 of IFRS 15, when determining whether a licence provides a right to access or to use the entity's intellectual property, an entity should disregard restrictions of time, geographical region or use because, those restrictions define the attributes of the promised licence, rather than whether the entity satisfies its performance obligation at a point in time or over time.

According to paragraph B58 of IFRS 15, the entity's intellectual property provides a right to access if all of the following criteria are met:

"a. the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights (see paragraphs B59 and B59A);
b. the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities identified in paragraph B58(a); and
c. those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 25)."

The length of a licence term is a restriction that represents an attribute of the asset transferred, and it does not provide information on the nature of the underlying intellectual property or on the nature of the entity's promise.

Additional elements to consider are the following:

- The licence term does not impact whether the licence fee is recognised over time or at a point in time (paragraph B62 of IFRS 15).
- The timing of revenue recognition would be affected if, for example, the term of the licence to use intellectual property does not commence until a future date (paragraph B63 of IFRS 15).

V.2 Franchise agreements *(cont'd)*

Solution

HS concludes that there are two separate PO's due to the different locations and time periods. The transaction price should be allocated between the two licences.

There is a reasonable expectation that HS will undertake activities that will significantly affect the brand name to which the franchisee has rights, and the franchisee is directly exposed to any positive or negative effects of that brand and image throughout the franchise period.

Therefore the licences are rights to access intellectual property, and they are recognised over time. The fact that the licences are for a period of three years is not considered in the assessment of whether the fee is recognised over time or at a point in time.

The licence fee allocated to the right to operate a restaurant using the HS brand name in Liverpool would be recognised starting from 1 January 20x1, over a period of three years. The licence fee allocated to the licence to operate the restaurant in Marseilles would be recognized, starting from 1 January 20x2, over a period of three years.

V.3 Sales to a franchise

Background

- A&C Plc, a franchisor, grants a five-year franchise to an overseas company in exchange for an up front payment of €100,000, to accelerate its global expansion.
- A&C specialises in woollen underwear which is normally sold for €100. As part of the franchise arrangement, it agrees to sell this product to the franchisee for €70 throughout the franchise period – a 30% discount on usual market prices to third parties.
- At this stage, no other services will be provided by the franchisor.

How does the franchisor account for the arrangement?

Relevant guidance

Paragraph 22 of IFRS 15*: «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 good or service (or a bundle of goods or services) that is distinct; or
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 23).”

If a customer has a material right to acquire future goods or services, and those goods or services are similar to the original goods or services in the contract and are provided in accordance with the terms of the original contract, then an entity can, as a practical alternative to estimating the stand-alone 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.

Paragraph B56 of IFRS 15: *“If the promise to grant the licence is distinct from the other promised goods or services in the contract and, therefore, the promise to grant the licence is a separate performance obligation, an entity shall determine whether the licence transfers to a customer either at a point in time or over time. In making this determination, an entity shall consider whether the nature of the entity’s promise in granting the licence to a customer is to provide the customer with either:*
a. a right to access the entity’s intellectual property as it exists throughout the licence period; or
b. a right to use the entity’s intellectual property as it exists at the point in time at which the licence is granted.”

Solution

The franchisor has transferred two performance obligations under the contracts: a licence of the brand for five years; and the material right to acquire goods at a 30% discount to the market price. The consideration should be allocated by A&C between the two performance obligations, based on the relative stand-alone price. The stand-alone selling price of the franchise right might be calculated using a relief-from-royalty valuations model. The stand-alone selling price of the material right would consider the expected value of the discounts from planned purchases.

There is a reasonable expectation that the franchisor will undertake activities that will significantly affect the brand name to which the franchisee has rights, and the franchisee is directly exposed to any positive or negative effects of that brand and image throughout the franchise period. Therefore, the revenue from the franchise rights is recognised pro rata over the duration of the franchise arrangement, and the right to discounted products is recognised as the units are sold.

***V.4 Franchise** – Non-refundable upfront fee*

Background

Hollywood Film Legends plc ("HFL") owns the HFL brand. Several restaurants around the world are operated by franchisees.

- As part of its franchise agreement, HFL requires a franchisee to pay a non-refundable upfront fee of €200,000 on the signing of the contract.
- According to the agreement, the franchisee obtains the right to operate a restaurant using the HFL brand name, concept and menus for a period of two years, during which time HFL must maintain the brand through celebrity endorsements and regional advertising.
- In addition, HFL provides branded front-of-house fixtures, cooking equipment and cash registers, valued at €50,000 (that is, the stand-alone selling price of these goods).

