Accounting

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IFRS Viewpoint

Inventory discounts and rebates

What's the issue?

Discounts and rebates can be offered to purchasers in a number of ways, for example trade discounts, settlement discounts, volume-based rebates and other rebates. Accounting for these reductions will vary depending on the type of arrangement. This IFRS Viewpoint provides our views on the purchaser's accounting treatment for the different types of rebate and discount along with some application examples.

Our 'IFRS Viewpoint' series provides insights from our global IFRS team on applying IFRSs in challenging situations. Each issue will focus on an area where the Standards have proved difficult to apply or lack guidance.

Relevant IFRS

IAS 2 Inventories

IFRS 15 Revenue from Contracts with Customers

IAS 1 Presentation of Financial Statements

Our view

Below is an overview of the accounting treatment of a variety of discounts:

Type of discount	Description	Treatment
Trade discount	A reduction in the price charged when a vendor makes a sale to a reseller rather than directly to the end customer	Deduct from the cost of inventories.
Settlement discount	A discount for payment within a certain time period	Deduct settlement discounts received from the cost of inventories, such that the inventory and related liability are initially recorded at the net (lower) amount. If a settlement discount is available but not taken, our preferred view is to record the inventory net of the available discount and record the additional amount as a finance charge. An acceptable alternative is to record the inventory at the amount actually paid (provided the invoice is payable within normal credit terms).
Inventory-related rebate	A discount for retrospective and volume-based rebates	Recognise once receipt is probable. Once recognised, the rebate should be recorded as a reduction to the cost of the related inventory.
Other rebate	A rebate that does not in substance relate to the inventory purchase, for example contributions to promotional costs	The appropriate accounting treatment will depend on the specific arrangement.

More analysis

Trade discounts

IAS 2 'Inventories' requires that: 'trade discounts, rebates and other similar items are deducted in determining the cost of purchase'. The treatment of trade discounts is therefore clear.

Settlement discounts

The treatment of settlement discounts is not specified by IAS 2. However, in November 2004 the IFRS Interpretations Committee (IFRIC) considered this and issued a so-called 'agenda decision' concluding that settlement discounts received should be deducted from the cost of the inventories.

The IFRIC did not provide guidance on accounting for settlement discounts that are not taken. Our preferred view is that inventory purchases for which the supplier offers a settlement discount should be recorded net of the available discount. Under this view, if the purchaser does not take advantage of the discount the additional amount paid is recorded as a finance charge.

This is because:

- a settlement discount is effectively a financing arrangement and should be accounted for accordingly; and
- the amount recorded for the related liability on initial recognition should be its fair value, which should not exceed the amount that would be paid to settle the liability at that date.

However, in the absence of authoritative guidance we consider that it is also acceptable record the inventory at the amount actually paid (ie gross of the settlement discount that was available but not taken), provided that the purchase is on normal credit terms. However, if the purchase is on deferred settlement terms and effectively contains a financing element, that element is recognised as interest expense over the period of the financing.

Inventory-related rebates

In our view, volume-based discounts should be recognised when it is **probable** they will be received. When the 'cost' for IAS 2 purposes is subject to uncertainties, the most likely cost is used. Therefore rebates that are probable should be deducted from the cost of the inventory and recognised as a prepayment or similar asset. The probability of obtaining the rebate should be reviewed at future period ends if the arrangement remains open. If receipt is no longer probable, then the prepayment asset should be reversed with a corresponding adjustment to inventories and/or cost of sales as appropriate.

If receipt of the rebate is not probable, or the amount cannot be measured reliably, then the inventory should be recorded at its gross amount. Again, this assessment should be reviewed regularly. If the conclusion changes, then the rebate should be recorded at this stage (refer to example). If at this point some of the related inventory has been sold, then the proportion of the discount relating to those items should be reflected in cost of sales.

The discount recorded should be based on the number of units purchased and should result in a reduction to the cost of those units.

Other rebates

It is common in some industries for purchasers to enter into arrangements that involve receiving payments from their suppliers ('supplier payment arrangements'). These arrangements vary widely and can be complex. Some of these arrangements relate to inventory purchases but others do not. This IFRS Viewpoint is not intended to provide comprehensive guidance on accounting for supplier payment arrangements but some of the factors to consider are discussed briefly below.

