Nexia Australia

Accounting Update

Applying AASB 15 - Retail, Wholesale and Consumer Products

May 2018

This publication explores some of the potential effects of the new revenue standard on the Retail, Wholesale and Consumer Products (RWCP) sector. It supplements our Accounting Update *Applying AASB 15 Revenue* and should be read in conjunction with that publication.

Applying to for-profit entities for financial years commencing from 1 January 2018, AASB 15 *Revenue from Contracts with Customers* replaces AASB 118 *Revenue*, AASB Interpretation 13 *Customer Loyalty Programmes* and four other interpretations.

In this publication, we highlight some of the key impacts arising from the introduction of AASB 15 to entities in the RWCP sector. While some RWCP entities will find that applying the new Standard will result in an accounting outcome that is similar to AASB 118, other complexities may exist and entities will need to examine their own specific arrangements to determine the extent to which AASB 15 will impact their organisation.

Identify the performance obligations in the contract

At contract inception, it is necessary to identify all the distinct performance obligations within the contract. Separate performance obligations represent promises to transfer to the customer either:

- A good or service (or a bundle of goods and services) that is distinct; or
- A series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer.

If those goods or services are distinct, the promises are performance obligations and are accounted for separately. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

RWCP entities frequently give customers the option to acquire additional goods or services. These additional goods and services may be priced at a discount or may even be offered free of charge. Options to acquire additional goods or services at a discount can take the form of sales incentives (e.g., discount vouchers or gift cards issued in conjunction with a current purchase that may be used to purchase future goods or services), volume-tiered pricing structures, customer award credits (e.g., loyalty or reward programs) or contract renewal options (e.g., waiver of certain fees, reduced future rates).

An option to acquire additional goods or services is a separate performance obligation in a contract only if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds 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. However, if the option gives the customer the right to acquire an additional good or service at a price that would reflect the standalone selling price for that good or service, that option does not provide the customer with a material right.

Determine the transaction price

An entity must determine the amount of consideration it expects to receive in exchange for transferring promised goods or services to a customer. Usually, the transaction price is a fixed amount. However, the transaction price can vary because of discounts, rebates, price concessions, refunds, volume bonuses, or other factors. An entity should consider the effects of variable consideration and include those elements in the transaction price.

To estimate the total variable contract price, an entity applies the method below that better predicts the amount of consideration to which it will be entitled:

i. The expected value—the sum of probability-weighted amounts in a range of possible amounts; or

ii. The most likely amount—the single most likely amount in a range of possible outcomes (i.e. the single most likely outcome of the contract).

When a contract has a significant financing element, the effects of the time value of money are taken into account by adjusting the transaction price and recognising interest income over the financing period. However, a finance component does not exist if the timing of the future billings coincides with when the entity expects to perform under the contract. Consequently, entities will have to evaluate whether a contract includes a significant financing component.

Volume discounts

RWCP entities may provide incentives to their customers through volume discounts. These discounts can take different forms, such as tiered pricing (e.g., discounted pricing on future purchases over a certain volume level) or a discount that applies to all purchases under the agreement (e.g., discounted pricing on a retrospective basis once a certain volume level is met).

Generally, a volume rebate or discount that is applied retrospectively to past sales will be accounted for as variable consideration for those sales. This is because the final price of each good or service sold depends on the customer's total purchases subject to the rebate program. That is, the consideration relating to the past sale is contingent upon the occurrence or non-occurrence of future events. This view is consistent with Example 24 in AASB 15.

However, if a volume rebate or discount is applied prospectively (that is, a discount is only applied to subsequent sales once cumulative sales reaches a certain threshold), the rebate or discount should be accounted for as a customer option (and not variable consideration on the past sales). This is because the consideration for the goods or services already delivered is not contingent upon or affected by any future purchases. Rather, any discount affects the price of future purchases.

