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# Ihre Ansprechpartner

**Sehr geehrte Damen und Herren,**

für Rückfragen zur beigefügten aktualisierten Ergänzung „Retail and consumer industry supplement“ zu unserer Publikation „In depth“ zur Thematik „Revenue from contracts with customers“ stehen Ihnen folgende Ansprechpartner gerne zur Verfügung:



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# In depth

A look at current financial reporting issues



## Revenue from contracts with customers

The standard is final – A comprehensive look at the new revenue model

## Retail and consumer industry supplement

No. INT2014-02 (supplement)  
18 June 2014  
(Revised 8 September 2014\*)

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### At a glance

On 28 May, the IASB and FASB issued their long-awaited converged standard on revenue recognition. Almost all entities will be affected to some extent by the significant increase in required disclosures. But the changes extend beyond disclosures, and the effect on entities will vary depending on industry and current accounting practices.

In depth 2014-02 is a comprehensive analysis of the new standard. This supplement highlights some of the areas that could create the most significant challenges for retail and consumer entities as they transition to the new standard.

### Overview

Historically, the accounting for revenue in the retail and consumer sectors has been governed by multiple pieces of literature under US GAAP and by a single revenue standard and the related interpretations under IFRS. The new revenue recognition standard introduces a new model for revenue recognition, and while it may not have a broad impact on some aspects of the retail and consumer industry, certain areas will be significantly affected. This is the case especially for US GAAP preparers, where, for example, certain aspects of transactions that include customer incentives and loyalty programmes will be affected.

Arrangements in the retail and consumer sectors are often unique to the parties and the specific facts and circumstances should be evaluated closely when applying the new standard.

\* This In depth was revised on 8 September 2014 to include the following additional sections: (1) Amounts collected on behalf of third parties, and (2) Bill-and-hold arrangements.

## Right of return

Return rights are commonly granted in the retail and consumer industry and may take the form of product obsolescence protection, stock rotation, trade-in agreements, or the right to return all products upon termination of an agreement. Some of these rights may be articulated in contracts with customers or distributors, while others are implied during the sales process, or based on historical practice.

New model	Current US GAAP	Current IFRS
<p>Revenue should not be recognised for goods expected to be returned, and a liability should be recognised for expected refunds to customers. The refund liability should be updated each reporting period for changes in expected refunds.</p> <p>An asset and corresponding adjustment to cost of sales should be recognised for the right to recover goods from customers on settling the refund liability. The asset will be initially measured at the cost of inventory sold less any expected costs to recover the goods and the impact of any reduction in the value of those goods. At the end of each reporting period, the asset should be re-measured (if necessary) based on changes in expectations.</p> <p>The guidance for variable consideration is applied to determine how much revenue to recognise. Entities will recognise the amount of revenue they expect to be entitled to when control transfers to the extent it is 'highly probable' (IFRS) or 'probable' (US GAAP) that significant reversal will not occur in the future.</p> <p>Exchanges of products for another of the same type, quality, condition and price are not considered returns. Defective product exchanges should be considered in accordance with the guidance on warranties.</p>	<p>Revenue is recognised at the time of sale if future returns can be reasonably estimated. Returns are estimated based on historical experience with an allowance recorded against sales.</p> <p>Revenue is not recognised until the return right lapses if an entity is unable to estimate potential returns.</p> <p><b>Potential impact:</b></p> <p>The accounting for product returns under the revenue standard will be largely unchanged from current guidance under IFRS and US GAAP. There might be some retail and consumer entities that are deferring revenue today because they are unable to reliably estimate returns. The new guidance requires that the impact of returns be estimated using a probability-weighted approach or most likely outcome, whichever is most predictive. Consideration received is included in revenue to the extent that it is highly probable (probable) that there will be no significant reversal when the uncertainty is resolved. This could result in revenue being recognised earlier than under today's guidance.</p> <p>There is diversity in existing practice in the balance sheet presentation of expected returns. The revenue standard specifies that the balance sheet should reflect both the refund obligation and the asset for the right to the returned goods on a gross basis, which should eliminate the current diversity in presentation.</p>	<p>Revenue is typically recognised net of a provision for the expected level of returns, provided that the seller can reliably estimate the level of returns based on an established historical record and other relevant evidence. Current IFRS does not specify the balance sheet accounting for expected returns.</p>

## Example 1 – Right of return

**Facts:** A retailer sells 100 mobile phones for C100 each. The mobile phones cost C50 and the terms of sale include a return right for 180 days. The retailer estimates that 10 mobile phones will be returned based on historical sales patterns. In establishing this estimate, the retailer uses an expected value method and estimates a 40% probability that eight mobile phones will be returned, a 45% probability that nine mobile phones will be returned, and a 15% probability that 18 mobile phones will be returned. The retailer also concludes it is probable (highly probable) that there will not be a significant reversal of revenue recognised based on this estimate when the uncertainty is resolved. How should the retailer record the revenue and expected returns related to this transaction?

**Discussion:** At the point of sale, C9,000 of revenue (C100 x 90 mobile phones) and cost of sales of C4,500 (C50 x 90 mobile phones) is recognised. An asset of C500 (cost of C50 x 10 mobile phones) is recognised for the anticipated return of the mobile phones (assuming they are returned in a re-saleable condition), and a liability of C1,000 (C100 x 10 mobile phones) is recognised for the refund obligation. The probability of return is evaluated at each subsequent reporting date. Any changes in estimates are adjusted against the asset and liability, with adjustments to the liability recorded to revenue and adjustments to the asset recorded against cost of sales.

## Sell-through approach/consignment arrangements

The sell-through approach is used today for some arrangements with distributors where revenue is not recognised until the product is sold by the distributor to the end customer (that is, the consumer) because the distributor may be able to return the unsold product, rotate older stock, or receive pricing concessions. As a result, the risks and rewards of ownership have not transferred. Some entities sell products using consignment arrangements under which the buyer (a dealer or distributor) takes physical possession of the goods, but does not assume all of the risks and rewards.

