

IFRS
Developments
Retail and
Consumer
Products

The new revenue recognition standard – retail and consumer products

What you need to know

- ▶ Application of the new revenue recognition standard will require retail and consumer products entities to exercise a greater degree of judgement to meet its requirements.
- ▶ For example, entities may need to change the way they estimate returns and account for licensing and franchising arrangements. Early preparation will be the key to a successful implementation of the new standard.
- ▶ The standard is effective for annual reporting periods beginning on or after 1 January 2017, with early adoption permitted.

Retail and consumer products entities will have to change some aspects of their accounting.

Overview

Retail and consumer product entities will have to change some aspects of their accounting for revenue as a result of IFRS 15 *Revenue from Contracts with Customers*, the new revenue recognition standard jointly issued by the International Accounting Standards Board (the IASB) and the Financial Accounting Standards Board (the FASB) (collectively, the Boards). The new revenue recognition standard will supersede virtually all revenue recognition guidance in IFRS and US GAAP.

IFRS 15 provides requirements for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other IFRS requirements, such as IAS 17 *Leases*). IFRS 15 also provides a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property, equipment and intangible assets.

This publication summarises the key implications of IFRS 15 for retail and consumer product entities. Our *Applying IFRS, A closer look at the new revenue recognition standard*, provides an in-depth discussion of the new revenue standard.¹

The views we express in this publication are preliminary. We may identify additional issues as further analyses are done, and our views may evolve during that process.

Key industry considerations

IFRS 15 is expected to affect retail and consumer product entities. Entities will need to carefully evaluate all of their contracts and exercise more judgement than they do today. In general, there may not be significant changes to the amount and timing of revenue recognition. However, entities will need to use judgement when estimating return of goods, accounting for options granted to customers, consideration paid or payable to customers, reseller or distributor arrangements, and licensing and franchising agreements. We expect that entities will generally reach similar conclusions to those they reach today on accounting for warranties.

Rights of return

Retail and consumer products entities often provide a right of return to customers. Under IFRS 15, a right of return creates variable consideration. That is, until the right of return expires or returns are no longer accepted, the entity is uncertain how many sales will fail, and therefore the amount of consideration to which the entity is entitled. Hence, IFRS 15 requires the potential for customer returns to be considered when an entity estimates the transaction price and include amounts for which it is highly probable that a significant revenue reversal will not occur (i.e., they apply a constraint on variable consideration). In doing so, an entity will exclude the products expected to be returned when determining the consideration to which it expects to be entitled. While the amounts that entities estimate for returns may not change significantly under the new standard, entities may need to adjust their processes and documentation to appropriately apply IFRS 15.

An entity must recognise the amount of expected returns as a refund liability, representing its obligation to return the customer's consideration. The entity must also recognise a return asset (and adjust the cost of sales) for its right to recover the goods returned by the customer. The balance sheet classification for amounts related to the return asset will likely change from current practice. Today, the carrying value associated with any product expected to be returned typically remains in inventory. IFRS 15 requires entities to record the asset separately from inventory, which provides greater transparency, and to present the refund liability separately from the return asset (i.e., on a gross basis, rather than a net basis).

Customer options for additional goods or services

Retail and consumer products entities frequently give customers the option to purchase additional goods or services. These options come in many forms, including sales incentives (e.g., coupons with a limited distribution) and customer award credits (e.g., loyalty or reward programmes, gift cards issued by a retailer as a promotion). An option to acquire additional goods or services is a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that market).

Current IFRS does not require entities to distinguish between an option and a marketing offer. Nor does it address the accounting for options that provide a material right to customers. The assessment of whether a retail or consumer products entity has granted an option that gives its customer a material right could require significant judgement, and may result in a change from current practice.

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¹ See [Applying IFRS: A closer look at the new revenue recognition standard \(June 2014\)](#)

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Consideration paid or payable to customers

Retail and consumer products entities commonly provide discounts, coupons and free products or services to customers. In addition, some consumer products entities also provide such discounts or free products to the customers of retailers. To determine the appropriate accounting treatment, an entity must first determine whether the consideration paid or payable to a customer is: a payment for a distinct good or service; a reduction in the transaction price; or a combination of both. For a payment by the entity to a customer to be treated as something other than a reduction of the transaction price, the good or service provided by the customer must be distinct.

Manufacturers of consumer products commonly pay retailers fees (i.e., slotting fees) to have their goods displayed prominently on shop shelves. The shelves may be physical (i.e., in a shop front) or virtual (i.e., space in an internet reseller's online catalogue). Generally, such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction in the transaction price.

