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Observations on the Implementation of the New Revenue Standard by Canadian Public Companies

OCTOBER 2018

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Background

Canadian public companies with calendar year ends began applying a new accounting standard for revenue recognition in the first quarter of 2018. For most companies the new standard is IFRS® 15, *Revenue from Contracts with Customers*; those companies using U.S. GAAP apply the similarly named ASC 606. These new standards are the result of a joint project by the International Accounting Standards Board (IASB®) and the U.S. Financial Accounting Standards Board (FASB). Although there are some differences, the two standards are substantially the same. For the purpose of this document, they are considered as one and will be referred to as the "new revenue standard".

The new revenue standards reflect a different accounting model from the preceding standards for both IFRS and U.S. GAAP. While the previous revenue standards were based more on the concept of the transfer of risks and rewards, the new standard generally focuses on identifying performance obligations in contracts between a supplier and a customer. Revenue is recognized when these performance obligations are satisfied. For further information on the new revenue standard, see ***CPA Canada's External Resources on IFRS 15 Revenue from contracts with customers***.

We value the views and feedback of our members. Comments should be addressed to:

Rosemary McGuire, CPA, CA
Director, Research, Guidance and Support
Chartered Professional Accountants
of Canada
277 Wellington Street West
Toronto ON M5V 3H2
rmcguire@cpacanada.ca

Michael Massoud, CPA, CA, CPA (IL)
Principal, Research, Guidance and Support
Chartered Professional Accountants
of Canada
277 Wellington Street West
Toronto ON M5V 3H2
mmassoud@cpacanada.ca

The Study

The new revenue standard was much anticipated and accompanied by much hype about how major changes in practice would be likely. CPA Canada conducted this study to better understand the impacts of the adoption of the new standard on financial statements.

The study comprised the review of financial statements of 60 Canadian public companies for the first quarter of 2018 (Q1 2018) — the first financial statements to include the effects of the adoption of the new revenue standard. Of these companies, 45 were listed on the S&P/TSX Composite Index (TSX) and 15 were listed on the S&P/TSX Composite Venture Index (TSXV). These companies represented a cross section of industries. All companies had fiscal year ends of either December 31, 2017, or January 28, 2018. Most of the 60 companies reported using IFRS, but 10 reported using U.S. GAAP. For further details on the population sample, see Appendix A: Scope and Methodology.

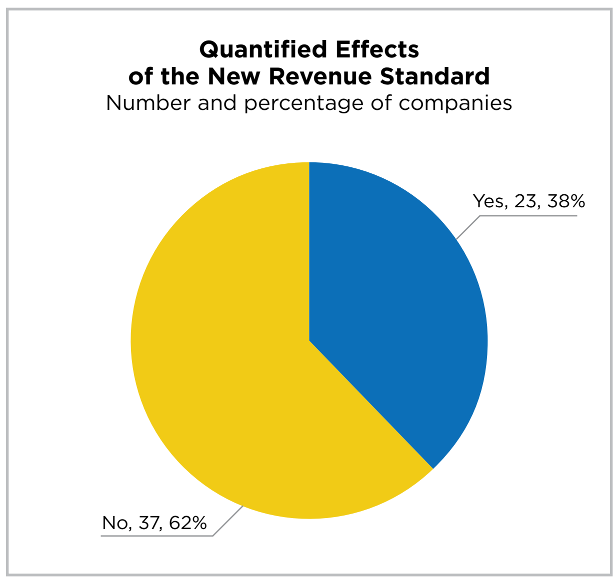
Given the limited sample size in the study, caution should be exercised in drawing broad conclusions.

Key Observations

While the new revenue standard introduced a significantly different accounting model for revenue recognition, for most companies the financial results were not significantly affected. For the first quarter of 2018, 95% of companies (57 companies), disclosed that the net effects of adoption on revenue was either not material or less than 2% of revenue.[1]

Sixty-two per cent of the companies (37 companies) declared that the effect of adopting the new revenue standard was not material and did not quantify the effects.

FIGURE 1: THE NUMBER AND PERCENTAGE OF COMPANIES THAT QUANTIFIED THE EFFECTS OF THE NEW REVENUE STANDARD IN Q1 2018



1 The term "not material" was used interchangeably with other terms such as "immaterial" and "not significant".

For most of the remaining 38% (23 companies) that did quantify the effects, those effects were less than 2% of revenue, net income and opening retained earnings. Only 15% of companies (nine companies) disclosed that the effects of adoption exceeded 2% of net income in Q1 2018.

- Companies in the Communications & Media sector were most impacted, as three of the four companies in this sector quantified the impacts on net income as exceeding 2%.
- The modified retrospective approach was applied by 58% of the companies (35 companies) in transitioning to the new revenue standard.
- Thirty-eight per cent of the companies (23 companies) provided a greater breakdown of revenue in the notes as a result of adopting the new revenue standard.

Quantitative Effects of the New Revenue Standard on the Income Statement

Figures 2 to 5 look at the significance of the effects of the new revenue standard on revenue and net income.