New model	Current US GAAP	Current IFRS
<p>Revenue should be recognised when a good or service is transferred to the customer. An entity transfers a good or service when the customer obtains control of that good or service. A customer obtains control of a good or service if it has the ability to direct the use of and receive the benefit from the good or service.</p> <p>Indicators that the customer has obtained control of the good or service include:</p> <ul style="list-style-type: none"> <li>• The entity has a present right to payment for the asset.</li> <li>• The customer has legal title to the asset.</li> <li>• The entity transferred physical possession of the asset.</li> <li>• The customer has the significant risk and rewards of ownership.</li> <li>• The customer has accepted the asset.</li> </ul>	<p>Revenue is recognised once the risks and rewards of ownership have transferred to the end customer under the sell-through approach.</p> <p>Goods delivered to a consignee pursuant to a consignment arrangement are not considered sales, and do not qualify for revenue recognition. Once it is determined that substantial risk of loss, rewards of ownership, as well as control of the asset have transferred to the consignee, revenue recognition would then be appropriate, assuming all other criteria for revenue recognition have been satisfied.</p>	<p>A contract for the sale of goods normally gives rise to revenue recognition at the time of delivery, when the following conditions are satisfied:</p> <ul style="list-style-type: none"> <li>• The risks and rewards of ownership have transferred.</li> <li>• The seller does not retain managerial involvement to the extent normally associated with ownership nor retain effective control.</li> <li>• The amount of revenue can be reliably measured.</li> <li>• It is probable that the economic benefit will flow to the customer.</li> <li>• The costs incurred can be measured reliably.</li> </ul> <p>Revenue is recognised once the risks and rewards of ownership have transferred to the end customer under the sell-through approach.</p>

New model	Current US GAAP	Current IFRS
<p>A product is held on consignment if the buyer has physical possession of a good, but has not obtained control. An entity should not recognise revenue for products held on consignment. Indicators that there is a consignment arrangement include:</p> <ul style="list-style-type: none"> <li>• The product is controlled by the seller until a specified event, such as a sale to an end customer.</li> <li>• The entity is able to require the return or transfer of the product.</li> <li>• The dealer does not have an unconditional obligation to pay for the product.</li> </ul>	<p><b>Potential impact:</b></p> <p>The effect of the revenue standard on the sell-through approach and on consignment arrangements will depend on the terms of the arrangement. The new revenue standard requires management to determine when control of the product has transferred to the customer. Revenue is recognised when the customer or distributor has control of the product, even if the terms include a right of return (that is, not when the product is transferred to the end customer). Expected returns or price concessions affect the amount of revenue, but not when revenue is recognised. Revenue could therefore be recognised earlier under the revenue standard.</p> <p>The timing of revenue recognition could change for some entities because today's guidance is focused on the transfer of risks and rewards rather than the transfer of control. The transfer of risks and rewards is an indicator of whether control has transferred under the new revenue standard, but additional indicators will also need to be considered.</p> <p>If the entity can require the customer or distributor to return the product (that is, it has a call right), control likely has not transferred to the customer or distributor; therefore, revenue is only recognised when the products are sold to an end customer. The entity would continue to recognise the product as inventory and account for any payments received from the customer as a financial liability.</p>	<p>Revenue is not recognised on consignment sales until performance has taken place. If the purchaser of goods on consignment has undertaken to sell the items on the seller's behalf, then revenue should not be recognised by the seller until the goods are sold to a third party.</p>

### *Example 2 – Sale of products to a distributor using a sell-through approach*

**Facts:** A consumer products entity uses a distributor network to supply its product to the end customer. The distributor receives legal title and is required to pay for the products upon receipt, but may return unsold product at the end of the contract term. Once the products are sold to the end customer, the consumer products entity has no further obligations for the product and the distributor has no further return rights. When does the consumer products entity recognise revenue?

**Discussion:** Revenue is recognised once control of the product has transferred, which requires an analysis of the indicators of the transfer of control. The distributor has physical possession, legal title, a present obligation to pay for the asset, and the right to determine whether the goods are returned, which are all indicators that control transferred when the goods were delivered to the distributor. If control has transferred to the distributor and revenue is recognised, the consumer products entity would recognise a liability for expected returns.

**Note:** If the consideration the entity receives is dependent on the sell-through price to the end customer (or on the extent of any returns) and if it was determined that control transfers and revenue is recognised on transfer to the retailer, the guidance for variable consideration would be applied.

### Example 3 – Sale of products on consignment

**Facts:** A manufacturer provides household goods to a retailer on a consignment basis (for example, scan-based trading). The manufacturer retains title to the products until they are scanned at the register. The retailer does not have an obligation to pay the manufacturer until a sale occurs and any unsold products may be returned to the manufacturer. The manufacturer also retains the right to call back or transfer unsold products to another retailer until the sale to the consumer. Once the retailer sells the products to the consumer, the manufacturer has no further obligations for the products, and the retailer has no further return rights. When does the manufacturer recognise revenue?

**Discussion:** The manufacturer should recognise revenue when control has passed to the retailer, which requires an analysis of the indicators of the transfer of control. Although the retailer has physical possession of the products, it does not take title or have an unconditional obligation to pay the manufacturer, and the manufacturer maintains a right to call the products. Therefore, control does not transfer and revenue is not recognised until the product is sold to the consumer.

### FOB synthetic destination

Consumer products entities often have a customary practice of replacing or crediting lost or damaged goods even when sales contracts contain ‘free on board’ (FOB) shipping point terms, and the customer obtains control at the time of shipment. In such instances, the customer is in the same position as if the shipping terms were FOB destination. Revenue would likely be recognised when the product is received by the customer under today’s guidance because the risks and rewards of ownership have not been substantively transferred to the customer at the point of shipment. The timing of revenue recognition might change under the new standard’s control-based model.

New model	Current US GAAP	Current IFRS
<p>Revenue should be recognised when a good or service is transferred to the customer, as described in the Sell-through approach.</p> <p>Situations where an entity transfers a good but retains the risk of loss or damage based on shipping terms could indicate that an additional performance obligation exists that has not yet been fulfilled. Performance obligations are discussed further in the Customer incentives section.</p>	<p>Revenue from the sale of a good should not be recognised until the seller has substantially accomplished what it must do pursuant to the terms of the arrangement, which usually occurs upon delivery.</p> <p>The risks and rewards of ownership need to substantively transfer to the customer. Revenue is deferred until the goods have been delivered to the end customer if the vendor has established a practice of covering risk of loss in transit.</p>	<p>A contract for the sale of goods normally gives rise to revenue recognition at the time of delivery, as described in the Sell-through approach section above.</p> <p>Revenue is typically recognised once the goods reach the buyer when there are FOB synthetic destination terms, as risks and rewards of ownership typically transfer at that time.</p>
<p><b>Potential impact:</b></p> <p>The timing of revenue recognition could change under the new revenue standard as the focus shifts from transfer of risks and rewards to the transfer of control of the goods. The indicators of whether control has transferred would need to be assessed based on facts and circumstances. For example, a good may be shipped under FOB destination terms. However, control may transfer upon shipment if the customer has the ability to sell the good and re-direct delivery to its own customers while in transit.</p> <p>Management will also need to assess whether the shipping terms create an additional performance obligation when control transfers on shipment. Examples of this could be shipping and in-transit risk of loss coverage. Control</p>		

New model	Current US GAAP	Current IFRS
	of the underlying goods could be transferred and revenue recognised when the product leaves the seller’s location, based on legal title transfer, the entity’s right to receive payment, or the customer’s ability to redirect and sell the goods, but there might be a second performance obligation for shipping and in-transit risk of loss. Management will need to allocate the transaction price to each of the performance obligations, and recognise revenue when each performance obligation is satisfied, which might be at different times. Management should consider the effect of these arrangements based on the facts and circumstances of each transaction.	