How should entity A recognise revenue for this arrangement?

Relevant guidance

Guidance for the treatment of non-refundable upfront fees is provided in paragraphs B48-B51 of IFRS 15.

Paragraphs B48 of IFRS 15: *"In some contracts, an entity charges a customer a non-refundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts and initial fees in some supply contracts."*

Paragraphs B49 of IFRS 15: *"To identify performance obligations in such contracts, an entity shall assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised good or service to the customer (see paragraph 25). Instead, the upfront fee is an advance payment for future goods or services and, therefore, would be recognised as revenue when those future goods or services are provided."*

Paragraphs B50 of IFRS 15: *"If the non-refundable upfront fee relates to a good or service, the entity shall evaluate whether to account for the good or service as a separate performance obligation in accordance with paragraphs 22–30."*

Paragraphs B56 of IFRS 15: *"If the promise to grant the licence is distinct from the other promised goods or services in the contract and, therefore, the promise to grant the licence is a separate performance obligation, an entity shall determine whether the licence transfers to a customer either at a point in time or over time. In making this determination, an entity shall consider whether the nature of the entity's promise in granting the licence to a customer is to provide the customer with either:*
a) a right to access the entity's intellectual property as it exists throughout the licence period; or
b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted."

***V.4 Franchise** – Non-refundable upfront fee (cont'd)*

Solution

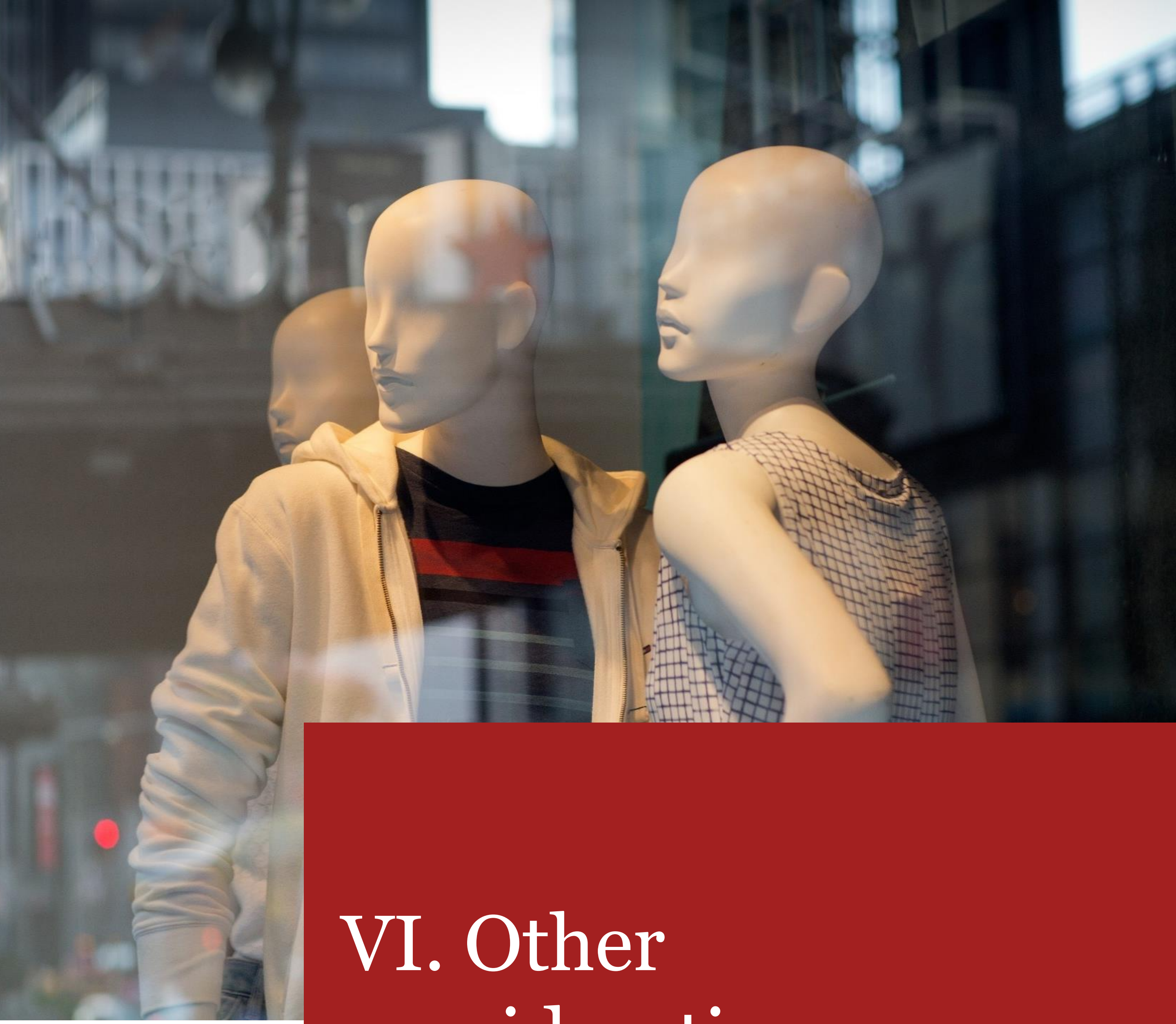
HFL determines that it has two performance obligations :