Effects on Revenue

Figure 2 shows that 75% of companies (45 companies) stated the effects of adopting the new revenue standard on revenue were not material but did not quantify the effects. Of the remaining 25% (15 companies), 12 disclosed that the effects of adoption on revenue were less than 2%, and only three quantified the effects as exceeding 2%.

FIGURE 2: THE EFFECTS OF ADOPTING THE NEW REVENUE STANDARD ON REVENUE REPORTED IN Q1 2018

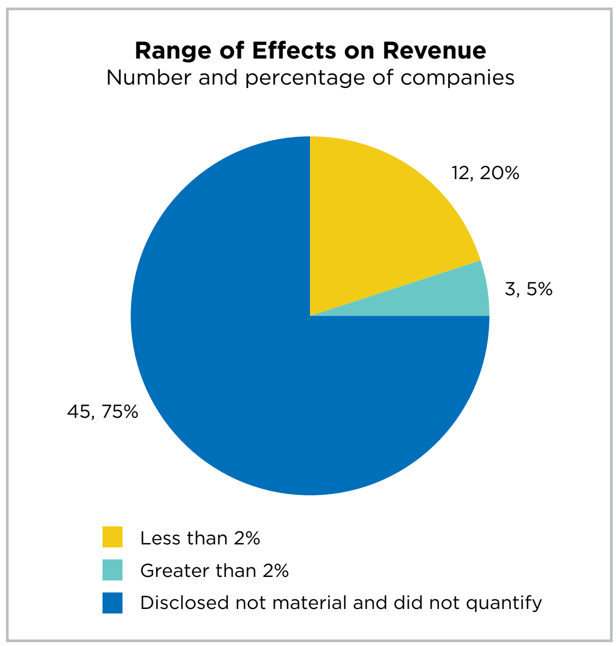
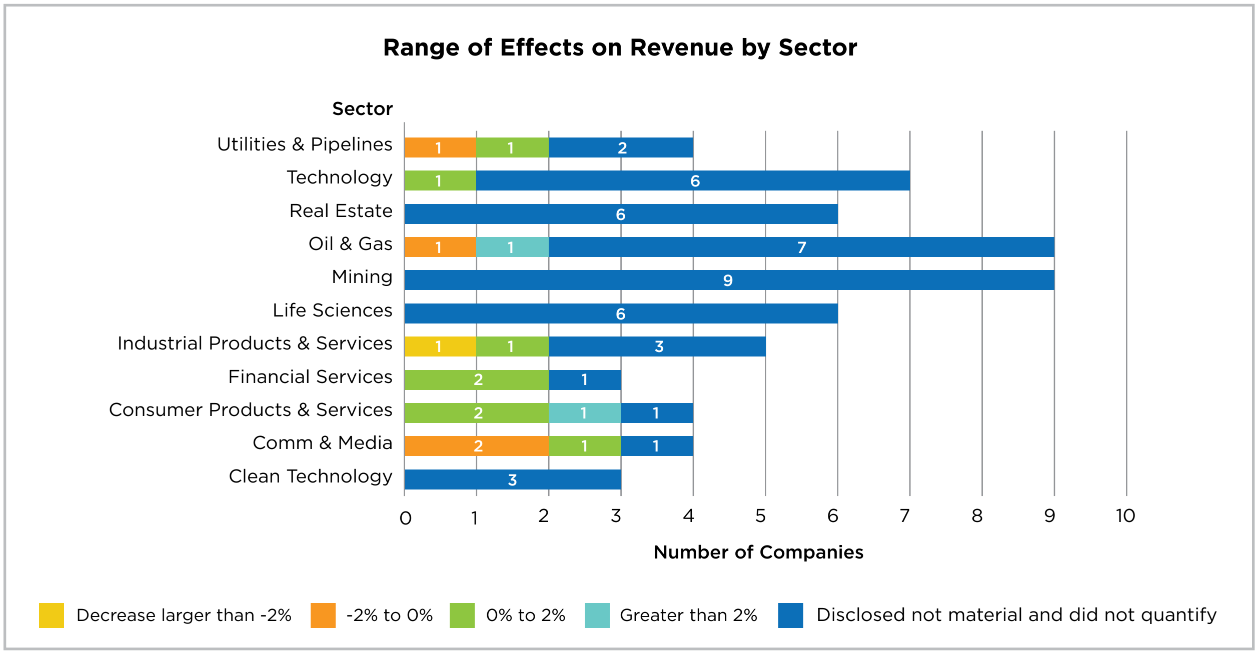


Figure 3 shows that only three companies (all in different sectors: Oil & Gas, Industrial Products & Services, and Consumer Products & Services) disclosed that the effects of the new revenue standard exceeded 2% of revenue. The reasons for the effects varied from company to company. For instance, one company in the Consumer Products & Services sector reported the increase in revenue was primarily due to a change in accounting for advertising fund contributions received to show them as revenue rather than as a reduction of costs. Similar classification issues were reported by other companies.

