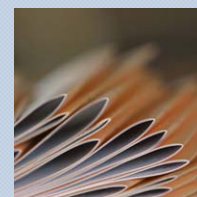


Canadian GAAP - IFRS Comparison Series Issue 1 – Revenue Recognition



Both IFRS and Canadian GAAP are principle based frameworks, and from a conceptual standpoint many of the general principles are the same. However, the application of those general principles in IFRS can be significantly different from Canadian GAAP. Therefore, to understand the magnitude of the differences between IFRS and Canadian GAAP, it is essential to look beyond the general principles and look at the detailed guidance provided in the standards. This is our first in a series of publications which will provide detailed information on the key differences between IFRS and Canadian GAAP.

In this issue, revenue recognition issues will be presented, with focus on:

- the topics covered in EIC-141 - Revenue Recognition, such as evidence of an arrangement, bill and hold arrangements, layaway sales, non-refundable fees, license fees, and fixed and determinable sales price;
- multiple deliverable arrangements covered in EIC-142; and
- long-term contracts such as construction contracts

Be advised that this publication is a guide to the differences between Canadian GAAP and IFRS and is not meant to be a comprehensive manual. Please contact a BDO Dunwoody representative for specific details and information.

References

IFRS: IAS 1, IAS 8, IAS 11, IAS 18, IFRIC 12, IFRIC 13

Canadian GAAP: Section 3400, EIC-65, EIC-78, EIC-84, EIC-123, EIC-141, EIC-142, EIC-143, EIC-144, EIC-156, AcG-2, AcG-4

Introduction

The criteria for revenue recognition under Canadian GAAP are defined in Section 3400, Revenue. In IFRS the revenue recognition criteria are defined in IAS 18, Revenue. The guidance provided in both Section 3400 and IAS 18 is very limited. Under Canadian GAAP, further guidance can be obtained by looking at the relevant EICs. In the case of IFRS, the appendix to IAS 18 provides specific guidance on many of the topics covered by the EICs; however, the appendix is not actually part of the standard.

That said, the basic revenue recognition criteria for the sale of goods are very similar under both Canadian GAAP and IFRS.



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Canadian GAAP	IFRS
<p>Revenue from the sale of goods should be recognized when the following conditions are met:</p> <ul style="list-style-type: none"> - the seller transfers to the buyer the significant risks and rewards of ownership, in that all significant acts have been completed and the seller no longer has managerial involvement in, or effective control of, the goods that were transferred; - reasonable assurance exists regarding the measurement of the consideration that will be derived from the sale of goods, and the extent to which goods may be returned; and - ultimate collection of consideration is reasonably assured. 	<p>Revenue from the sale of goods shall be recognized when all the following conditions are met:</p> <ul style="list-style-type: none"> - the significant risks and rewards of ownership of the goods has been transferred to the buyer; - the seller keeps neither continuing managerial involvement nor effective control over the goods sold; - the amount of revenue can be measured reliably; - it is probable that the economic benefits associated with the transaction will flow to the seller; and - the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue Recognition

Under IFRS, the revenue from the sale of goods is recognized when the seller has transferred the significant risks and rewards of ownership to the buyer and no longer has control or managerial involvement over the goods. This is similar to Canadian GAAP; however there are more specific criteria underlying these principles such as: the existence of persuasive evidence of an arrangement, the occurrence of delivery or rendering of services, and whether the seller's price to the buyer is fixed or determinable.

Canadian GAAP	IFRS
Evidence of an Arrangement	
<p>Persuasive evidence of an arrangement must exist. Such evidence is based on customary business practices.</p>	<p>Under IFRS, there is no requirement of written or formal evidence of an arrangement. However, from a practical viewpoint, it would be difficult to audit the details of a sale transaction without such evidence.</p>
Bill & Hold Arrangements	
<p>With regard to bill & hold arrangements, if delivery has not occurred, the following criteria are generally required to be met in order to recognize revenue:</p> <ul style="list-style-type: none"> - the risks of ownership have passed to the buyer; - the customer must have made a fixed commitment to purchase the goods, either in written documentation or in electronic form; 	<p>Under IFRS, revenue is recognized when the buyer takes title, provided:</p> <ul style="list-style-type: none"> - it is probable that delivery will be made; - the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognized; - the buyer specifically acknowledges the deferred delivery instructions; and