Reseller or distributor arrangements

Some consumer products entities sell their products through distributors or resellers (collectively, resellers). Currently, some entities do not recognise revenue until the product is sold to the end-customer because they do not meet all of the criteria in the risks and rewards model in IAS 18 *Revenue* to recognise revenue on delivery to the reseller.

Under IFRS 15, consumer products entities must first evaluate when control of the product transfers to the customer. In this respect, they need to assess whether their contracts with resellers are consignment arrangements. In a consignment arrangement, control generally does not transfer (and, thus, revenue is not recognised) until the reseller sells the product to an end-customer. This result is consistent with current practice.

If an entity concludes that its contract with a reseller is not a consignment arrangement, waiting until the end-sale has occurred before revenue is recognised will no longer be acceptable if the only uncertainty is the variability in the pricing. The entity must recognise revenue upon the transfer of control of the promised goods based on its estimate of the amount of consideration to which it expects to be entitled, considering the constraint on variable consideration. An entity may recognise revenue earlier than it does today if it can determine that it is highly probable that a significant reversal will not occur for at least some of the variable consideration (i.e., the entity is able to estimate an amount of consideration that is not constrained).

Licences and franchise arrangements

Retail and consumer products entities frequently enter into brand licensing and franchising arrangements. Entities will have to consider whether such contracts include distinct licences of intellectual property (IP) in order to apply the application guidance appropriately. IFRS 15 requires the use of judgement when analysing whether a licence of IP is a right to access the IP or a right of use the IP. This determination affects whether amounts allocated to the distinct licence should be recognised as revenue over the licence period (right to access) or at the time when the licence is provided (right to use). This determination depends on the facts and circumstances for licences of IP and may lead to interpretive questions.

In addition, IFRS 15 requires entities to recognise sales and usage-based royalties from licences of IP generally when the sale or usage occurs. This is an exception to the standard's general requirement to estimate variable consideration and will likely result in accounting that is consistent with current practice.

It is unclear whether this exception will apply to royalties that relate to both licensed IP and other goods or services in a contract (e.g., a contract with two performance obligations such as a distinct franchise licence and consulting or training services that would be provided over time and would affect the amount of royalties earned).

To support stakeholders with the implementation of IFRS 15, the Boards have established a Transition Resource Group (TRG). The TRG has discussed a number of views, including whether the exception should apply solely to a licence that is a separate performance obligation or whether it should apply regardless of whether the royalty also relates to a non-licence good or service. It is not yet clear whether the Boards will provide additional application guidance.

How we see it

- ▶ Requirements in IFRS 15 for transactions that are common in the retail and consumer products sector will impact entities. Sale of goods with rights of return, licences, franchise arrangements, material options granted to customers and consideration paid or payable to customers are just some of the areas that may be impacted. We encourage retail and consumer products entities to gain an understanding of IFRS 15 and evaluate how it will affect their specific revenue recognition policies and practices.
- ▶ Entities should perform a preliminary assessment of how they will be affected as soon as possible so that they can prepare to implement IFRS 15. While the impact on entities will vary, all entities need to do an evaluation of the requirements of IFRS 15.
- ▶ Entities should also consider their investor communication plans, as well as communications with other stakeholders, including their plans for disclosure of the potential effects of IFRS 15 required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Entities' disclosures should evolve in each reporting period as more information becomes available.

Next steps

- ▶ Entities may wish to monitor the ongoing developments at the Boards as well as the discussions at the various implementation groups. The TRG was created to help the Boards determine whether more application guidance or education is needed on implementation issues and other matters submitted by stakeholders. The TRG will not make formal recommendations to the Boards or issue application guidance.² Separately, the American Institute of Certified Public Accountants (AICPA) has established 16 industry task forces to help develop a new Accounting Guide on revenue recognition and to aid industry stakeholders in implementing the US equivalent standard to IFRS 15. There is no industry-specific task force for retail or consumer products entities. However, other industry groups may discuss topics that are relevant to retail and consumer products entities. Any views discussed by the TRG or guidance produced by the AICPA are non-authoritative.
- ▶ EY plans to issue a more detailed sector-specific *Applying IFRS* for the retail and consumer products sector and it will host a sector-specific webcast on *IFRS 15 Revenue from Contracts with Customers* in the coming months.

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² IFRS Developments Issue 85: Joint Transition Resource Group for Revenue Recognition debates implementation issues (July 2014). See [IFRS Developments Issue 85 July2014](http://www.ey.com/au/en/issues/ifrs-developments-issue-85-july2014)