- a promise to grant a licence; and
- a promise to transfer fixtures and equipment.

At the signing of the contract, there is no transfer of goods or services to the customer; therefore, no revenue is recognized, even if the upfront fee is non-refundable.

Assuming that €50,000 represents the stand-alone selling price of the equipment and €150,000 represents the stand-alone selling price of the licence, HFL would recognise €50,000 on transfer of the equipment.

There is a reasonable expectation that the franchisor will undertake activities that will significantly affect the brand name to which the franchisee has rights, and the franchisee is directly exposed to any positive or negative effects of that brand and image throughout the franchise period. Therefore, €150,000 for the licence is recognised pro rata over the two years.



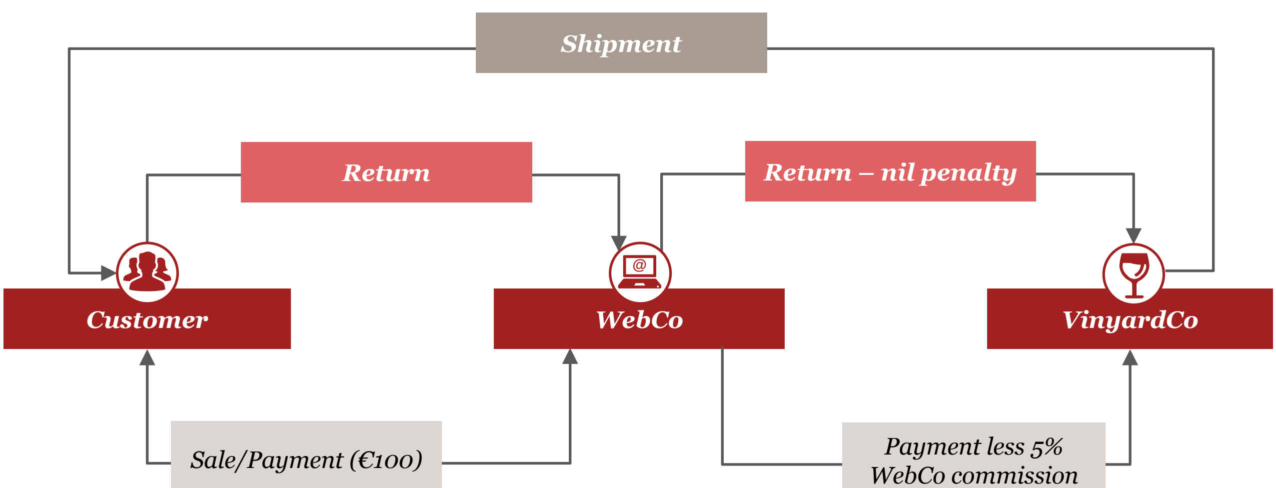
VI. Other considerations

VI.1 Sales of goods – Agent

Background

- **WebCo operates a website that sells the wine produced by a selection of vineyards.**
- WebCo enters into a contract with VinyardCo to sell VinyardCo's wine on-line.
- WebCo's website facilitates payments between VinyardCo and the customer.

