Such as warranty

If the consideration promised in a contract has an element of variability, whether it be explicitly stated in the contract or customers have a valid expectation (e.g., inferred from customary business practices) the entity will accept an amount lower than that stated in the contract, or there is an intention to offer a price concession to a customer, then the contract is considered to include "variable consideration" for the purposes of applying IFRS 15.

EXAMPLE: VOLUME DISCOUNT

HOW TO ANSWER Q2,3 AND SCORE PROFESSIONAL MARKS FOR CLARITY AND QUALITY OF THE DISCUSSION

On January 1, 20XX, an entity (with a December 31 year end) enters into a contract with a customer for the sale of a product for total consideration of $100/unit for a one-year period. If the customer purchases more than 75 units of this product, the total consideration will be $80/unit retrospectively applied (i.e., all purchases will be at $80/unit). Initially, the entity does not believe the customer will purchase more than 75 units. However, on May 20, 20XX, the entity infers from the customer's purchasing pattern that the customer will in fact meet this target. Assume that the purchase pattern is as follows:

The basic premise that supports the reasoning that is developed.

January	10 units
February	15 units
March	15 units
May 20	12 units

The fixed component is conditional on the inference that the customer will infact purchase more than 75 units.

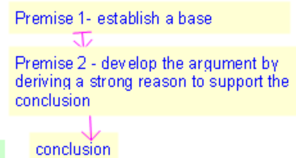
Because the total contract consideration of $100/unit includes a fixed component (i.e., $80/unit) and a variable component (i.e., $20/unit), the variable component must be assessed to determine the estimated value and whether this amount should be constrained. Consider the following:

This is a good way to start a question 2 discussion: get straight to the point; embed the reference to the scenario; move the argument quickly to its supportable conclusion.

Answers the question: (not what should the revenue be but) why should the revenue be $100/unit?

DEDUCTIVE REASONING

- **Contract Inception**
  Based on past history (that has predictive value) with this particular product and the customer, the entity does not believe the customer will meet the target required for the consideration to drop to $80/unit. The entity believes instead there is a high probability a significant revenue reversal will not occur because the target expected purchases will *not* exceed 75 units and therefore the entity expects to be entitled to consideration of $100/unit rather than $80/unit. The entity records the total consideration amount of $100/unit.



CORE QUALITIES OF THIS ANSWER you can apply to score full marks including professional marks.

Flow of thought

Unity and coherence
- Using the data to develop the arguments (see deductive reasoning)
- Embedding the reference to write succinctly with precision

Technical language

CONTINUED BELOW

EXAMPLE: VOLUME DISCOUNT

- **March 31, 20XX**
  If the conclusions reached at inception remain appropriate, revenue for the period ending March 31, 20XX will be recognized using the $100/unit price.

IF ... THEN...

- **May 20, 20XX**
  The entity now estimates that because of increased purchases the customer will likely exceed the targeted 75 units. It is now highly probable a significant revenue reversal will occur. Therefore revenue will have to be retrospectively adjusted to the $80/unit price. This adjustment will be recorded in the current period, meaning May 20XX (i.e., in Q2).

Premise (explanation)
Premise (consequence)
Conclusion

Time Period	Amount of Revenue to Be Recognized	
January—March	$4,000	= (10+15+15 units) × $100/unit
May 20	$160	= (10+15+15 units) × ($80/unit-$100/unit)[14] + (12 units) × $80/unit

Consideration Payable to a Customer

Another factor that must be considered when determining the transaction price is "consideration payable to a customer".

Consideration payable to a customer may constitute a payment for distinct goods or services, or payment of a discount or refund. Some common examples include coupons, vouchers, signing bonuses, slotting and listing fees, etc. This type of consideration must be accounted for as a reduction of the transaction price (and therefore revenue), unless it is related to a distinct good or service received from the customer, in which case there is no reduction of the transaction price and the transaction would be treated as a regular purchase similar to any other external third-party purchase. Additionally, if this amount is variable when determining the transaction price, the variable consideration constraint must be assessed.

