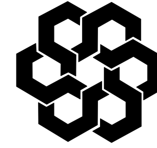

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International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: **November 2007, London**

Project: **Deposits on returnable containers (Agenda Paper 7B)**

Background

1. In some industries, eg brewers, heating gas, entities distribute their products in returnable containers. These entities often collect a deposit for each container delivered and have an obligation to refund this deposit when containers are returned by the customer. The original invoice may be required to be presented with the container for the deposit to be repaid. Depending on the nature of the product, the value of the deposit, and the alternative uses for the returnable containers, a large or small proportion of the deposits is unlikely to be claimed from the entity.

Issue

2. The issue is how the entity's obligation to refund the deposit for returned containers should be accounted for. A subsequent issue is when revenue should be recognised from sales of containers.

Staff analysis

1) Is the obligation a financial liability?

3. Some believe that the obligation meets the definition of a financial liability and should be accounted for in accordance with IAS 39.

4. The staff note that paragraph 11 of IAS 32 defines a financial instrument as 'any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity'. Therefore, the entity's obligation to exchange cash for returned containers (non-financial assets) does not meet the definition of a financial instrument in accordance with IAS 32.

2) If not, what are the relevant standards to account for the obligation?

5. The staff note that the obligation relates to the recognition of revenue from the sales of containers and, therefore, IAS 18 *Revenue* applies in the first place:

   - Does paragraph 13 or paragraph 19 of IAS 18 apply?
   - Can an analogy be drawn with a sale of goods with right of return?

Does paragraph 13 or paragraph 19 of IAS 18 apply?

6. The staff note that, when discussing the issue of customer loyalty programmes, three views emerged (see BC 6 to BC 9 of IFRIC 13 *Customer Loyalty Programmes*):

   - One view was that the obligation to provide free or discounted goods or services should be recognised as an expense at the time of the initial sale (applying paragraph 19 of IAS 18) and be measured by reference to the amount required to settle it in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
   - A second view was that some of the consideration received in respect of the initial sale should be allocated to the awards credit and recognised as a liability until the entity fulfils its obligation to deliver awards to customers (applying paragraph 13 of IAS 18).
   - A third view was that the accounting should depend on the nature of the customer loyalty programme.

7. BC 9 of IFRIC 13 states that 'In the IFRIC's view, paragraph 13 applies if a single transaction requires two or more separate goods or services to be delivered at different times; it ensures that revenue for each item is recognised only when that item is delivered. In contrast, paragraph 19 applies only if the entity has to incur further costs directly related to items already delivered, eg to meet warranty claims' (emphasis added).
8. Therefore, the staff believe that the first view above is relevant in the context of the issue of deposits on returnable containers because both contents and containers are delivered at the same time.

Can an analogy be drawn with a sale of goods with right of return?

9. The staff are of the view that an analogy to sales of goods with right of return by the buyer can be drawn. Paragraph 17 of IAS 18 states that 'Another example of an entity retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Revenue in such cases is recognised at the time of sale provided the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors'.
10. Whilst IAS 18 does not give detailed guidance on how to measure the liability, the staff note that, to be consistent with warranties, the entity should refer to IAS 37.
11. If the seller cannot reliably estimate future returns, then revenue should be deferred. Paragraph 2(b) of the Appendix to IAS 18 gives an example and states that 'If there is uncertainty about the possibility of return, revenue is recognised when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.'
12. The staff note that US GAAP and UK GAAP also provide guidance on revenue recognition when a right of return exists. This guidance is generally consistent with IAS 18:
    - SFAS 48 *Revenue Recognition When a Right of Return Exists* requires revenue from the sales transaction to be recognised at time of sale only if six conditions are met and any costs or losses that may be expected in connection with any returns are accrued.

- FRS 5 - Application note G paragraphs G49 to G59 deal with sales with rights of return and requires accounting for revenue from such sales 'to the extent that [the seller's] performance has earned it the right to consideration, taking account of the expected loss […]. The amount recorded as turnover should exclude the sale value of estimated returns from the total sales value of the goods supplied to customers'.

Staff conclusion

13. The staff believe that, under existing guidance, revenue from the sales of returnable containers should be recognised at the time of delivery (that is, at the same time as the sale of contents) provided the seller can reliably estimate future returns and recognises a liability for returns in accordance with IAS 37.

Staff recommendation

14. The staff do not support the view that the obligation meets the definition of a financial liability (see paragraphs 3 to 4 of this paper).
15. The staff conclude in paragraph 13 that the obligation should be accounted for in accordance with IAS 37. The staff had asked IFRIC members whether diversity exists in practice. From the responds received, it appears that divergence in this area is unlikely to be significant.
16. In respect of the revenue recognition issue (that does not form part of the submission) the staff believe that any guidance beyond that given in IAS 18 and IFRIC 13 would be more in the nature of application guidance than an Interpretation.
17. For these reasons, the staff recommend the IFRIC not to take this item on its agenda.
18. **Questions to the IFRIC: do you agree with the staff recommendation not to take this item onto the agenda and the wording for such decision set out in the appendix to this paper?**

Appendix: proposed wording for rejection

[Appendix removed from observer notes]