

Impact of IFRS on the Retail Industry

September 2008

Canadian public companies are required to adopt IFRS in 2011. IFRS and Canadian GAAP differ in some significant ways—are you prepared for the accounting issues and other challenges that you’re likely to encounter?

Top Accounting Issues

For retail organizations, the move to IFRS in 2011 could have enterprise-wide implications. We highlight below some accounting areas that warrant attention to see whether or not they may affect you and, if so, how.

Revenue Recognition

Many concepts underlying revenue recognition are consistent under IFRS and Canadian GAAP, particularly regarding right of return and agent versus principal. Nevertheless, because IFRS provides less application guidance, differences may arise in practice.

Rebates

Under IFRS, non-cash rebates (e.g., free gift with purchase or buy one get one free) are generally treated as a reduction in revenues. In contrast, under Canadian GAAP, non-cash rebates are usually classified as an expense. Further differences arise if you cannot reliably measure the amount of rebates you will have to give to a customer. In our view, under IFRS, you may not recognize the rebate until the payment is probable and the amount can be estimated reliably. Under Canadian GAAP, you accrue the maximum amount.

For rebates received by a retailer from a supplier, IFRS provides no separate guidance on consideration received by a retailer from a supplier, other than the discussion in IAS 2 – *Inventories*.

Layaway sales

Under both IAS 18 and Canadian GAAP, layaway sales would generally be recognized when the goods are delivered. Under IFRS, however, revenue could also be recognized when a significant deposit is received, provided that the goods are on hand, identified, and ready for delivery to the buyer. Because “significant” is not defined under IFRS, you will have to carefully apply judgment upon determining when to recognize revenue.



Customer loyalty programs

The International Financial Reporting Interpretations Committee (IFRIC) has issued guidance on accounting for customer loyalty programs, but Canadian GAAP provides no specific guidance.

When loyalty awards are granted, IFRS requires that the consideration be separated into two components—the fair value of the goods and services provided, and the fair value of the awards given to the customer. The value of the award is then deferred as a liability until the obligation has been fulfilled.

This IFRS requirement could significantly change the timing of when revenue is recognized, compared to Canadian GAAP, and may also require systems changes.

Property, Plant, and Equipment, and Investment Property

Retail operations typically incur significant expenditures for evaluating store locations, building and/or refurbishing stores.

IFRS requires that costs for feasibility assessments be expensed and that each item of property, plant, and equipment be identified and recorded at a component level, with individually significant components depreciated separately over their respective useful lives. Under IFRS, additional components may need to be captured, and you may require modifications to fixed assets systems.

IFRS also provides separate guidance for accounting for investment property (property held for purposes of generating rental income or capital appreciation).

IFRS permits companies to elect to carry property, plant, and equipment as well as investment property at fair value. Under Canadian GAAP, this approach is not currently allowed. IFRS also requires that the fair value of investment property be disclosed at least annually.

Impairment of Assets

IFRS has one impairment model covering property, plant, and equipment, goodwill, and intangible assets. Assets are evaluated either individually or grouped in a cash-generating unit (CGU) for impairment-testing purposes. A CGU is the smallest group of assets that is largely capable of generating independent cash inflows; it may be smaller than an asset group or reporting unit under Canadian GAAP.

A key difference will arise in the level at which a goodwill impairment test is conducted. Under IFRS, goodwill is allocated post-acquisition to those CGUs expected to benefit from the combination, and a CGU can be as low as a store level. Accordingly, goodwill impairment testing may need to be done by store. In contrast, under Canadian GAAP, such testing may be done at a much higher level.

Under the IFRS standard, assets are tested and any resulting impairment charges measured, using a one-step test that compares the carrying value of an asset or CGU to its recoverable amount. Recoverable amount is the higher of fair value less cost to sell (a market-based model) and value in use (an entity-specific model). IFRS factors in discounting when assessing impairment, by using a one-step approach as opposed to a two-step approach under existing Canadian GAAP. Entities are therefore more likely to have impairments under IFRS.

Another key difference from Canadian GAAP is that under IFRS, impairment losses associated with property, plant, and equipment and intangible assets are reversed in subsequent periods—if the circumstances that led to the impairment have changed. When an entity adopts IFRS, it may therefore need to reverse prior-year impairment losses and review for further impairment.

Provisions

Under IFRS, a provision is recognized for both legal and constructive obligations when it arises from a past event, the outflow of resources is probable, and the amount can be estimated reliably. In this context, “probable” means “more likely than not” and represents a lower threshold than “likely.” More items may, therefore, need to be provided for under IFRS, particularly for obligations to restore sites to certain conditions (referred to as asset retirement obligations under Canadian GAAP).

Under IFRS, provisions are measured based on management’s best estimate of the amount required to

settle the obligation. When a range of estimates exists, and no single estimate is better than another, the obligation is measured at the midpoint of the range. A range of estimates is often encountered with legal claims.

IFRS also requires discounting on all provisions for which the effect of the time value of money is material. The discount rate should reflect current market assessments of the time value of money and the risks specific to the liability. Provisions should be re-measured when discount rates change.

Other Accounting Areas

Web site development costs – Such costs can generally be capitalized under IFRS when it is probable that expected future economic benefits will arise. However, for Web sites for which the primary purpose is to advertise, promote, and facilitate the on-line sale of goods or services, the associated costs should be expensed.

Enterprises may encounter difficulties where they cannot differentiate whether the costs are associated with the on-lines sales function or other Web functions.

Deferred store opening costs/pre-operating costs – Under IFRS, such costs are expensed as incurred.

Prepaid advertising costs – Recent amendments to IFRS will severely restrict the recognition of prepaid advertising and marketing costs. Certain prepaid costs associated with catalogues or advertising will likely have to be expensed earlier than currently required under Canadian GAAP.

Multi-employer pension plans – Under IFRS, multi-employer pension plans are not automatically accounted for as defined contribution plans and, even when they are, further assets and liabilities may be required where the employers have a contractual agreement to share plan surpluses and fund plan shortfalls.

Leases – Although Canadian GAAP and IFRS are generally similar in accounting for operating leases, the classification of leases under IFRS as either operating or capital can create differences because IFRS provides no quantitative “bright line” thresholds.

Affiliate and franchised stores – Affiliated or franchised stores that are currently consolidated as variable interest entities may not qualify for consolidation under IFRS, because such stores may not meet the definition of a special purpose entity.

Entities required to deconsolidate these stores could face not only significant impact on reported operating results but also systems implications.



How Can KPMG Help?

KPMG has helped many organizations assess the impact of IFRS and implement it. Our established conversion methodology incorporates the different disciplines critical to a successful conversion. KPMG's IFRS Conversion Services teams are multidisciplinary teams comprised of professionals knowledgeable in IFRS and Canadian GAAP, and skilled in financial reporting processes and financial integration. Our teams are supported by internationally trained professionals with global experience in both converting to and applying IFRS.

For details about our conversion services, please refer to our publications, *Managing the Transition to IFRS: The Journey to 2011* and *Managing the Transition to IFRS: Clearing the Path*, available at www.kpmg.ca/ifrs.

To learn more about how the move to IFRS can affect your company, please contact your local KPMG adviser.

Contacts

Farah Bundeali
416-777-3917
fbundeali@kpmg.ca

Sebastian Distefano
416-777-8386
sdistefano@kpmg.ca

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