### Example 4 – FOB synthetic destination

**Facts:** An electronics manufacturer enters into a contract to sell flat screen televisions to a retailer. The delivery terms are free on board (FOB) shipping point (legal title passes to the retailer when the televisions are handed over to the carrier). A third-party carrier is used to deliver the televisions. The manufacturer has a past business practice of providing replacements to the retailer at no additional cost if the televisions are damaged during transit.

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. The manufacturer is also precluded from selling the televisions to another customer while in transit. Does the manufacturer have a separate performance obligation with respect to the risk of loss during transit?

**Discussion:** The manufacturer might conclude that it has two performance obligations: one for fulfilling the order for the televisions and a second for covering the risk of loss during transit based on its past business practice. The manufacturer has not satisfied its performance obligation regarding risk of loss at the point of shipment. The consideration from the customer should be allocated to the televisions and to the service that covers the risk of loss. Revenue for the televisions is recognised at the time of shipping when control transfers. Revenue allocated to the risk of loss service is recognised when performance occurs.

## Customer incentives

Retail and consumer entities offer a wide array of customer incentives. Retailers commonly offer coupons, rebates issued at the point of sale, free products (‘buy-one-get-one-free’), price protection, or price matching programmes to their customers. Consumer product entities commonly provide vendor allowances, including volume rebates and cooperative advertising allowances, market development allowances, and mark-down allowances (compensation for poor sales levels of vendor merchandise) to their customers. Consumer product entities also pay product placement or slotting fees to retailers. Various pieces of guidance apply today and there is some diversity in practice in accounting for such incentives.

Customer incentives can affect the amount and timing of revenue recognition in several ways. They can create additional performance obligations, which can affect the timing of revenue recognition, and they often introduce variability into the transaction price, which can affect the amount of revenue recognised. The new revenue standard includes specific guidance addressing these areas. The guidance for variable consideration in particular will apply to a wide range of customer incentives and is different from the existing guidance under IFRS and US GAAP.

New model	Current US GAAP	Current IFRS
<p><b>Performance obligations</b></p> <p>The revenue standard requires entities to identify all promised goods or services in a contract and determine whether to account for each promised good or service as a separate performance obligation.</p> <p>A performance obligation is a promise in a contract to transfer a distinct good or service to a customer.</p> <p>A good or service is distinct and is separated from other obligations in the contract if both:</p> <ul style="list-style-type: none"> <li>the customer can benefit from the good or service separately or together with other resources; and</li> <li>the good or service is separable from other goods or services in the contract.</li> </ul>	<p>The following criteria are considered to determine whether elements included in a multiple-element arrangement are accounted for separately:</p> <ul style="list-style-type: none"> <li>The delivered item has value to the customer on a stand-alone basis.</li> <li>If a general return right exists for the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the vendor.</li> </ul>	<p>The revenue recognition criteria are usually applied separately to each transaction. It might be necessary to separate a transaction into identifiable components to reflect the substance of the transaction in certain circumstances. Separation is appropriate when identifiable components have stand-alone value and their fair value can be measured reliably.</p> <p>Two or more transactions might need to be grouped together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.</p>
<p><b>Options to acquire additional goods or services</b></p> <p>An entity may grant a customer the option to acquire additional goods or services free of charge or at a discount. These options may include customer award credits or other sales incentives and discounts that will give rise to a separate performance obligation if the option provides a material right that the customer would not receive without entering into the contract. The entity should recognise revenue allocated to the option when the option expires or when the additional goods or services are transferred to the customer.</p> <p>An option to acquire an additional good or service at a price that is within the range of prices typically charged for those goods or services does not provide a material right, even if the option can be exercised only because of entering into the previous contract.</p>	<p>When an option is determined to be substantive, an entity would need to evaluate whether that option has been offered at a significant incremental discount. If the discount in an arrangement is more than insignificant, there is a presumption that an additional deliverable is being offered which requires that a portion of the arrangement consideration be deferred at inception.</p> <p>Loyalty programmes and gift cards are discussed in a separate section.</p>	<p>The recognition criteria are usually applied separately to each transaction (that is, the original purchase and the separate purchase associated with the option). However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components as a single transaction in order to reflect the substance of the transaction.</p> <p>If an entity grants its customers, as part of a sales transaction, an option to receive a discounted good or service in the future, the entity accounts for that option as a separate component of the arrangement, and therefore allocates consideration between the initial good or service provided and the option.</p>

New model	Current US GAAP	Current IFRS
<p><b>Consideration payable to a customer</b></p> <p>An entity needs to determine the transaction price, which is the amount of consideration it expects to be entitled to in exchange for transferring promised goods or services to a customer. Consideration payable by an entity to a customer is accounted for as a reduction of the transaction price unless the payment is for a distinct good or service that the customer transfers to the entity.</p> <p><b>Variable consideration</b></p> <p>The transaction price might include an element of consideration that is variable or contingent on the outcome of future events, including (but not limited to) discounts, rebates, price concessions, refunds, returns, credits, incentives, performance bonuses, and royalties.</p> <p>Variable consideration is estimated using either an expected value or most likely outcome, whichever provides the best estimate.</p> <p>Variable consideration is included in the transaction price to the extent that it is highly probable or probable that there will not be a significant reversal in the amount of cumulative revenue recognised when the uncertainty is resolved.</p> <p>Judgement will often be needed to determine whether it is probable or highly probable there will not be a significant reversal. The revenue standard provides indicators that might suggest such a reversal would take place.</p>	<p>Sales incentives offered to customers are typically recorded as a reduction of revenue at the later of the date at which the related sale is recorded by the vendor or the date at which the sales incentive is offered.</p> <p>Volume rebates are recognised as each of the revenue transactions that results in progress by the customer toward earning the rebate occurs.</p> <p><b>Potential impact:</b></p> <p>Entities will need processes that identify the different performance obligations in each agreement and pinpoint when and how those obligations are fulfilled. Retailers often offer customers a right to purchase free or discounted goods or services in the future in connection with the sale of goods (for example, coupons toward additional purchases). These arrangements typically create additional performance obligations.</p> <p>Payments to customers may result in a reduction to revenue, similar to today's accounting model. The principles used to determine when these payments would not reduce revenue now focus on whether an entity receives a distinct good or service in exchange for the payment.</p> <p>Entities that defer revenue recognition under current guidance because the price is not reliably measurable (IFRS) or fixed or determinable (US GAAP) might be significantly affected by the revenue standard. In a situation where the price is fixed, but the entity has a history of granting concessions, entities would be required to recognise the minimum amount of revenue they expect to be entitled to when control transfers as long as it is 'highly probable' (IFRS) or 'probable' (US GAAP) that there will not be a significant reversal of cumulative revenue recognised when the uncertainty is resolved.</p> <p>The evaluation of variable consideration will require judgement in many cases. Some entities will need to recognise revenue before all contingencies are resolved, which might be earlier than under current practice. Management might need to put into place new processes to monitor estimates on an ongoing basis as more experience is obtained.</p>	<p>Sales incentives offered to customers are recorded as a reduction of revenue at the time of sale. Management uses its best estimate of incentives expected to be awarded to estimate the sales price. The potential impact of volume discounts is considered at the time of the original sale. Revenue from contracts that provide customers with volume discounts is measured by reference to the estimated volume of sales and the expected discounts. Revenue should not exceed the amount of consideration that would be received if the maximum discounts were taken if management cannot reliably estimate the expected discounts.</p>

### Example 5 – Retailer-issued coupons

**Facts:** A retailer sells goods to a customer for C100,000 and at the same time provides a coupon for a 60% discount off a future purchase during the next 90 days. The retailer intends to offer a 10% discount on all sales as part of a promotional campaign during the same period. Management estimates that 75% of customers that receive the coupon will exercise the option for the purchase of, on average, C40,000 of discounted additional product. How should the retailer account for the option provided by the coupon?