- The sales price is established by VinyardCo and WebCo earns a commission equal to 5% of the sales price.
- VinyardCo ships the bottles directly to the customer and insures for loss/damage during shipment.
- Legal title is transferred from VinyardCo to WebCo when bottles are leaving VinyardCos warehouse.
- The customer returns the bottles to WebCo if they are dissatisfied.
- WebCo has the right to return bottles to VinyardCo without penalty if they are returned by the customer.



Is WebCo the principal or agent for the sale of wine to the customer?

VI.1 Sales of goods *– Agent (cont'd)*

Relevant guidance

Paragraph 33 of IFRS 15: *"Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:*

a. using the asset to produce goods or provide services (including public services);

b. using the asset to enhance the value of other assets;

c. using the asset to settle liabilities or reduce expenses;

d. selling or exchanging the asset;

e. pledging the asset;

f. holding the asset."

Paragraph B34A of IFRS 15: *"An entity that is a principal obtains control of any one of the following:*

a. a good or another asset from the other party that it then transfers to the customer.

b. a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.

c. a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer."

Solution

WebCo's management considers that the following are indicators that it is acting as agent:

- WebCo only takes legal title once the end-customer has committed to and paid for the goods.
- WebCo does not have the ability to benefit from the goods in other ways, such as redirecting the asset to another customer onward sale.
- WebCo is reimbursed for corked bottles by VinyardCo in the rare case of a dissatisfied customer.

WebCo also considered indicators that it is acting as principal, including the fact that WebCo takes legal title and that dissatisfied customer return the goods directly to WebCo. However, legal title is only retained by WebCo during a short period of time, and WebCo has a right to return goods to VinyardCo.

On this basis, WebCo concluded that it is **acting as agent** and should recognise commission revenue, on a net basis, when the end-customer has confirmed the contract with a credit card payment.

VinyardCo should recognise revenue of €100, and simultaneously, a commission charge of €5.

VI.2 Concession outlet within a department store

Background

- A department store contains concession outlets. The store provides the concessionaire with serviced space in the store, sales staff, point of sale equipment and stock-room space.
- The department store is in charge of selling the products and receiving the cash from end-consumers.
- The concessionaire pays the department store a fixed contractual fee of €10,000 per annum plus 20% of the outlet's revenue.
- The concessionaire determines the stock lines sold and the prices charged to customers, and it has the right to move stock between its concessions in different stores. At the end of a season, the concessionaire must take back any unsold stock.

How does the department store account for this arrangement?

Relevant guidance

Paragraph 33 of IFRS 15: *"Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:*

a. using the asset to produce goods or provide services (including public services);
b. using the asset to enhance the value of other assets;
c. using the asset to settle liabilities or reduce expenses;
d. selling or exchanging the asset;
e. pledging the asset;
f. holding the asset."

Paragraph B34A of IFRS 15: *"An entity that is a principal obtains control of any one of the following:*

a. a good or another asset from the other party that it then transfers to the customer.
b. a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.
c. a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer."

Solution

The department store does not, at any point, have control of the goods which are sold. Although the department store transacts with the end-customer, it does not set prices or take inventory risk. Therefore, the department store is acting as **agent** in selling to the end-consumer and is receiving a 'commission' in consideration for the service that it is performing for the concessionaire (that is, making space *available* in the department store and related services).

The department store recognises the 'commission' receivable from the concessionaire as revenue, rather than the gross revenue from the sale of the concessionaire's goods.

VI.3 Excise taxes and duties

Background

SpiritsCo is a global producer and distributor of branded alcoholic drinks. The products are distributed via a network of subsidiaries located in SpiritsCo's strategic markets. In most countries, SpiritsCo collects excise taxes from its customers and remits them to governmental agencies.

In country 1: SpiritsCo or its local subsidiary has to pay excise duty based on the value as well as on the volume of products that leave a bonded warehouse. The movement of products from the bonded warehouse for customs clearance is the triggering event of the obligation to pay excise duty. SpiritsCo or its local subsidiary can receive a refund of excise duty only if it decides not to sell the products or to re-export them.

In case of payment failure from a customer or if products are not sold, SpiritsCo or its local subsidiary cannot claim the refund of the excise duty that it has paid. Consequently, the credit risk related to excise duty is borne by SpiritsCo or its local subsidiary.

In addition, SpiritsCo or its local subsidiary has no legal or constructive obligation to reflect any change of the rate of excise duty in the selling price of products. An increase in the rate of excise duty can lead SpiritsCo to increase its selling price, but such increases are a commercial decision and would not be automatic. The tax is not separately presented on the invoice.