Transaction price v revenue
- conceptual significance
- operational signifgicance

14 Change in transaction price for the reduction of revenue

MONITOR DEVELOPMENTS

IASB | FASB Joint Transition Resource Group for Revenue Recognition (TRG)

The topic of a significant financing component was discussed by the TRG at its January 2015 meeting. Specific questions brought to the attention of the TRG were:

- Should the factor in IFRS 15 paragraph 62(c) be applied broadly?
- If the implied interest rate in an arrangement is zero (i.e., interest free financing) such that the consideration to be received is equal to the cash selling price, does a financing component exist?
- How should an entity adjust for the time value of money in situations where the consideration is received upfront and revenue is recognized over multiple years?

Stakeholders should monitor developments on this issue.

To download audio recordings or meeting reports of agenda topics visit www.ifrs.org or click here.

Rather like presentation of pension expense

Interest income or interest expense resulting from a significant financing component should be presented separately from revenue from contracts with customers. An entity might present interest income as revenue in circumstances in which interest income represents income from an entity's ordinary activities.

8. Sales with a Right of Return

How are sales returns accounted for under IFRS 15?

How does this work in practice?

How does this compare with sales on warranty?

Sales returns are a form of variable consideration. IFRS 15 provides specific guidance for this form of variable consideration.

Entities in many industries (e.g., retail, industrial products, consumer products, etc.) often grant customers a right of return with purchased goods, which may result in one of the following:

- a full or partial refund of any consideration paid
- a credit applicable to amounts owed, or that will be owed, to the entity
- another product in exchange (e.g., "stock rotation rights").

Under IFRS 15, when sales are made to customers with a right of return, the selling entity will need to account for them as follows:

How is this determined? - considerable judgement is involved;

a. Recognize revenue for the consideration to which the entity expects to be entitled. In making this assessment, entities must apply the guidance on variable consideration, including the constraint. Therefore, for the goods the entity estimates are going to be returned, no revenue is recognized (i.e., because it is highly probable that a significant revenue reversal will occur), rather a refund liability is recognized (refer to step 2 below).

Not a contingent liability - what is this based on?

b. Set up a liability for the amount of consideration the entity expects it will have to refund (i.e., products expected to be returned).

DR Asset
CR Inventory

which is included in cost of sales when a refund liability is settled.

Contingent asset?

confusing

c. Set up an asset with a corresponding entry to cost of sales for the right to recover products when a refund liability is settled (i.e., this will be at the cost of the initial inventory less any expected costs to recover the products).

EXAMPLE: ACCOUNTING FOR PRODUCT RETURNS

A retailer has a stated policy that any products may be returned within 30 days subject to a cap of 20% (i.e., only up to a maximum of 20% of goods purchased may be returned within the 30 day window).

On January 1, 20XX, the retailer introduced a new product with a carrying value of $35 in inventory. The following return patterns occurred during the next three months:

January	1% returned
February	19% returned
March	5% returned

This data enables an assessment of the variability of returns to determine if it is highly probable that a significant reversal of the cumulative recognized revenue will not occur if the variable element is included in the transaction price. Notice how the reasoning develops on this foundation.

Deductive reasoning

On April 1, 20XX, the retailer enters into a new contract and sells 150 units of this new product at a price of $50/unit. However, given that the product has been newly introduced to the market and there is a large range of possible consideration amounts (i.e., as evidenced by the pattern of returns over the last few months), the retailer is unable to assert that it is highly probable a significant revenue reversal will not occur for the variable component (i.e., the 20%). Therefore this variable consideration (i.e., 20% of the transaction price subject to return) cannot be recognized until May 1, 20XX, when the 30-day right of return lapses and the following entries will be made:

Premise

Premise

Conclusion

Refer, do not restate:
How to use scenario data without restating it. Use "given", "because", "as", "since" to begin sentences or to link clauses in developing arguments with evidence from the scenario.

Time Period	Entries	DR	CR
April 1, 20XX	Dr Asset (right to recover product)	$1,050	
	Dr Cost of Sales	$4,200	
	Cr Inventory		$5,250
	Dr Cash	$7,500	
	Cr Refund Liability		$1,500
	Cr Revenue		$6,000
	As sales of the product occur.		
May 1, 20XX	Dr Refund Liability	$1,500	
	Cr Revenue		$1,500
	Dr Cost of Sales	$1,050	
	Cr Asset (right to recover product)		$1,050
	When the 30-day refund period lapses (assuming no returns).		