

## Consumer products sector

# Clearly IFRS

## Industry insights for IFRS 15

*New revenue Standard could impact profile of revenue and profit recognition*

### What's happened?

The International Accounting Standards Board (IASB) has published a new Standard, IFRS 15 Revenue from Contracts with Customers ('the new Standard'). The new Standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, which is found currently across several Standards and Interpretations within IFRSs. The core principle is that an entity recognises revenue to reflect the transfer of goods or services, measured as the amount to which the entity expects to be entitled in exchange for those goods or services.

The new Standard is effective for reporting periods beginning on or after January 1, 2017, with earlier application permitted. Entities can choose to apply the Standard retrospectively or use a modified approach in the year of application. It is the result of a convergence project with the US Financial Accounting Standards Board (FASB) that began in 2002. Almost fully converged, the most significant differences between IFRSs and US GAAP relate to interim disclosures and timing of adoption.

#### Implications for the consumer products sector

Below, we highlight certain key impacts resulting from the new Standard that will be of particular interest to those in the consumer products sector and then consider parts of the new Standard that may contribute to those impacts. Of course many more complexities exist and, as described below, Deloitte has produced further guidance which explores these in greater detail.

### How might this affect you?

#### The timing of revenue and profit recognition may be significantly affected by the new Standard

Whereas previously IFRSs allowed significant room for judgement in devising and applying revenue recognition policies and practices, IFRS 15 is more prescriptive in many areas relevant to the consumer products sector.



Applying these new rules may result in significant changes to the profile of revenue and, in some cases, cost recognition. This is not merely a financial reporting issue. As well as **preparing the market and educating analysts** on the impact of the new Standard, entities will need to consider wider implications. Amongst others, these might include:

- changes to **key performance indicators** and other **key metrics**;
- changes to the **profile of tax cash payments**;
- availability of **profits for distribution**;
- for **compensation and bonus plans**, impact on the timing of targets being achieved and the likelihood of targets being met; and
- potential non-compliance with **loan covenants**.

### Headlines

The **profile of revenue and profit recognition** will change for some entities as the new Standard is more detailed and more prescriptive than the existing guidance and introduces new complexities. In particular, consumer products companies will need to consider:

- whether revenue should be recognised **over time** or at a **point in time**;
- the impact of new guidance where pricing mechanisms include **variable amounts**;
- how **shipping terms** will impact the timing of recognition of revenue;
- the type of **warranty coverage** offered to customers;
- how the new Standard will impact presentation of **payments made to customers**, e.g. slotting fees; and
- whether particular **costs relating to obtaining a contract** must be capitalised.

The new Standard requires significantly more **disclosures** relating to revenue and entities will need to ensure that **appropriate processes** are in place to gather the information.

### Current accounting processes may require changes to cope with the new Standard

As explained below, IFRS 15 introduces new requirements to move to a more conceptual approach. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard in the consumer products sector may require modifications to existing accounting processes. Entities should ensure they allow sufficient time to develop and implement any required modifications to processes.

## What are the most significant changes?

### Should revenue be recognised over time or at a point in time?

IFRS 15 introduces a new approach to determine whether revenue should be recognised over time or at a point in time. Three scenarios are specified in which revenue will be recognised over time – broadly, they are when (i) the customer receives and consumes the benefits of the seller's performance as the seller performs; (ii) the seller is creating a 'work in progress' asset which is controlled by the customer; and (iii) the seller is creating a 'work in progress' asset which could not be directed to a different customer and in respect of which the customer has an obligation to pay for the entity's work to date. If revenue is to be recognised over time, a method should be used which best reflects the pattern of transfer of goods or services to the customer. If a transaction does not fit into any of the three scenarios described above, revenue will instead be recognised at a point in time, when control passes to the customer.

Where consumer products are manufactured under contract, the timing of revenue recognition may be significantly impacted by these new requirements if the products manufactured cannot be directed to another customer and if the manufacturer is entitled to payment for work to date. The former may be the case, for example, where an 'own brand' product is manufactured for a particular supermarket such that the product could not be readily redirected to a different customer. Careful analysis will be required as relatively small differences between otherwise similar contracts could have a fundamental impact on the timing of revenue recognition and could, for example, require entities to recognise revenue over time when previously they have been recognising it at a point in time. It will often be particularly important to focus on contractual terms that allow the customer to cancel, curtail or significantly modify a contract and whether, in such cases, the seller is entitled to adequate compensation for work performed to date.

### When should variable or uncertain revenues be recognised?

Contracts in the consumer products sector can include significant variable elements, such as volume rebates, credits and incentives. There are new specific requirements in respect of variable consideration such that it is only included in the transaction price if it is highly probable that the amount of revenue recognised would not be subject to significant future reversals when the uncertainty is resolved. The approach to variable and contingent consideration is different from that previously reflected in IFRSs and, in certain scenarios, will require a significant degree of judgement to estimate the amount of consideration that should be taken into account. Accordingly, the profile of revenue recognition may change for some entities as a result.