**Discussion:** The retailer should account for the option as a separate performance obligation, as the discount represents a material right. It is a material right because it is incremental to the discount offered to a similar class of customers during the period (only a 10% discount is offered more widely). The stand-alone selling price of the option is C15,000, calculated as the estimated average purchase price of additional products (C40,000) multiplied by the incremental discount (50%) multiplied by the likelihood of exercise (75%). The transaction price allocated to the discount based on its relative stand-alone selling price will be recognised upon exercise (that is, upon purchase of the additional product) or expiry.

An entity should consider whether it needs to assume 100% redemption of the options if it does not have sufficient history to estimate the extent of redemption.

### Example 6 – Manufacturer-issued coupons

**Facts:** A manufacturer sells 1,000 boxes of laundry detergent to a retailer for C10 per box. Control transfers when the product is delivered to the retailer. There are no return rights, price protection, stock rotation or similar rights. The retailer sells the laundry detergent to consumers for C12 per box. The manufacturer simultaneously issues coupons directly to consumers via newspapers which are valid for the next six months and provide a C1 discount on each box of detergent purchased. The coupons are presented by the consumer to the retailer upon purchase of the detergent. The retailer submits coupons to the manufacturer and is compensated for the face value of the coupons (C1). Using the expected value method (which the manufacturer believes is most predictive of the consideration it will be entitled to), the manufacturer estimated that 400 coupons will be redeemed. The manufacturer has recent experience with similar promotions involving similar pricing and discounting levels. Therefore, it concludes it is highly probable (IFRS) or probable (US GAAP) that the actual number of coupons redeemed will not result in a significant reversal of the cumulative revenue recognised. How much revenue should the manufacturer and retailer recognise?

**Discussion:** The manufacturer will recognise C9,600 of revenue (C10,000 less estimated coupon redemptions of C400) for detergent sold to the retailer. While the retailer's accounting in this scenario is not specifically addressed by the new standard, we generally believe the additional consideration paid by the manufacturer is revenue to the retailer, as the fair value of the total consideration received by the retailer is C12. Following this logic, the retailer will recognise revenue of C12 and cost of sales of C10 for each box upon sale to the consumer, whether or not they present a coupon. Cost of sales remains at the original amount paid by the retailer to the manufacturer.

### Example 7 – Free product rebate

**Facts:** A vendor is running a promotion whereby a consumer who purchases three boxes of golf balls at C20 per box in a single transaction receives an offer for one free box of golf balls if the customer fills out a request form and mails it to the vendor before a set expiration date (a mail-in rebate). The vendor 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 golf balls. How is the consideration allocated to the various deliverables in the arrangement?

**Discussion:** The purchase of three boxes of golf balls 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. The transaction price is allocated to the right using relative stand-alone selling price, which considers estimated redemptions. Therefore, the value of the option is C16 (C20 x 100% discount x 80% expected redemption). Management will allocate C12.63 (C60 x (C16 / (C16 + C60))) of the transaction price to the mail-in rebate. The vendor recognises revenue of C47.37 when the three boxes of golf balls are sold, assuming control transfers, and recognises a liability for C12.63 until the rebate is redeemed or expires unredeemed. If the vendor is unable to determine the number of mail-in rebates that will be used, management will assume 100% redemption. Management will allocate C15 (C60 x (C20 / (C20 + C60))) to the undelivered box and recognise revenue on delivery following redemption, expiration of the rebate, or until it is able to make an estimate.

## Example 8 – Slotting fees

**Facts:** A manufacturer sells products to a retailer for C8 million. The manufacturer also makes a C1 million non-refundable upfront payment to the retailer for favourable product placement. How does the manufacturer account for the upfront payment? How does the retailer account for the upfront payment?

**Discussion:** The product placement services cannot be sold separately. The service is not distinct because the manufacturer would not obtain any rights or receive any benefit without selling products to the retailer. The manufacturer recognises a reduction in the transaction price of C1 million and recognises C7 million in revenue when control of the products transfers to the retailer.

From the retailer’s perspective, the C1 million upfront payment for product placement services is not a payment for satisfying a distinct performance obligation and should be recognised as a reduction of cost of goods sold.

## Example 9 – Price protection

**Facts:** A retailer sells a product to a customer for C100 on 1 January and agrees to reimburse the customer for the difference between the purchase price and any lower price offered by a certain direct competitor during the three-month period following the sale. The retailer has recent experience with similar promotions of similar products. On a probability-weighted basis, the retailer estimates it will reimburse the customer C5. How does the retailer account for the potential refund?

**Discussion:** The consideration expected to be repaid to the customer is excluded from revenue and recorded as a liability at the time of sale. Management concludes based on its recent experience that it is probable (or highly probable) that recognising C95 would not result in significant reversal of cumulative revenue upon resolution of the uncertainty. Therefore, the retailer recognises revenue of C95 and a refund liability of C5.

## Loyalty programmes

Retailers often use customer loyalty programmes to build brand loyalty and increase sales volume by providing customers with incentives to buy their products. Each time a customer buys goods or services, or performs another qualifying act, the retailer grants the customer award credits. The customer can redeem the credits for awards such as free or discounted goods or services. The award credits are a separate performance obligation.

