IND AS WORKED EXAMPLE

Accounting for Customer Loyalty Program under Ind AS 115

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Worked Example

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SCENARIO

KMR Ltd, a multistate chain store dealing in retail garments has a customer loyalty program that rewards a customer with customer loyalty points for a certain amount of purchases.

ADDITIONAL INFORMATION

1 customer loyalty point for	every CU 100 of purchases
Each point redeemable for	CU 5 discount, which is linked to individual purchases or groups of purchases or to continued purchases for a period of 3 years.
Income tax rate	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.

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***.

A performance obligation is a promise in a contract with a customer to transfer to the customer either –

- a good or service (or a bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have been the same pattern of transfer to the customer.

WHAT THE STANDARD SAYS

An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie, an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price that is allocated to that performance obligation.

OUR VIEW

It can be comprehended that the rights and obligations in a contract with a customer are interdependent – the right to receive consideration from a customer depends on the entity's performance obligation and, similarly, the entity performs only as long as the customer continues to pay within the stipulated period.

In a customer loyalty program, customers are given an option to purchase additional goods or services. Therefore, it is an option that the customer pays for as part of an existing contract, which would be a performance obligation to which part of the transaction price is allocated. **An entity is required to determine the stand-alone selling price of the option so that it can allocate part of the transaction price to that performance obligation.**

SOLUTION

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

Performance obligation	Amount	Calculation
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

		Dr	Cr
1.	Cash	CU 200,000	
	Revenue		CU 191,388
	Contract liability		CU 8,612 **

** *Contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration from the customer. An entity can use different descriptions of contract liabilities and additional line items to present those liabilities.*

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