In country 2: A state-specific excise tax is payable by SpiritsCo based on volume of products sold to, and paid for, by customers. In this country, the SpiritsCo local entity has to collect the tax received from customers and then pay the tax to the local state. The triggering event of the obligation to pay the tax is the shipment of products to the customer, depending on the state where the products are delivered. Any increase of state excise tax would result in the increase of the tax rate that is charged to the customer. State excise tax is separately presented on the invoice. SpiritsCo does not pay excise taxes to the government if the receivables are not collected.

Should SpiritsCo recognise the excise taxes that it collects from its customers gross (that is, as revenue and expense) or net of the amount remitted to a third party (such as governmental agencies)?

VI.3 Excise taxes and duties *(cont'd)*

Relevant guidance

According to paragraph 47 of IFRS 15, the transaction price excludes amounts collected on behalf of third parties (for example, some sales taxes). Management needs to assess each type of tax, on a jurisdiction-by-jurisdiction basis, to conclude whether to net these amounts against revenue or to recognise them as an operating expense. The intended purpose of the tax, as written into the tax legislation in the particular jurisdiction, should also be considered. Assessment should be made whether the tax is levied:

- on the entity and its production: if so, report tax gross (as expense);
- on the customer and is collected by the entity as an agent on behalf of the government: if so, report tax net (contra-revenue – no impact on P&L).

Some indicators to consider

- Is the entity primarily obligated for the payment of tax? Is the entity obliged to pay the tax even if the customer fails to pay the receivable to the entity?
- Does the entity bear the inventory and credit risks ? In other words, would excise taxes paid to the governmental agency be refunded to it if the goods are not sold or if receivables are not collected?
- Does the entity have a legal or constructive obligation to change selling prices in order to reflect excise price taxes ?
- Must the tax be separately identified on the invoice to the external customer ?
- What triggers the present obligation to pay the tax: production, importation, or sale to customer?
- What is the basis for calculation of the excise tax: Is the tax based on the quantities produced (indicator for principal), or is it based on selling price (indicator for agent)?

Solution

Country 1

The inventory and credit risks related to the excise tax are borne by the SpiritsCo's local subsidiary. SpiritsCo entity has no obligation to reflect any change of the rate of excise duty in the selling price of products. The entity bears the excise duty and makes the decision whether to pass the tax on to the customer. The tax is not separately identified on the invoice to the customer.

These considerations indicate that SpiritsCo entity is acting as **principal**, and the excise tax is similar to a cost of production. Excise duty is levied on SpiritsCo local subsidiaries and therefore should not be deducted from the transaction price.

Country 2

The state excise tax is separately identified on the invoice to the customer, any increase of the tax would result in an increase of the tax rate that is charged to the customer, and SpiritsCo does not hold the credit risk.

These considerations indicate that the state excise tax is levied on the customer. The SpiritsCo local entity is likely to be acting as **agent** in collecting the tax on behalf of a governmental agency/state commission. As a result, the tax that is collected on the invoice should be deducted from the transaction price, and no related expense should be recognised. The accounting treatment of the collection and payment of the tax should only impact balance sheet accounts.

Contacts
PwC Retail & Consumer Industry Accounting Group

Christine Bouvry	***France*** christine.bouvry@pwc.com I +33 1 56 57 80 49
Andrea Allocco	***United Kingdom*** andrea.allocco@uk.pwc.com I +44 (0)7841490926
David Mason	***Switzerland*** david.mason@ch.pwc.com I +41 58 792 9490
Guillaume Nayet	***Switzerland*** guillaume.nayet@ch.pwc.com I +41 58 792 9668
Sebastian Heintges	***Germany*** sebastian.heintges@de.pwc.com I +49 211 981 2873
Bjoern Seidel	***Germany*** bjorn.seidel@de.pwc.com I +49 40 63 78 81 63
Elena Cogliati	***Italy*** elena.cogliati@it.pwc.com I +39 348 2503 360
Julia Tabakova	***CEE*** julia.tabakova@ru.pwc.com I +7 495 232 5468
David Duan	***China*** david.duan@cn.pwc.com I +86 21 2323 3975
Alison Tait	***Australia*** alison.tait@au.pwc.com I +61 3 38603 213