New model	Current US GAAP	Current IFRS
<p>An option to acquire additional goods or services gives rise to a separate performance obligation if the option provides a material right that the customer would not receive without entering into that contract. The revenue standard requires management to estimate the transaction price to be allocated to the separate performance obligations and to recognise a contract liability for the performance obligations that will be satisfied in the future.</p> <p>The customer is paying for the future goods or services to be received when the award credits are issued in conjunction with a current sale. The entity recognises revenue for the</p>	<p>There is divergence in practice in US GAAP in the accounting for loyalty programmes. Two models commonly followed are an incremental cost accrual model and a multiple-element revenue model.</p> <p>Under the incremental cost model, revenue is typically recognised at the time of the initial sale and an accrual is made for the expected costs of satisfying the award credits. The multiple-element model results in the transaction price being allocated to the products or services sold and to the award credits, with revenue recognised as each element is delivered. The incremental cost model is more prevalent in practice.</p>	<p>Loyalty programmes are accounted for as multiple-element arrangements. Some revenue, based on the fair value of award credits, is deferred and recognised when the awards are redeemed or expire.</p> <p>Revenue is allocated between the good or service sold and the award credits, taking into consideration the fair value of the award credits to the customer. The assessment of fair value includes consideration of discounts available to other buyers absent entering into the initial purchase transaction and expected forfeitures.</p>

New model	Current US GAAP	Current IFRS
option when those future goods or services are transferred to the customer or when the option expires.	<p><b>Potential impact:</b></p> <p>The revenue standard is consistent with the multiple-element model currently required under IFRS, but may have a greater impact on US GAAP reporters. The transaction price is allocated between the product and the loyalty reward performance obligations based on relative stand-alone selling price. The amount allocated to the loyalty rewards is recognised as a contract liability and revenue is recognised when the rewards are redeemed or expire. This will generally result in later revenue recognition for a portion of the transaction price for those currently using an incremental cost model.</p>	

### Example 10 – Loyalty points

**Facts:** A retailer has a loyalty programme that rewards customers one point per C1 spent. Points are redeemable for C0.10 off future purchases (but not redeemable for cash). A customer purchases C1,000 of product at the normal selling price and earns 1,000 points redeemable for C100 off future purchases of goods or services. The retailer expects redemption of 950 points (that is, 5% of points will expire unredeemed). The retailer therefore estimates a stand-alone selling price for the incentive of C0.095 per point based on the likelihood of redemption (C0.10 less 5%). How is the consideration allocated between the points and the product?

**Discussion:** The retailer would allocate the transaction price of C1,000 between the product and points based on the relative stand-alone selling prices of C1,000 for the product and C95 for the loyalty reward as follows:

Product	C913 (C1,000 x C1,000/C1,095)
Points	C87 (C1,000 x C95/C1,095)

The revenue allocated to the product is recognised upon transfer of control of the product and the revenue allocated to the points is recognised upon the earlier of the redemption or expiration of the points. The estimate of the number of awards that will expire unredeemed is updated at each period end.

### Gift cards

The use of gift certificates and gift cards is common in the retail industry. The gift cards or certificates are typically sold for cash and may be used by customers to obtain products or services in the future up to a specified monetary value. The amount of gift certificates that are forfeited is commonly referred to as breakage. Breakage will typically result in the recognition of income for a retailer; however, the timing of recognition depends on expected customer behaviour and the legal restrictions in the relevant jurisdiction.

New model	Current US GAAP	Current IFRS
When a customer purchases a gift card, it is pre-paying for goods or services to be delivered in the future. The vendor has an obligation to transfer, or stand ready to transfer, the goods or services in the future – creating a performance obligation. The vendor should recognise a contract liability for the amount of the prepayment and derecognise the liability (and recognise revenue) when it fulfils the performance obligation.	<p>When the gift card is sold to the customer, a liability is recognised for the future obligation of the retailer to honour the gift card. The liability is relieved (and revenue recognised) when the gift card is redeemed.</p> <p>Currently, three accounting models are generally accepted for the recognition of breakage, depending on the features of the programme, legal requirements and the vendor's ability to reliably estimate breakage:</p>	<p>Payment received in advance of future performance is recognised as revenue only when the future performance to which it relates occurs. That is, revenue from the sale of a gift card or voucher is accounted for when the seller supplies the goods or services upon exercise of the gift card.</p> <p>No specific models are provided for recognising breakage. The models used under US GAAP are acceptable under IFRS.</p>

New model	Current US GAAP	Current IFRS
<p>Expected breakage (that is, the customer's unexercised right) should be estimated and recognised as revenue in proportion to the pattern of rights exercised by the customer. The guidance for variable consideration is followed when estimating breakage. If the entity is unable to estimate the breakage amount, revenue for the unused portion of the gift card is recognised when the likelihood of the customer exercising its remaining rights becomes remote.</p> <p>If an entity is required to remit consideration to a third-party, such as a government body responsible for unclaimed property, based on a customer's unexercised rights, then the entity should not recognise revenue related to unexercised rights.</p>	<ul style="list-style-type: none"> <li>• proportional model - recognise as redemptions occur;</li> <li>• liability model - recognise when the right expires; and</li> <li>• remote model - recognise when it becomes remote that the holder of the rights will demand performance.</li> </ul> <p>Where escheat laws apply, the vendor cannot recognise breakage revenue for escheatable funds since it is required to remit the funds to a third party even if the customer never demands performance.</p>	
	<p><b>Potential impact:</b></p> <p>Similar to today's accounting model, entities will continue to recognise a contract liability for the obligation to deliver goods and services. Expected breakage should be estimated and recognised as revenue in proportion to the pattern of rights exercised by the customer. If the entity does not expect to be entitled to a breakage amount, it will recognise breakage revenue when the likelihood of exercise becomes remote.</p> <p>The specific guidance for breakage in the revenue standard should eliminate the diversity in practice that exists today.</p>	

### Example 11 – Gift cards/breakage

**Facts:** A customer buys a C100 gift card from a retailer, which can be used for up to one year from the date of purchase. Using the guidance for variable consideration and its history of issuing gift cards, the retailer estimates that the customer will redeem C90 of the gift card and that C10 will expire unused (10% breakage). The entity has no requirement to remit any unused funds to the customer or any third party when the gift card expires unused. A contract liability of C100 is recorded upon sale of the gift card. How is revenue recognised when the gift card is redeemed?

**Discussion:** For every C1 of gift card redemptions, the retailer recognises C1.11 (C1.00 x C100/C90) of revenue with C0.11 of the revenue reflecting breakage. For example, if the customer purchases a C50 product using the gift card, the retailer recognises C55 of revenue, reflecting the product's selling price and the estimated breakage of C5.

## Licences and franchise agreements

Licences are common in the retail and consumer sector. Many products include a licensed image or name. Retail and consumer entities may license their trade names or grant franchise rights to others. Accounting for licences and franchise rights under the revenue standard may be different compared to today.

