



Solution 91.9

Component Index	Service and construction contract revenue Services performed over more than one accounting period
Short title	Sales of extended warranty

Attention: This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety. Guidance based on the previous version of the standards is included in the “Applying IFRS 2004” guidance.

Issue

When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognised by reference to the transaction’s stage of completion at the balance sheet date [IAS18R.20].

How should management recognise the sale of an extended warranty?

Background

Entity A sells electrical goods. The goods come with a manufacturer’s 1-year warranty. Entity A also offers customers the option of purchasing an extended warranty to cover years 2 to 5.

The sales price of the extended warranty is 100 and A typically receives valid warranty claims from 4% of customers during the extended warranty period. The average cost of repairing or replacing the goods under the warranty is 600 per valid claim.

How should management recognise revenue from the sale of the extended warranties and the associated costs?

Solution

Management should defer the revenue and recognise it on a straight-line basis over years 2 to 5, which is the period over which the extended warranty is provided [IAS18R.25].

The costs incurred under the warranty should be charged to cost of sales as incurred.

Management should not recognise a provision for the expected costs of the warranty but should monitor the arrangements to ensure that the expected future cost of the warranty does not exceed the amount of unamortised deferred revenue. The warranty contract will be onerous if, at any time, the expected future costs of meeting the warranty obligations exceed the unamortised



warranty revenue. Management should recognise a provision to the extent that the future warranty costs are estimated to exceed the unamortised warranty revenue.