Entities will need to evaluate whether the volume rebate or discount provides the customer with an option to purchase goods or services in the future at a discount that represents a material right (and is therefore accounted for as a performance obligation).

Loyalty or reward programs

Retail and consumer products entities frequently offer loyalty or reward programs under which customers accumulate points that they can redeem for "free" or discounted products or services. Under the standard, a loyalty or reward program will typically be determined to provide a material right to customers that they would not receive without entering into a contract. A loyalty or reward program that is a material right should be identified as a performance obligation for purposes of revenue recognition.

However, if a customer has the option to acquire an additional good or service at a price that would reflect the standalone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract.

Consequently, arrangements involving sales incentives, customer award credits (or points), contract renewal options or other discounts on future goods or services need to be carefully analysed to determine whether a separate performance obligation exists.

The below example in AASB 15 illustrates the accounting for loyalty programs.

Loyalty programs (AASB 15.IE267-IE270)

An entity has a customer loyalty programme that rewards a customer with one customer loyalty point for every $10 of purchases. Each point is redeemable for a $1 discount on any future purchases of the entity's products. During a reporting period, customers purchase products for $100,000 and earn 10,000 points that are redeemable for future purchases. The consideration is fixed and the stand-alone selling price of the purchased products is $100,000. The entity expects 9,500 points to be redeemed. The entity estimates a stand-alone selling price of $0.95 per point (totalling $9,500) on the basis of the likelihood of redemption in accordance with paragraph B42 of AASB 15.

The points provide a material right to customers that they would not receive without entering into a contract. Consequently, the entity concludes that the promise to provide points to the customer is a performance obligation. The entity allocates the transaction price ($100,000) to the product and the points on a relative stand-alone selling price basis as follows:

Product	$91,324	[$100,000 × ($100,000 stand-alone selling price ÷ $109,500)]
Points	$8,676	[$100,000 × ($9,500 stand-alone selling price ÷ $109,500)]

At the end of the first reporting period, 4,500 points have been redeemed and the entity continues to expect 9,500 points to be redeemed in total. The entity recognises revenue for the loyalty points of $4,110 [(4,500 points ÷ 9,500 points) × $8,676] and recognises a contract liability of $4,566 ($8,676 – $4,110) for the unredeemed points at the end of the first reporting period.

Right of return

In some cases, customers have the right to return goods to the RWCP entity for a full refund. A customer's right of return may only exist for a short period of time. In these cases, revenue would only be recognised to the extent that it is highly probable that a significant reversal in the amount of revenue recognised will not occur by the end of the return period. This may require the entity to analyse past patterns of returns and estimate the extent to which customers seek refunds. When the entity determines that it cannot recognise all of the consideration received as revenue for the sale of goods with a right of return, the entity would recognise some of the consideration received as a refund liability. Exchanges of similar goods would not cause a reversal of the amount of revenue recognised.

Customer credit risk

AASB 15 requires that revenue should be recognised at the amount to which the entity expects to be entitled, not what the entity expects to receive, in exchange for transferring the promised goods or services to the customer. If, at contract inception, it is not probable that the entity will collect the consideration to which it will be entitled, no revenue is recognised until that condition is satisfied.

Therefore, adjustments are not usually made to the measurement of revenue to reflect a customer's credit risk. Rather, after initially meeting the criteria to recognise revenue, the entity recognises an impairment loss for a receivable not expected to be recoverable.

Consignment and bill-and-hold arrangements

Revenue is recognised under AASB 15 when the supplier transfers control of an asset to the customer. When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, the entity considers 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. A supplier does not recognise revenue upon delivery of a product if it is held on consignment.

A bill-and-hold arrangement is a contract under which a supplier bills a customer for a product but retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request the supplier to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.

A supplier determines when it has satisfied its performance obligation to transfer a product by evaluating when a customer obtains control of that product. For some contracts, control is transferred either when the product is delivered to the customer's site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). However, for some contracts, a customer may obtain control of a product even though that product remains in an supplier's physical possession.