New model	Current US GAAP	Current IFRS
<p>Licences (including franchise agreements) are either a promise to provide a right, which transfers at a point in time, or a promise to provide access to an entity's intellectual property, which transfers over time.</p> <p>The key consideration in determining the revenue recognition pattern is therefore whether the licence provides a customer a <u>right to access</u> an entity's IP or a <u>right to use</u> an entity's IP.</p> <p>A licence provides a <u>right to access</u> IP when it provides the customer with access to the IP as it exists throughout the licence period. The IP to which the customer has access might change over time based on actions of the licensor. A customer will therefore not be able to direct the use of and obtain substantially all of the remaining benefits from the licence at the time of initial transfer.</p> <p>A licence provides a <u>right to use</u> IP when the customer receives IP that does not change after the licence transfers to the customer.</p> <p>The boards established three criteria to distinguish licences that are rights to access IP from those that are rights to use IP. Licences that meet all of these criteria provide access to IP and revenue should be recognised over time:</p> <ul style="list-style-type: none"> <li>• The licensor will undertake activities that significantly affect the IP to which the customer has rights.</li> <li>• The rights granted by the licence directly expose the customer to any effects (both positive and negative) of those activities on the IP.</li> <li>• The licensor's activities do not otherwise transfer a good or service to the customer as they occur.</li> </ul> <p>The following factors should <u>not</u> be considered to determine whether a</p>	<p>Consideration is allocated to the licence and revenue is recognised when earned and realised or realisable. Revenue is generally earned at either the beginning or throughout the licence term, depending upon the nature of the licence and any other obligations of the licensor.</p> <p>Royalty revenue is generally recognised when realised or realisable.</p> <p>ASC 952-605 provided specific guidance on the recognition of franchise fee revenue.</p>	<p>Revenue is not recognised under licensing and franchise agreements until performance occurs and the revenue is earned.</p> <p>The assignment of rights for a non-refundable amount under a non-cancellable contract permits the licensee to use those rights freely and where the licensor has no remaining obligations to perform is, in substance, a sale. A fixed licence term is an indicator that the revenue should be recognised over the period because the fixed term suggests that the licence's risks and rewards have not been transferred to the customer. However, the following indicators should be considered to determine whether a licence fee should be recognised over the term or upfront:</p> <ul style="list-style-type: none"> <li>• Fixed fee or non-refundable guarantee.</li> <li>• The contract is non-cancellable.</li> <li>• Customer is able to exploit the rights freely.</li> <li>• Vendor has no remaining performance obligations.</li> </ul> <p>Royalties are recognised on an accrual basis in accordance with the relevant agreement's substance.</p>
	<p><b>Potential impact:</b></p> <p>The new guidance for licences is different from today's models, so the timing of revenue recognition might change depending on the model currently followed. An entity should first consider the guidance for distinct performance obligations to determine if the licence is distinct from other goods or services in the arrangement. Licences that are not distinct are combined with other goods and services in the contract to identify a distinct performance obligation. Revenue is recognised when that performance obligation is satisfied. Complex arrangements, which include licences and other performance obligations, will require careful consideration to determine whether the licence should be accounted for separately.</p> <p>The next step for distinct licences is to determine whether the licence provides access, in which case revenue is recognised over time, or a right to use an entity's IP, in which case revenue is recognised when control has transferred to</p>	

New model	Current US GAAP	Current IFRS
<p>licence provides access or transfers a right:</p> <ul style="list-style-type: none"> <li>Restrictions of time, geography, or use, as these are attributes of the licence and do not define how the performance obligation is satisfied (for example, a term licence could be a right to access or use IP depending on the arrangement).</li> <li>Guarantees that the licensor has a valid patent and will defend the licensed IP from infringement, as these guarantees protect the value of the IP licensed by the customer.</li> </ul> <p>If a licensing arrangement has multiple deliverables, an entity should consider whether the licence is a separate performance obligation or whether it should be combined with other performance obligations.</p> <p>The transaction price in a licensing arrangement might include an element of consideration that is variable or contingent on the outcome of future events, such as a royalty. In most instances variable consideration is included in the transaction price to the extent that it is highly probable or probable that there will not be a significant reversal in the amount of cumulative revenue recognised when the uncertainty is resolved. However, there is an exception in the case of sales- or usage-based royalties from the licence of IP.</p> <p>Sales- or usage-based royalties from licences of IP are not included in the transaction price until they are no longer variable (that is, when the customer's subsequent sales or usage occur). The exception is limited to sales- or usage-based royalties arising from the licence of IP and does not apply to other royalty arrangements.</p> <p>Revenue cannot be recognised before the beginning of the period during which the customer can use and benefit from the licensed intellectual property, notwithstanding when the licence is transferred.</p>	<p>the licensee and the licence period has begun. Licensors may have to perform a much more detailed assessment than previously to determine the nature of the licence and when revenue is recognised.</p> <p>Licences of IP that involve variable consideration due to sales- or usage-based royalties are subject to specific guidance about the transaction price. Variable consideration from the licence of IP that is based on a sales- or usage-based royalty is excluded from the transaction price until the sale or usage occurs. Entities will need to consider whether their licence arrangements fall within this guidance.</p> <p>The specific guidance in US GAAP regarding the accounting for franchise agreements has been eliminated. Entities that grant franchise rights to third parties will apply the principles for licence agreements described above. Franchise agreements common to the retail and consumer industry will often be accounted for as rights to access IP, as the activities of franchisors continue to affect the IP. Sales-based royalties will continue to be recognised over time, as the subsequent sales occur. The 'right to access' model will require upfront payments to be recognised over time, unless those payments relate to a separate performance obligation distinct from the IP, which might differ from existing accounting.</p>	

## Example 12 – Licences

**Facts:** A designer of jeans has a worldwide recognised brand. A global manufacturer of dolls contracts with the designer for the right to use its brand name on the dolls' clothes. The terms of the agreement provide the doll manufacturer with rights to use the brand name on the dolls' clothes for two years. The designer will receive C1 million upfront and 12% of all proceeds from the sales of the dolls that include branded jeans. The doll manufacturer will provide updated sales estimates on a quarterly basis and actual sales data on a monthly basis. When does the designer recognise revenue?

**Discussion:** The licence is a distinct performance obligation and is a right to access IP transferred over time. There is a reasonable expectation that the designer will undertake activities that will significantly affect the brand name to which the doll manufacturer has rights and the doll manufacturer is directly exposed to any positive or negative effects of the jeans' brand throughout the licence period.

The upfront payment of C1 million is recognised as the performance obligation is satisfied, which is over time. The variable consideration to be received by the designer depends on the level of sales of dolls and is a sales-based royalty arrangement. Therefore, this component of the consideration is excluded from the transaction price until the sales have occurred.

## Example 13 – Franchise agreement

**Facts:** An entity grants a franchisee the right to operate a restaurant in a specific domestic market using the entity's brand name, concept and menu for a period of ten years. The entity has granted others similar rights to operate this restaurant concept in other domestic markets. The entity commonly conducts national advertising campaigns, promoting the brand name, and restaurant concept generally. The franchisee will also purchase kitchen equipment from the entity. The entity will receive C950,000 upfront (C50,000 for the kitchen equipment and C900,000 for the franchise right) plus a royalty, paid quarterly, based on 4% of the franchisee's sales over the life of the contract. When does the entity recognise revenue?

**Discussion:** The franchise right is a distinct performance obligation and is a right to access IP, which is transferred over time. There is a reasonable expectation that the entity 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. The entity's national advertising campaign is an example of such activity.

