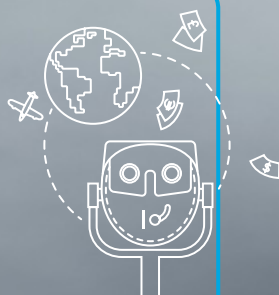


Financial INSIGHT

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CHANGES TO REVENUE RECOGNITION – DON'T BE CAUGHT OUT

The nature of revenue is changing. Underestimating the impact of the new revenue recognition standard may result in unforeseen issues surfacing at year-end. It is vital to assess the impact now, as waiting until you first prepare financial statements under the new standard will not leave enough time to address all the issues.

[AASB 15 Revenue from Contracts with Customers](#) came into force for periods beginning on or after 1 January 2018. This means that entities with a 31 December year-end should already be operating under the new rules, while those whose financial year finishes on 30 June will start to apply the standard from 1 July 2018. [RSM's previous article](#) explained the requirements of the new standard, and the five-step process behind when revenue may be recognised.

It is tempting to assume that there will be no impact, or that any impact will not be material – what you sell hasn't changed, after all, and the revenue figure in the financial statements is just the result of these sales. However, this is a dangerous assumption that often does not match reality. In helping entities implement the new standard, we have come across several common areas where the accounting treatment can be significantly different under AASB 15.

JOINING OR MEMBERSHIP FEES

It is common for sports or social clubs, and other membership-based organisations, to charge a joining or nomination fee to members. Such payments are often, one-off, non-refundable, and payable at the start of membership. Previously, they were usually recognised immediately, and on the basis that they were refundable, and that there was a separate annual membership fee that was recognised over time.

However, under AASB 15, revenue can only be recognised when the performance obligation to the customer is satisfied. In the case of a membership to a club, it is satisfied over time, as the customer enjoys the benefits of access to the club and its facilities. Therefore, the joining fee must be deferred, and only recognised over the term of the membership that the member has purchased.

CONTRACTS WITH EARLY-COMPLETION BONUSES OR LIQUIDATED DAMAGES

Construction contracts, and other significant bespoke arrangements, often contain "bonus" or "damages" clauses. Such clauses may present the arrangement as a bonus for early completion, or a price reduction for delays. They may be in the form of an adjustment to the price formula, or they may be described as liquidated damages. Regardless of their legal form in the contract, they would all fall under AASB 15's new rules on variable consideration.

Where the amount payable by a customer under a contract is variable, AASB 15 requires the entity to estimate the likely outcome, and recognise revenue based on that. This is further subject to a variable consideration constraint, which requires that the estimate should be made sufficiently prudently that only very rarely is previously recognised revenue reversed.

Example

XYZ Construction signs a contract to build a building for a customer for \$10 million, on that customer's land. The contract specifies a completion date, and provides that, for each day after this date that the contract is completed, liquidated damages of \$10,000 are payable.

At the next year-end, XYZ estimates that it will be 50 days late in delivering the building. The building is 50% complete.

XYZ would therefore reduce the total revenue it expects to generate from that contract by \$500,000 to \$9.5m. It would recognise only \$4.75m of revenue for that year.

PROMPT PAYMENT DISCOUNTS OR VOLUME REBATES

The requirement to estimate variable consideration also covers any form of rebate or discount offered to customers. The scope of this requirement is wide, and may include for example, volume rebates offered to key customers, trade discounts, prompt payment discounts, seasonal pricing adjustments, marketing support credits, or any other contractual term that may cause the price of the contract to vary. These can often be buried deep within complex contracts.

Example

DistCo is an importer and wholesale distributor of electrical components. It invoices its customers with 60 day credit terms, but offers a 3% discount if invoices are paid within two weeks. The majority of customers take advantage of this discount.

Previously, DistCo may have recognised revenue based on the face value of its invoices, with the prompt payment discount treated as an administration expense. Under AASB 15, on delivery of goods with an invoice price of \$1m, DistCo would only recognise revenue of \$970,000. The remaining \$30,000 would be recognised after two weeks, if the customer had not accepted the discount.

REFUNDS OR GUARANTEES

If you sell a product with any sort of refund option, warranty, or guarantee included, then there may be an accounting impact. The treatment depends on the nature of the guarantee, which will require assessment for each type of contract.

“Assurance” guarantees relate only to the correct functioning of a product in line with its expected use, and the offer to replace or repair it if defective. These are not considered to be a separate performance obligation, as they are not distinct from the delivery of the product itself. Therefore, no revenue is deferred in respect of such arrangements. Consistent with current practice, a provision would be recognised under AASB 137 Provisions, Contingent Liabilities, and Contingent Assets, for the estimated expense of meeting such obligations.

Guarantees or extended warranties which are sold separately are always considered a separate performance obligation, against which revenue should be allocated and recognised over the term of the warranty.

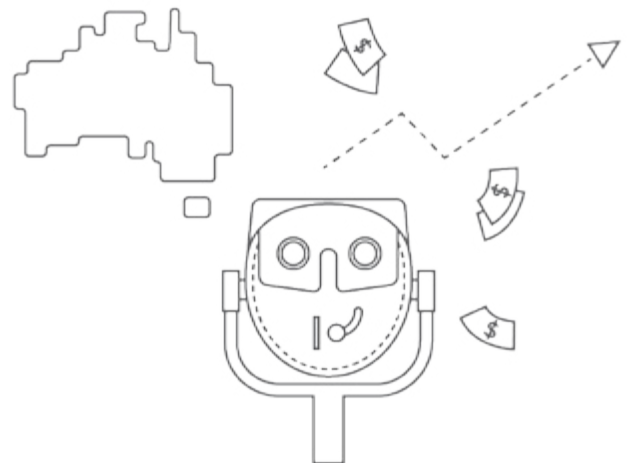
It is common for retailers to offer a “no questions asked” refund period, during which customers can return goods in a saleable condition. In such cases, revenue equal to the estimated amount of goods expected to be returned needs to be deferred to account for sales that will not be completed.

LICENSING

Licences of intellectual property (for example, software, brands, or media rights) fall under one of two categories under AASB 15:

- A right to access the intellectual property as it exists throughout the licence period, which is recognised over the licence term.
- A right to use the intellectual property in the form in which it exists when the licence is granted, which is recognised at a point in time.

The distinction between a right-to-use and a right-to-access can be a complex and challenging one, requiring the application of judgment. It will depend on whether there is a promise to provide future enhancements to the licensed material. Such a promise can be either explicit in the contract, or implicit through customary business practice.



Further information

RSM's National Technical accounting consulting team have been assisting businesses across multiple industries in applying the new standard, and in determining the necessary changes to their systems and processes. We strongly encourage affected entities to prepare a transition plan as soon as possible, and to seek advice where appropriate.

For further information, please contact Ralph Martin, National Technical Director, or your local RSM adviser.

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