<ul style="list-style-type: none"> - the buyer, not the seller, must request the transaction be on a bill and hold basis and the buyer must have a substantial business purpose for ordering on this basis; - there must be a fixed schedule for delivery and the date of delivery must be reasonable and consistent in light of business purpose of transaction; - the seller must not have retained any specific performance obligations such that the earnings process is not complete; - the ordered goods must have been segregated from the seller's inventory and not be subject to being used to fill other orders; and - the product must be complete and ready for shipment. 	<ul style="list-style-type: none"> - the usual payment terms apply. <p>The criteria are similar to Canadian GAAP; however, IFRS is much less detailed.</p>
<p>Customer Acceptance</p>	
<p>Under Canadian GAAP, after delivery of a product or performance of a service, if there is uncertainty about customer acceptance, then revenue should not be recognized until acceptance occurs. Formal customer sign-off is not always necessary to recognize revenue as long as the seller objectively demonstrates that the criteria specified in the acceptance provisions are satisfied. Canadian GAAP has guidance on some specific scenarios regarding customer acceptance - including trial productions, right of return based on subjective matters, return or replacement based on seller-specified objective criteria, return or replacement based on customer-specified objective criteria.</p>	<p>Under IFRS, revenue is normally recognized when the buyer accepts delivery, and installation and inspection are complete.</p> <p>However, revenue is recognized immediately upon the buyer's acceptance of delivery when:</p> <ul style="list-style-type: none"> - the installation process is simple; or - the inspection is performed only for purposes of final determination of contract prices. <p>If there is uncertainty about the possibility of return, revenue is recognized when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.</p> <p>The principles related to customer acceptance are similar to Canadian GAAP, however less detail is provided.</p>
<p>Layaway Sales</p>	
<p>For layaway sales, provided that the other criteria for revenue recognition are met, the revenue should be recognized only upon delivery of the merchandise to the customer.</p> <p>Because the seller retains the risks of ownership of the merchandise, receives only a deposit from the customer, and does not have an enforceable right to the remainder of the purchase price, it would not be appropriate to recognize any revenue upon receipt of the cash deposit.</p>	<p>Revenue is recognized when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognized when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the buyer.</p> <p>As a result, revenue recognition may occur earlier than under Canadian GAAP.</p>

Non-refundable Fees / Licensing fees	
<p>For non-refundable fees, up-front fees, even if non-refundable, are earned as the products and / or services are delivered and / or performed over the term of the arrangement or the expected period of performance.</p> <p>Generally these should be deferred and recognized systematically over the periods that the fees are earned only if the upfront fee is an exchange for products delivered or services performed that represent the culmination of a separate earnings process, deferral not required.</p> <p>The consensus states that upfront license fees can be recognized if:</p> <ul style="list-style-type: none"> - the product has been physically delivered; - the license period has started; and - there is no remaining continuing involvement required of licensor. 	<p>Under IFRS, the revenue is recognized when no uncertainty about collection exists. It is recognized on a basis that reflects the timing, nature and value of the benefits provided.</p> <p>Examples are provided in the appendices to the standard.</p>
Fixed or Determinable Sales Price	
<p>For fixed or determinable sales price, Canadian GAAP requires reasonable assurance of regarding measurement of the sales price. The consensus to this issue provides specific guidance on measuring the sales price in situations where uncertainty exists such as cancelable sales agreements, rights of return, price protections and refundable fees.</p>	<p>Although the recognition principles related to measurement of the consideration are similar, no specific guidance exists.</p>

Multiple Deliverable Arrangements

Canadian GAAP provides a detailed approach for revenue recognition for multiple-deliverable arrangements which is not specific to a scenario or industry; IFRS does not provide such detailed guidance, however, it does consider some specific scenarios.

In Canadian GAAP, all of the guidance on when to separate the components of a multiple-deliverable arrangement can be found in EIC-142. In contrast, the guidance under IFRS can be found in various standards and associated appendices. Canadian GAAP details three specific criteria that must be met to separate the deliverables. Under IFRS, such stringent criteria do not exist; rather, the substance of the transaction as a whole is evaluated.