The kitchen equipment is also a distinct performance obligation. The entity will satisfy this performance obligation upon transfer of the equipment. If C900,000 and C50,000 reflect the stand-alone selling prices of the franchise right and kitchen equipment, respectively, then the entity would recognise C50,000 of the upfront fee upon transfer of the equipment.

The remaining upfront payment of C900,000 is recognised as the franchise right performance obligation is satisfied, which is over time. The variable consideration to be received by the restaurant company is excluded from the transaction price until the subsequent sales have occurred in accordance with the exception for sales-based royalties.

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## Warranties

Products are often sold with standard warranties that provide protection to the consumer that the product will work as intended for a fixed period of time. Many entities also offer extended warranties that cover defects that arise after the initial warranty period has expired. Standard warranties have historically been accounted for as a cost accrual while extended warranties result in the deferral of revenue. The revenue standard draws a distinction between product warranties that the customer has the option to purchase separately (for example, warranties that are negotiated or priced separately) and product warranties that the customer does not have the option to purchase separately. Management will need to exercise judgement when assessing a warranty that is not sold separately to determine if there is a service component embedded in the warranty that should be accounted for as a separate performance obligation.

New model	Current US GAAP	Current IFRS
<p>A warranty that can be purchased separately should be accounted for as a separate performance obligation because the entity promises a service to the customer in addition to the product.</p> <p>If a customer does not have the option to purchase a warranty separately, the entity should account for the warranty in accordance with other existing guidance on product warranties.</p> <p>A promised warranty, or a part of the promised warranty, which is not sold separately but provides the customer with a service in addition to the assurance that the product complies with agreed specifications, creates a performance obligation for the promised service.</p> <p>An entity that cannot reasonably separate the service component from a standard warranty should account for both together as a separate performance obligation.</p>	<p>Warranties are commonly included with product sales. Such warranties may be governed by third-party regulators depending on the nature of the product. Estimates of warranty claims are accrued at the time of sale for the estimated cost to repair or replace covered products for standard warranties.</p> <p>Extended warranties result in the deferral of revenue for the value of the separately priced extended warranty. The amount deferred is amortised to revenue over the extended warranty period.</p>	<p>Management must determine if the warranty obligation is a separate element in the contract.</p> <p>When a warranty is not a separate element, and it represents an insignificant part of the transaction, the seller has completed substantially all of the required performance and can recognise the consideration received as revenue at the time of sale. The expected future cost relating to the warranty is recorded as a cost of sale, as the warranty does not represent a return of a portion of the sales price. Expected warranty costs are determined at the time of sale, and a provision is recognised. If the cost of providing the warranty service cannot be measured reliably, no revenue is recognised prior to the expiration of the warranty obligation.</p> <p>The consideration for sale of extended warranties is deferred and recognised over the period covered by the warranty. When the extended warranty is an integral component of the sale (that is, bundled into a single transaction), management ascribes a relative fair value to each component of the bundle.</p>
<p><b>Potential impact:</b></p> <p>Extended warranties create separate performance obligations under the new revenue standard. Therefore, revenue is recognised over the warranty period. This is similar to existing guidance.</p> <p>Warranties that are separately priced might be affected as the transaction price will be allocated based on relative stand-alone selling prices rather than at the contract price. It may be difficult to separate standard warranties from those that also provide a service in some situations. Determining the estimated stand-alone selling price for the latter category when such warranties are not sold separately could also be challenging. The contract liability for extended warranties might be different from current guidance.</p> <p>Product warranties that are not sold separately and that provide for defects at the time a product is shipped will result in a cost accrual similar to current guidance.</p>		

### Example 14 – Warranty, cost accrual

**Facts:** A manufacturer sells stereo equipment. The manufacturer also provides a 60-day warranty that covers certain components of the stereo equipment. The warranty is not sold separately by the entity. How should the manufacturer account for the warranty?

**Discussion:** The manufacturer should accrue the cost it expects to incur to satisfy the warranty, similar to existing provisions (IFRS) or contingency (US GAAP) guidance.

### Example 15 – Warranty, separate performance obligation

**Facts:** A manufacturer sells stereo equipment. A customer has elected to also purchase the optional 12-month extended warranty. How should the manufacturer account for the warranty?

**Discussion:** The manufacturer should treat the 12-month warranty as a separate performance obligation. A portion of the transaction price is allocated to the warranty based on its relative stand-alone selling price and is recognised as revenue when the warranty obligation is satisfied. The manufacturer will need to assess the pattern of warranty satisfaction to determine when revenue is recognised (that is, rateably or some other pattern).

## Amounts collected on behalf of third parties

Entities often collect amounts from customers that must be remitted to a third party (for example, collecting and remitting taxes to a governmental agency). Taxes collected from customers could include sales, use, value added, and some excise taxes. Amounts collected on behalf of third parties, such as certain sales taxes, are not included in the transaction price as they are collected from the customer on behalf of a third party, such as the government. The entity is acting as an agent for the third party in these situations. Other types of arrangement frequently involve more than two unrelated parties, and must be assessed to determine whether an entity is the principal or an agent in the arrangement.

New model	Current US GAAP	Current IFRS
<p><b>Principal/agent</b></p> <p>An entity recognises revenue on a gross basis if it is the principal in the arrangement and on a net basis if it is an agent.</p> <p>An entity is the principal in an arrangement if it obtains control of the goods or services of another party in advance of transferring control of those goods or services to a customer.</p> <p>The entity is an agent if its performance obligation is to arrange for another party to provide the goods or services.</p> <p>Indicators that an entity is an agent include:</p> <ul style="list-style-type: none"> <li>The other party has primary responsibility for fulfilment of the contract (that is, the other party is</li> </ul>	<p><b>Principal/agent</b></p> <p>Specific indicators are provided for management to consider in assessing whether an entity is the principal or an agent in an arrangement.</p> <p>Revenue is recognised net (for example, based on the amount of the commission) in an agency relationship.</p> <p>All amounts billed to a customer in a sale transaction for shipping and handling costs represent revenues earned and are classified as revenue. Deducting shipping and handling costs from revenue is not permitted.</p> <p><b>Sales/excise taxes</b></p> <p>Taxes within the scope of ASC 605-45 include any tax assessed by a governmental authority that is both</p>	<p><b>Principal/agent</b></p> <p>IAS 18 refers to agency arrangements and states that revenue for an agent excludes amounts that the agent collects on behalf of its principal. The agent’s revenue consists of the commission that it earns for carrying out the agency function.</p> <p>Specific indicators are provided for entities to consider when assessing whether the entity is the principal or the agent in an arrangement.</p> <p>Revenue is recognised net in an agency relationship.</p> <p><b>Sales/excise taxes</b></p> <p>IAS 18 explains that revenue includes only the economic benefits that are received or receivable by the entity on its own account. It excludes amounts</p>