"In our view, volume-based discounts should be recognised when it is **probable** they will be received."

Supplier payment arrangements require careful analysis to determine whether they relate to inventory purchases or to something else. In making this analysis it should be noted that the legal description of the arrangement may not always reflect its substance. If these arrangements do not relate to inventory purchases, further analysis is required to determine the timing, amounts and presentation of any income arising. In a November 2004 agenda decision, the IFRIC concluded that rebates that "specifically and genuinely refund selling expenses" should not be deducted from the cost of inventories. This IFRIC agenda pre-dates the publication of IFRS 15, and this Standard should be considered in the analysis once it becomes effective.

If a supplier payment arrangement involves the purchaser providing goods or services to its supplier that are 'distinct' from the inventory purchases, the arrangement could result in revenue being recognised in accordance with IFRS 15. IFRS 15 applies to goods or services that are an output of the entity's ordinary activities. IFRS 15 then provides the applicable guidance on when to recognise the related revenue.

If the purchaser is not providing distinct goods or services the arrangement is likely to relate to inventory purchases, in which case the guidance in this IFRS Viewpoint applies.

In some situations, however, the purchaser might consider that amounts received do not relate to inventory purchases but are incidental to its main revenue-generating activities. In such cases it might be appropriate to present the related income in a ine item other than revenue. For example, if the amounts received are to reimburse specific costs incurred, it may be appropriate to offset the income against those costs in the statement of comprehensive income (see paragraph 34 of IAS 1). In such circumstances judgement will be required to determine the most appropriate presentation.

"If a supplier payment arrangement involves the purchaser providing goods or services to its supplier that are 'distinct' from the inventory purchases, the arrangement could result in revenue being recognised in accordance with IFRS 15."

Examples

Example 1 – settlement discount

Purchaser P buys inventory from supplier S on 1 Jan 20X1. The price is CU1,000 with a 2.5% discount for settlement within 30 days. P decides not to take advantage of the discount, and settles at CU1,000 on 28 Feb 20X1.

Analysis

P records the inventory net of the discount entitlement. The ultimate payment of the discount is recorded as a finance cost. The respective entries are as follows:

1 Jan 20X1 – initial recognition	Debit CU	Credit CU
Inventory	975	–
Current liability	–	975

Period 1 Jan 20X1 – 28 Feb 20X1 – accrue finance cost and record settlement	Debit CU	Credit CU
Finance cost	25	–
Current liability	–	25
Current liability	1,000	–
Cash	–	1,000

Note: in principle, the finance charge should be accrued evenly over the period of the liability, based on estimated cash flows.

Example 2 – volume rebate

Purchaser P buys inventory from supplier S at a basic unit price of CU10 per unit, fixed for the year 20X1. S agrees that if P makes total purchases of at least 10,000 in 20X1, it will pay a rebate of CU5,000 (maximum). At the beginning of the year P's forecast purchases are 8,000 units for the year. However, at 30 June 20X1 P revises its forecast to 11,000 units.

At 30 June 20X1 P has purchased 5,200 units, of which 3,900 have been used/sold. The remaining 1,300 are held in inventory at a cost of CU13,000.

Analysis

At 30 June 20X1, the adjustment to inventory cost has become probable. The revised best estimate of cost per unit for the first 10,000 units is:

(CU10 × 10,000 units – CU5,000)/10,000 units = CU9.50

Note: this calculation is made based only on the first 10,000 units because any purchases in excess of that figure do not attract any further rebate.

The cost of the 5,200 units purchased at 30 June 20X1 should therefore be adjusted downwards by CU0.5/unit. Because 75% of the units have been sold, a proportion of the rebate recognised should be recorded in the income statement (cost of sales). The respective entries are as follows:

30 June 20X1 – record probable rebate	Debit CU	Credit CU
Prepayment (rebate receivable)	2,600	–
Inventory	–	650
Cost of sales	–	1,950

Note: subsequent inventory purchases up to the first 10,000 units are recorded at CU9.5/unit as long as the rebate continues to be probable. Once the 10,000 threshold is exceeded the cost per unit reverts to CU10.

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