Ind AS
Worked Example

Customer Loyalty Program
under Ind AS 115

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How to account for a Customer Loyalty Program under Ind AS 115

SCENARIO

KMR Ltd, a multinational chain store dealing in retail garments has a customer loyalty programme that rewards a customer with 1 customer loyalty point for every CU 100 of purchases. Each point is redeemable for a CU 5 discount, which is linked to individual purchases or groups of purchases or to continued purchases for a period of 3 years. The applicable income tax rate is 40%.

During a reporting period, customers purchase products for CU 200,000 and earn 2,000 points (CU 200,000 ÷ CU 100) redeemable for future purchases. KMR Ltd expects 1,800 points to be redeemed on the basis of its past experience that it concludes is predictive of the amount of consideration to which it will be entitled. KMR Ltd estimates a stand-alone selling price of CU 4.50 (CU 5 x 1,800 ÷ 2,000) per point or CU 9,000 total (1,800 x CU 5) on the basis of the likelihood of redemption, in accordance with the following:

PARAGRAPH REFERENCE

As per **paragraph B42 of Ind AS 115** “an entity should allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the stand-alone selling price for a customer’s option to acquire additional goods is not directly observable, an entity shall estimate it. That estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following –

- any discount that the customer could receive without exercising the option; and
- the likelihood that the option will be exercised.”

The points provide a material right to customers that they would not receive without entering into a contract. Hence, KMR Ltd concludes that the points are a *separate performance obligation*.

KMR Ltd allocates the transaction price to the sales of retail garments and the customer loyalty points on a relative stand-alone selling price as follows –

Sales of products	CU 191,388	[CU 200,000 x CU 200,000 ÷ (CU 200,000 + CU 9,000)]
Customer loyalty points	CU 8,612	[CU 200,000 x CU 9,000 ÷ (CU 200,000 + CU 9,000)]
Transaction price	**CU 200,000**	

The consideration allocated to the customer loyalty points will be recognised as revenue when they are redeemed and KMR Ltd fulfils the obligations to supply the customer loyalty points. The amount of revenue recognised shall be based on the number of customer loyalty points that have been redeemed, relative to the total number expected to be redeemed.

Journal			
1.	Cash	CU 200,000	
	Revenue		CU 191,388
	Contract liability		CU 8,612

A deductible temporary difference arises and results in a deferred tax asset, when the carrying amount of revenue received in advance is more than its tax base. In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, *less* any amount of the revenue that will not be taxable in future period. The deferred tax asset is –

[(Carrying amount – Tax base) x Income tax rate]

= [(CU 8,612 – 0) x 40%]

= CU 3,445

2.	Deferred tax asset	CU 3,445	
	Deferred tax income		CU 3,445
3.	Deferred tax income	CU 3,445	
	Tax expense		CU 3,445

At the end of the 1st reporting period, 1,000 points have been redeemed and KMR Ltd continues to expect 1,800 points to be redeemed in total. KMR Ltd recognises revenue for the loyalty points of CU 4,784 (CU 8,612 x 1,000 points ÷ 1,800 points).

Journal			
1.	Contract liability	CU 4,784	
	Revenue		CU 4,784
2.	Tax expense	CU 1,914 (CU 4,784 x 40%)	
	Deferred tax asset		CU 1,914

During the 2nd reporting period, an additional 200 points are redeemed (cumulative points redeemed are 1,200). KMR Ltd expects that 1,900 points will be redeemed in total. The cumulative revenue that KMR Ltd recognises is CU 5,440 [(1,200 points ÷ 1,900 points) x 8,612]. KMR Ltd has recognised CU 4,784 in the 1st reporting period, so it recognises revenue for the loyalty points of CU 656 (CU 5,440 – CU 4,784)

Journal			
1.	Contract liability	CU 656	
	Revenue		CU 656
2.	Tax expense	CU 262 (CU 656 x 40%)	
	Deferred tax asset		CU 262

In the 3rd reporting period, an additional 700 points are redeemed (cumulative points redeemed are 1,900). KMR Ltd has already recognised revenue of CU 5,440, so it recognises revenue for the loyalty points of CU 3,172 (CU 8,612 – CU 5,440).

Journal			
1.	Contract liability	CU 3,172	
	Revenue		CU 3,172
2.	Tax expense	CU 1,269 (CU 3,172 x 40%)	
	Deferred tax asset		CU 1,269