New model	Current US GAAP	Current IFRS
<p>the primary obligor).</p> <ul style="list-style-type: none"> <li>The entity does not have inventory risk.</li> <li>The entity does not have discretion in establishing prices.</li> <li>The entity does not have customer credit risk.</li> <li>The entity's consideration is in the form of a commission.</li> </ul> <p><b>Sales/excise taxes</b></p> <p>The transaction price is defined to exclude amounts 'collected on behalf of third parties'. There is no additional explicit guidance on the presentation of sales and excise taxes.</p>	<p>imposed on and concurrent with a revenue transaction between a seller and a customer (for example, sales, use, value added, and excise taxes).</p> <p>Reporting these taxes on either a gross basis (included in revenues and costs) or a net basis (excluded from revenues) is an accounting policy election that requires disclosure.</p>	<p>collected by the entity, such as sales taxes, that the entity collects on behalf of the third party. There is no specific guidance on excise or use taxes.</p>
	<p><b>Potential impact:</b></p> <p><b>Principal/agent</b></p> <p>The explicit guidance currently in US GAAP for determining whether to present certain items billed to customers (that is, out-of-pocket expenses) as revenue or as a reduction of costs has been superseded by the new revenue standard.</p> <p>An entity should use the principal/agent framework to determine whether its promise is to provide a good or service (principal) or to arrange for a third party to provide goods or services (agent).</p> <p>The indicators of a principal or agent relationship in the revenue standard are similar to the current guidance in IFRS and US GAAP. The guidance does not weigh any of the indicators more heavily than others. The criteria should be carefully considered to determine whether an entity is the principal or an agent. There are no specific rules for specific transactions such as shipping and handling. There could be a difference between today's accounting and the application of the revenue standard.</p> <p><b>Sales/excise taxes</b></p> <p>The policy election regarding gross or net presentation of taxes collected from customers in US GAAP has been eliminated. Amounts collected on behalf of third parties, such as certain sales or excise taxes, are not included in the transaction price as they are collected from the customer on behalf of the government. The entity is the agent for the government in these situations.</p> <p>The name of the tax (for example, sales tax or excise tax) is not always determinative when assessing whether the entity is the principal or an agent for the tax. Whether or not the customer knows the amount of tax also does not</p>	

New model	Current US GAAP	Current IFRS
	necessarily impact the analysis. Management needs to look to the underlying characteristics of the tax and the tax laws in the relevant jurisdiction to determine whether the entity is primarily obligated to pay the tax or whether the tax is levied on the customer. This could be a significant undertaking for some entities, particularly those that operate in numerous jurisdictions with different tax regimes.	

## Bill-and-hold arrangements

Consumer product manufacturing entities may have bill-and-hold arrangements with their customers whereby the entities bill customers for goods, but do not deliver those goods until a later date. Retailers may have similar arrangements whereby customers are offered layaway services. Entities can currently recognise revenue when the product is billed (rather than on delivery) if the arrangement meets certain criteria.

New model	Current US GAAP	Current IFRS
<p>The new revenue standard focuses on when control of the goods transfers to the customer to determine when revenue is recognised. A customer may obtain control of a product even though that product remains in the vendor's physical possession in some circumstances. A customer has control when it has the ability to direct the use of, and obtain the remaining benefits from, the product, even if it does not have physical possession of the product.</p> <p>For a customer to have obtained control of a product in a bill-and-hold arrangement, the following criteria must be met: (1) the reason for the arrangement is substantive, (2) the product has been identified separately as belonging to the customer, (3) the product is ready for delivery in accordance with the terms of the arrangement, and (4) the vendor does not have the ability to use the product or sell the product to another customer.</p>	<p>All of the following criteria must be met to recognise revenue when delivery has not occurred: (1) risks of ownership have passed to the customer, (2) the customer has made a fixed commitment, (3) the arrangement has substantial business purpose, (4) there is a fixed schedule for delivery, (5) there are no other performance obligations of the seller, (6) the product is identified separately as belonging to the customer, and (7) the product is ready for shipment in its present condition.</p>	<p>Revenue is recognised in bill-and-hold transactions based on generally the same requirements as US GAAP, except there is no requirement for a fixed schedule of delivery.</p>

New model	Current US GAAP	Current IFRS
	<p><b>Potential impact:</b></p> <p>Entities will need to consider the facts and circumstances of their arrangements to determine whether control of the product has transferred to the customer prior to delivery.</p> <p>The requirement to have a fixed delivery schedule often precludes revenue recognition for bill-and-hold arrangements under current US GAAP; however, this requirement is not included in the new revenue standard.</p> <p>An entity that has transferred control of the goods and met the bill-and-hold criteria to recognise revenue needs to consider whether it is providing custodial services in addition to providing the goods. If so, a portion of the transaction price should be allocated to each of the separate performance obligations (that is, the goods and the custodial service).</p>	

### *Example 16 – Bill-and-hold arrangement*

**Facts:** A video game company enters into a contract to supply 100,000 video game consoles to a retailer. The contract contains specific instructions from the retailer about where the consoles should be delivered. The video game company must deliver the consoles in the next year at a date to be specified by the retailer. The retailer expects to have sufficient shelf space at the time of delivery. As of year-end, the video game company has inventory of 120,000 game consoles, including the 100,000 relating to the contract with the retailer. The 100,000 consoles are stored with the other 20,000 game consoles, which are all interchangeable products; however, the video game company will not deplete its inventory below 100,000 units.

When should the video game company recognise revenue for the 100,000 units to be delivered to the retailer?

**Discussion:** The video game company should not recognise revenue until the bill-and-hold criteria are met or if it no longer has physical possession and all of other criteria related to the transfer of control have been met. Although the reason for entering into the bill-and-hold transaction is substantive (lack of shelf space), the other criteria are not met, the game consoles produced for the retailer are not separated from other products.

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## About PwC's Retail & Consumer practice

Within PwC, we have combined both retail and consumer-oriented companies into one practice group. Drawing on the talents of approximately 15,000 partners and professional staff worldwide dedicated to serving clients within the R&C sector, we help companies to solve complex business problems and measurably enhance their ability to build value, manage risk, and improve performance in an internet-enabled world by providing industry-focused assurance, tax, and advisory services.

Our R&C practice is a leading financial accounting, tax, and advisory consulting business. Our experience cuts across all geographies and all segments of the R&C sector, serving the food & beverage, health & beauty care, tobacco & confectionery, and other consumer products manufacturers, as well as a broad spectrum of retailers to include food, drug, mass merchandisers, and specialty retailers. Our combined R&C practice allows us to understand issues across the entire supply chain, from source to sale, and to easily transfer our knowledge to clients related to attesting to and ensuring the accuracy of financial statements and reporting systems, providing local, state, and global tax and compliance advice, managing and mitigating enterprise risk, improving business processes and operations, implementing technologies, and helping clients with mergers and acquisitions to drive growth and improve profitability.

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 184,000 people who are committed to delivering quality in assurance, tax and advisory services.

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## Questions?

PwC clients who have questions about this *In depth* should contact their engagement partner. Engagement teams that have questions should contact members of the Revenue team in Accounting Consulting Services.