Under AASB 15, an RWCP entity will need to consider whether control passes to a customer at the point of shipment, the point of delivery, or some other point in time.

Principal versus agency

AASB 15 states that when other parties are involved in providing goods or services to an entity's customer, the entity must determine whether its performance obligation is to provide the good or service itself (i.e., the entity is a principal) or to arrange for another party to provide the good or service (i.e., the entity is an agent). The determination of whether the entity is acting as a principal or an agent will affect the amount of revenue the entity recognises. That is, when the entity is the principal in the arrangement, the revenue recognised is the gross amount to which the entity expects to be entitled. When the entity is the agent, the revenue recognised is the net amount the entity is entitled to retain in return for its services as the agent.

It is not always clear which party is the principal in a contract and careful consideration of the facts and circumstances of an arrangement is required.

Warranties

It is common for a RWCP entity to provide a warranty in connection with the sale of a product.

A warranty that requires an entity to repair or replace a product that develop faults within a specified period in accordance with statutory requirements is designed to protect customers from the risk of purchasing defective products. If the supplier is required by law (such as the Australian Consumer Law) to provide a warranty, the existence of that law indicates that the promised warranty is not a separate performance obligation because it is not distinct in the context of the contract. Instead, they are measured and recognised as separate liabilities in accordance with AASB 137.

However, where an entity either sells separately or negotiates separately with a customer so that the customer can choose whether to purchase the warranty coverage, or an extended warranty, that warranty provides a service to the customer in addition to the promised product. Consequently, this type of extended warranty is a separate performance obligation which is accounted for in accordance with AASB 15.

Payments made to customers

Suppliers may make payments to their customers as a sales incentive, a contribution towards joint advertising (marketing rebates), or to prominently display their products (slotting fees). An RWCP entity accounts for consideration payable to a customer as a reduction of revenue relating to the goods or services supplied to the customer unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

The following example in AASB 15 illustrates the requirements on consideration payable to a customer.

Consideration payable to a customer (AASB 15.IE160-IE162)

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least $15 million of products during the year. The contract also requires the entity to make a non-refundable payment of $1.5 million to the customer at the inception of the contract. The $1.5 million payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products.

The entity considers the requirements in paragraphs 70–72 of AASB 15 and concludes that the payment to the customer is not in exchange for a distinct good or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer's shelves. Consequently, the entity determines that, in accordance with paragraph 70 of AASB 15, the $1.5 million payment is a reduction of the transaction price.

The entity applies the requirements in paragraph 72 of AASB 15 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognises revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by 10 per cent ($1.5 million ÷ $15 million). Therefore, in the first month in which the entity transfers goods to the customer, the entity recognises revenue of $1.8 million ($2.0 million invoiced amount less $0.2 million of consideration payable to the customer).

Disclosures

Extensive qualitative and quantitative disclosures are required by AASB 15. These disclosures are more extensive than those required by AASB 118 and relate to:

- Disaggregation of revenue into categories to illustrate how the nature, amount, timing and uncertainty about revenue and cash flows are affected by economic factors. Such disaggregation may include by type of good or service; geographical region; type of contract; or contract duration.
- Contract balances, including explanations of significant changes in contract assets and liabilities during the period;
- Qualitative and quantitative information regarding the aggregate amount of contracted consideration not yet recognised as revenue and an explanation of when the entity expects to recognise those amounts;
- Significant judgements and estimates made in determining the transaction price; allocating the transaction price to performance obligations; and determining when performance obligations are satisfied; and
- Information about assets recognised from the costs to obtain or fulfil a contract.

Conclusion

The introduction of AASB 15 has the potential to change the timing of revenue recognition for RWCP entities. Nexia's Financial Reporting Advisory specialists can assist you analyse the potential impacts of the new revenue model on your operations and whether any changes to your present accounting processes may be required.

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