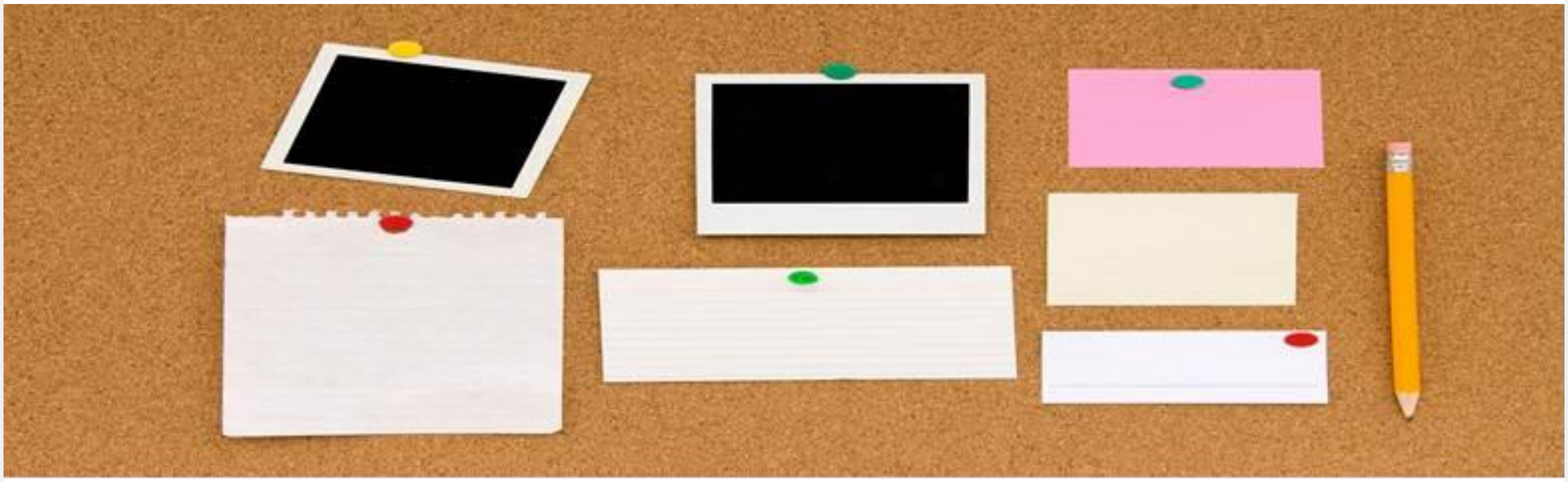
NavarroAmper&Co.

Philippines | Technical Research | 14 August 2014 (Issue 6)



Accounting & Auditing News

IFRS 15 — *Revenue from Contracts with Customers*: Part 3A – Impact on Consumer Products Sector

Should Revenue be Recognized Over Time or at a Point in Time?

Background

IFRS 15 introduces a new approach to determine whether revenue should be recognized over time or at a point in time. Three scenarios are specified in IFRS 15 in which revenue will be recognized over time. If revenue is to be recognized 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 specified in IFRS 15, revenue will instead be recognized at a point in time, when control passes to the customer.

Effect

Where consumer products are manufactured under contract, the timing of revenue recognition may be significantly impacted by the requirement of IFRS stated above, 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 easily redirected to 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, requires entities to recognized revenue over time when previously they have been recognizing it at a point in time. It is 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 worked performed to date.

When Should Variable or Uncertain Revenues be Recognized?

Background

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 recognized would not be subject to significant future reversals when the uncertainty is resolved.

Effect

Significant degree of judgment is required 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?

Background

Under IAS 18, the timing of revenue recognition is based primarily on the transfer of risk and rewards while IFRS 15 focuses on when control of those goods has transferred to the customer.

Effect

This different in 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). 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. If revenue is recognized 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 recognized when the service is provided.

How Should Warranties be Accounted for?

Background

The new standard distinguishes between a warranty providing assurance that the product meets agreed-upon specifications (accounted for as a cost provision) and warranty providing an additional service (for which revenue will be deferred). Considerations of factors such as whether 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 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 a consumer product sector, it is common for warranties to include both elements.

Effect

Where a warranty include both elements, judgment 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?

Background

In consumer products sector, suppliers often makes 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 addressed how to account for payments made to customer.

Effect

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 cost be capitalized?

Background

The new standard introduces specific criteria for determining whether to capitalized 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 are incurred that is directly attributable to obtaining contracts with customers, for example through 'success fees' (i.e. commissions that are only payable if a contract is obtained). At present, different entities might treat these costs differently, although most have previously been expensing them.

Effect

The new standard will require entities to capitalized success fees, which will have an impact on operating profits. In addition, the new standard requires capitalized contract costs to be amortized on a systematic basis that is consistent with the pattern of transfer of the goods or services. Entities will need to exercise judgment to determine the appropriate basis and time period for this amortization.

Please contact the Technical Research Group at +63 2 581 9000 local 9088/9078/9165 or e-mail phtr@deloitte.com for questions regarding this publication.

Deloitte.

Member of Deloitte Touche Tohmatsu Limited

19th Floor Net Lima Plaza
5th Avenue corner 26th Street
Bonifacio Global City, Taguig
Philippines 1634