IFRS 15 – REVENUE RECOGNITION TO CHANGE FOR RETAILERS

Potential delays in revenue recognition

This month we take a closer look at the impacts of IFRS 15 *Revenue from Contracts with Customers* on retailers. For retailers, IFRS 15 may result in a delay in revenue recognition. This could affect bank covenants, performance-based compensation (including bonuses and share-based payments), internal budgeting processes and market and investor communications. Obviously many retailers pay rent based on sales and these arrangements will have to be re-examined to properly determine what 'sales' means.

IFRS 15 contains more specific guidance on revenue recognition than the current IAS 18 *Revenue* standard.

The following areas are likely to be of significant impact for retailers under IFRS 15:

- Warranties – you will need to separately identify warranties that are 'assurance' type warranties and those that can be sold separately
- Free maintenance services – you will need to allocate a portion of revenue to 'free' services and only recognise revenue when the service is performed
- Customer incentives such as discount coupons will result in a portion of the revenue being deferred.

The effective date of this standard is annual reporting periods beginning on or after 1 January 2017.

Example

Retailer Y&Z has a 30 June year end and on 20 June 2018 launched its 10 day end of financial year sale.

On 29 June 2018, a customer purchases a washing machine for $1,000. The washing machine comes with a 12 month warranty against manufacturing defects (which is not sold separately). Y&Z also provides customers with an extended two year warranty against manufacturing defects and free repair and maintenance service for three years. The extended warranty and the free repair and maintenance service can be purchased separately.

Y&Z will also supply 1kg of washing powder every month for the next 18 months. In addition, the customer will receive a discount voucher for a 30% discount off its next in store purchase in the next six months, up to the value of $100.

How should Y&Z account for the sale under IFRS 15?

Y&Z has sold the following five goods or services to the customer under IFRS 15:

- A washing machine with a 12 month warranty
- Extended two year warranty
- Repair and maintenance services for three years
- 18kg of laundry powder
- Discount voucher.

Revenue ($1,000) needs to be allocated to each of the above goods or services based on the relative standalone selling prices of each good or service, and revenue is recognised as and when each good is delivered, or service is performed.

A washing machine with a 12 month warranty

The 12 month warranty is not accounted for separately because it provides the customer with the assurance that the washing machine will work as intended for one year, and it is not sold separately. Y&Z accounts for this 'assurance-type' warranty in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Extended two year warranty

A portion of the sales price needs to be allocated to the extended warranty and recognised over the period of the warranty because this extended warranty is sold separately. Assume that the extended warranty is sold separately for $200.

Repair and maintenance service for three years

Revenue needs to be allocated to the repair and maintenance service and recognised as that service is performed. Assume that the repair and maintenance service is sold separately for $150.

18kg of laundry powder

Revenue needs to be allocated to the laundry powder and recognised as the laundry powder is delivered each month over the next 18 months. Assume the laundry powder is sold separately for $5/kg.

Discount voucher

Y&Z needs to determine the standalone selling price of the discount voucher and defer the amount until the voucher is redeemed. Assume that Y&Z estimates the likelihood that the customer will use the voucher is 80% and the standalone selling price of the voucher is $80 ($100 x 80%).

Pattern of revenue recognition under IFRS 15

The following table sets out the amount of revenue allocated to each good or service in proportion to their standalone selling prices:

GOOD OR SERVICE	STANDALONE SELLING PRICE	REVENUE ALLOCATED
Washing machine & 12 month warranty	$1,000	$658 (($1,000x(1,000/1,520))
Extended two year warranty	$200	$132 (($1,000x(200/1,520))
Repair and maintenance	$150	$99 (($1,000x(150/1,520))
Laundry powder	$90 ($5X18)	$59 (($1,000x(90/1,520))*
Discount voucher	$80	$53 (($1,000x(80/1,520))
Total	$1,520	$1,000

*Financing element has been ignored for the purpose of this example.

The table below sets out the pattern of revenue recognition under IFRS 15:

GOOD OR SERVICE	REVENUE RECOGNITION UNDER IFRS 15				
	30/06/2018 year end	30/06/2019 year end	30/06/2020 year end	30/06/2021 year end	Total
Washing machine & 12 month warranty	$658	-	-	-	$658
Extended 2 year warranty	-	-	$66	$66	$132
Repair and maintenance	-	$33	$33	$33	$99
Laundry powder	-	$39	$20	-	$59
Discount voucher	-	$53	-	-	$53
Total	$658	$125	$118	$99	$1,000

You can see from the above that the IFRS 15 revenue model can result in a significant decrease in revenue and profit in the current year, with a compensating increase in the years that follow.

In practice under IAS 18, most retailers would recognise revenue of $1,000 for the 30 June 2018 year end, and a provision for the 36 month warranty. The costs for repairs and maintenance, and laundry powder, would only likely be recognised as and when they are incurred. When the customer uses its discount voucher in the next six months, the discounted selling price is recognised as revenue.

Impacts of significant changes

The impacts of IFRS 15 are not just delayed revenue as the above example has shown. Retailers will also need to think about the related deferred tax impacts, and also about system and process changes that would be required so that revenue is recognised in accordance with the new requirements.

In the above example, processes will have to change to determine all performance obligations promised to the customer, a suitable value must then be determined for each ‘promise’ made. Systems will then have to be modified to track and amortise the deferred revenue arising from this 'simple' sale.