### How will shipping terms impact the timing of revenue recognition?

Under IAS 18, the timing of revenue recognition from the sale of goods is based primarily on the transfer of risks and rewards. IFRS 15 instead focuses on when control of those goods has transferred to the customer. This different approach may result in a change of timing for revenue recognition for some entities. For example, some entities may supply goods on the basis that title passes to the customer at the point of shipment but, as a matter of business practice, may compensate customers for loss or damage during shipping (either through credit or replacement). Previously, revenue may have been recognised only at the point of delivery, on the basis that some exposure to risks and rewards is retained until then. Under IFRS 15, entities will need to assess whether control passes to the customer at the point of shipment or at the point of delivery. This may result in revenue being recognised at a different time. If revenue is recognised at the point of shipment, it may be necessary to allocate part of the transaction price to a distinct "shipping and risk coverage" service, with that element of revenue recognised when the service is provided.



### How should warranties be accounted for?

The new Standard distinguishes between a warranty providing assurance that a product meets agreed-upon specifications (accounted for as a cost provision) and a warranty providing an additional service (for which revenue will be deferred). Consideration of factors such as whether the warranty is required by law, the length of the warranty coverage period, and the nature of the tasks the entity promises to perform will be necessary to determine which type of warranty exists. If a customer can choose whether or not to purchase a warranty as an 'optional extra', that warranty will always be treated as a separate service. Where a warranty is determined to include both elements (assurance and service), the transaction price is allocated to the product and the service in a reasonable manner (if this is not possible, the whole warranty is treated as a service).

In the consumer products sector, it is common for warranties to include both elements. For example, a warranty may both assure the quality of the product and provide a free maintenance plan for two years. Where a warranty contains both elements, judgement will be needed in order to determine how to allocate the transaction price in a reasonable manner, and this may result in warranties being accounted for differently than at present.

### How will the new Standard impact the presentation of payments made to customers, e.g. slotting fees?

In this sector, suppliers often make payments to retailers of their products in order to have their products prominently displayed, or for co-operative advertising (advertising by the retailer of the supplier's product). Under the new Standard, there is explicit guidance that addresses how to account for payments made to a customer. Suppliers will need to consider whether the payment is made for a separate good or service or should alternatively be treated as a deduction from revenue.

### Should contract costs be capitalised?

In addition to more prescriptive guidance on revenue recognition, the new Standard introduces specific criteria for determining whether to capitalise certain costs, distinguishing between those costs associated with obtaining a contract (e.g. sales commissions) and those costs associated with fulfilling a contract. In the consumer products sector, this becomes an issue because significant costs may be incurred that are directly attributable to obtaining contracts with customers, for example sales commissions that are only payable if a contract is obtained. At present, different entities might treat these costs differently. The new Standard will require entities to capitalise success fees, which will have an impact on operating profits. In addition, the new Standard requires capitalised contract costs to be amortised on a systematic basis that is consistent with the pattern of transfer of the goods or services. Entities will need to exercise judgement to determine the appropriate basis and time period for this amortisation.

## What else might change?

In addition to the key changes discussed above, the new Standard introduces detailed guidance in many areas regarding the reporting of revenue, and entities will need to ensure that they have considered all of these when assessing the extent to which their accounting policy for revenue may need to be amended.

## Getting started

Some effective first steps to consider as you begin to evaluate the implications of the new Standard include:

- Evaluating significant revenue streams and key contracts to identify the specific revenue recognition changes required and the specific business units where these changes may have the greatest impact.
- Addressing the longer lead-time areas where new calculation engines or revised allocation processes may be required.
- Establishing a granular project plan and roadmap to manage the effort across multiple business units and countries.

### How Deloitte can help

Deloitte has an experienced team of professionals, both in Canada and globally across the member firms of Deloitte Touche Tohmatsu Limited, who can assist in developing an action plan to help you implement the new revenue recognition standard.

These capabilities include the full breadth of services and competencies needed to help clients address these issues, and would include accounting interpretative assistance, help with process revisions, support in making system changes (including development of system business requirements), tax and other matters.

More detailed information on the impact of IFRS 15 can be found in Deloitte's IFRS in Focus publication available from [www.iasplus.com](http://www.iasplus.com). Further industry publications are also available here.

---

Deloitte has an experienced team of professionals, both in Canada and globally

# Deloitte LLP contacts:

## Toronto

**Sean Morrison**

Partner  
416-601-6296  
seamorrison@deloitte.ca

**Stacey Nagle**

Partner  
416-643-8487  
stanagle@deloitte.ca

**Cindy Veinot**

Partner  
416-643-8752  
cveinot@deloitte.ca

**Mark Wayland**

Partner  
416-601-6074  
mawayland@deloitte.ca

## Montreal

**Nick Capanna**

Partner  
514-393-5137  
ncapanna@deloitte.ca

**Lucie Lazar**

Partner  
514-393-7388  
lulazar@deloitte.ca

**Maryse Vendette**

Partner  
514-393-5163  
mvendette@deloitte.ca

## Vancouver

**Terry Neill**

Partner  
604-640-3216  
tneill@deloitte.ca

## Calgary/Edmonton/Winnipeg

**Steve Aubin**

Partner  
403-503-1328  
saubin@deloitte.ca

**Marc Joiner**

Partner  
403-503-1346  
mjoiner@deloitte.ca

[www.deloitte.ca](http://www.deloitte.ca)

Deloitte, one of Canada's leading professional services firms, provides audit, tax, consulting, and financial advisory services. Deloitte LLP, an Ontario limited liability partnership, is the Canadian member firm of Deloitte Touche Tohmatsu Limited.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.