Canadian GAAP	IFRS
<p>Three criteria need to be met in order to separate the deliverables:</p> <ul style="list-style-type: none"> - delivered items have value to customer on a stand-alone basis; - objective and reliable evidence of fair value of undelivered items exists; and 	<p>Unlike Canadian GAAP, there are no explicit criteria under IFRS. The guidance is interpretive as to when to separate the deliverables:</p> <ul style="list-style-type: none"> - under certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction

<ul style="list-style-type: none"> - in situations where there is a general right of return relative to the delivered items, performance / delivery of undelivered items is probable and substantially in vendor's control. 	<p>in order to reflect the substance of the transaction;</p> <ul style="list-style-type: none"> - Service fees associated with a sale are referenced in the appendix; and - IAS 11, Construction Contracts also provides guidance which can be analogized to multiple deliverable arrangements. It requires consideration of the substance of a transaction and whether the commercial effect cannot be understood without reference to the series of transactions as a whole.
<p>When separation of the delivered items is required, there are two options for the allocation of the proceeds to the units of accounts:</p> <ul style="list-style-type: none"> - relative fair value method; or - in cases which there is objective and reliable evidence of the fair value of the undelivered item(s) but no such evidence for the delivered item(s), the residual method should be used to allocate the arrangement consideration (reverse residual method is not allowed). 	<p>Under IFRS there is no specific guidance however, our interpretation is that there are three options available; each derived from a different standard:</p> <ul style="list-style-type: none"> - allocation of the expected cost plus reasonable profit to the undelivered item; - per the IFRIC interpretation on Service Concession Arrangements, which requires use of the relative fair value method; or - per the IFRIC interpretation on Customer Loyalty Programs, which supports use of the fair value of the undelivered (residual value method).

Canadian GAAP also provides specific guidance on Accounting for Separately Priced Extended Warranty & Product Maintenance Contracts. IFRS does not provide such specific guidance; therefore, the guidance on multiple-deliverable arrangements discussed above would be used instead as a starting point.

Long Term Contracts and Construction Contracts

For accounting for long term contracts and construction contracts, the guidance in Canadian GAAP is very limited; in contrast, under IFRS more detailed guidance is provided. In fact, an entire standard is dedicated to such contracts.

Canadian GAAP provides an option to use Percentage of Completion or Completed Contract method. Under IFRS, the use of the Completed Contract method is prohibited. Revenue from long term contracts and construction contracts must be recognized using Percentage of Completion method or the Cost Recovery method if percentage of completion cannot be used reliably. In addition, in a service contract, when a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.

Note that the completed contract method is not the same as the cost recovery method of revenue recognition. Under the completed contract method, neither revenue nor costs are recognized until performance is complete or substantially complete. Under the cost recovery method, costs are expensed as incurred and revenue is recognized only to the extent of contract costs incurred that it is probable will be recoverable.

In addition, IFRS has specific guidance related to onerous contracts which we believe is consistent with general practice in Canada although there are no parallel standards. Under those standards, expected losses must be recognized immediately when it is probable that total contract costs will exceed total contract revenue.

Miscellaneous Revenue Topics

The Canadian GAAP on **Reporting Revenue Gross as a Principal versus Net as an Agent**, provides very specific guidance on presenting revenue on a gross vs. net basis. There are eight criteria to determine if the entity is acting as the principal or an agent. Although the principal is the same under IFRS, there is no such specific guidance. The only instance of guidance provided states: "In an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead revenue is the amount of commission."

The accounting for **consideration received from a vendor or customer** is discussed under Canadian GAAP, while detailed guidance is not provided for in IFRS. Limited guidance is provided, which appears to be consistent with Canadian GAAP.

The accounting for **franchise fees** is consistent with the IFRS guidance.

The accounting for **revenue related to lending activities** is consistent with the IFRS guidance.

The Future of Revenue Recognition under IFRS

The IASB and the FASB are conducting a joint project to develop concepts for revenue recognition and a general standard based on those concepts. The IASB plans to issue a Discussion Paper, jointly with the FASB, for consultation in the second quarter of 2008. We do not anticipate this project to be completed by the 2011 changeover date.

Conclusion

In general the principles related to revenue recognition under Canadian GAAP and IFRS are very similar. However IFRS lacks much of the specific guidance contained in EIC-141 and 142; as a result, much more judgment is required in the application of IFRS. If you require further guidance on Revenue Recognition under IFRS or any other IFRS information or reference sources, please contact your local BDO Dunwoody LLP office or visit www.bdo.ca/ifrs.