FIGURE 3: THE EFFECTS OF ADOPTING THE NEW REVENUE STANDARD ON REVENUE REPORTED IN Q1 2018 BY SECTOR



Effects on Net Income

Seventy-five per cent of the companies (45 companies) stated the effects of adopting the new revenue standard were not material and did not quantify the effects. Of the remaining 25% (15 companies), six disclosed that the effects of adoption on net income were less than 2%, and nine quantified the effects as exceeding 2%.

Figure 5 shows that companies in the Communications & Media sector seemed to be most impacted by the new revenue standard. Three of four companies in this sector quantified the effects on net income as exceeding 2%.

The disclosures on the causes of the effects of adopting the new revenue standard on first-quarter net income varied by sector. For instance, in the Communications & Media sector, where the effects exceeded 2%, companies disclosed that the effects on net income were partially due to the revenue recognition issues associated with multiple-element arrangements.

FIGURE 4: THE EFFECTS OF ADOPTING THE NEW REVENUE STANDARD ON NET INCOME IN Q1 2018

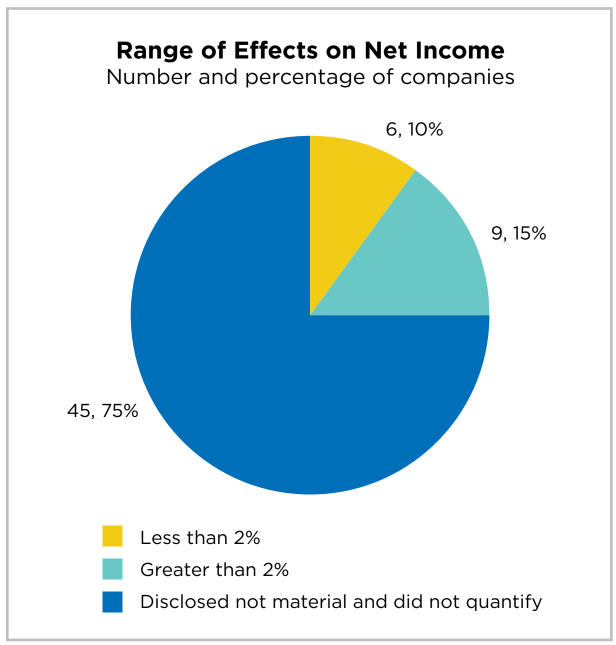
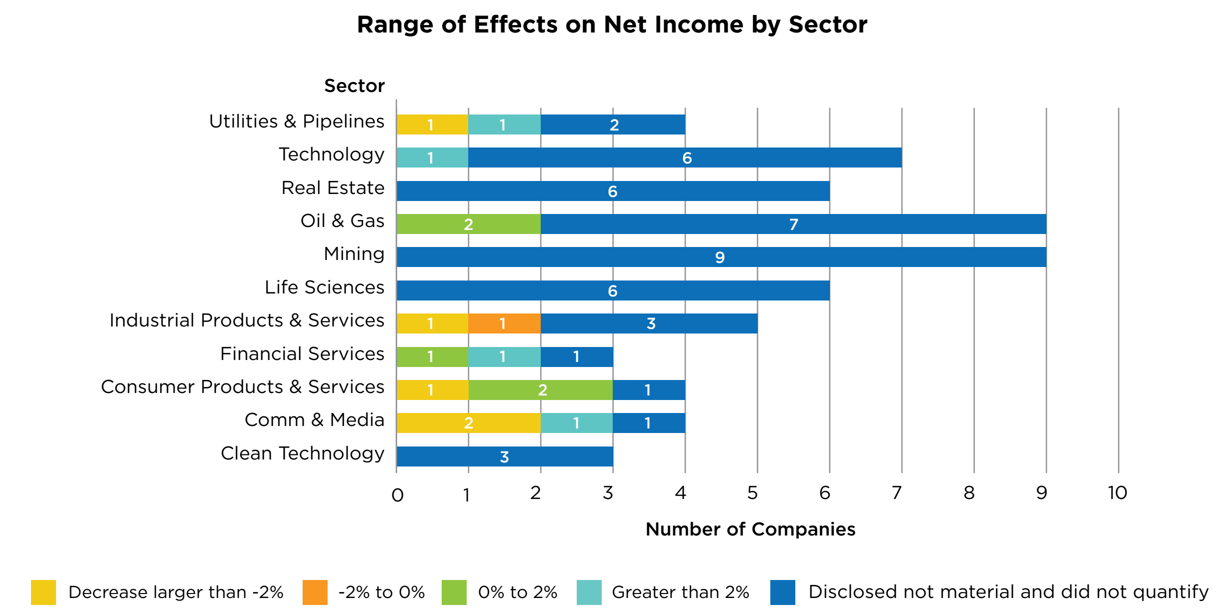


FIGURE 5: THE EFFECTS OF ADOPTING THE NEW REVENUE STANDARD ON NET INCOME IN Q1 2018 BY SECTOR



Quantitative Effects of the New Revenue Standard on Opening 2018 Equity

Figure 6 shows that 65% of companies (39 companies) simply stated the effects of adopting the new revenue standard were not material and did not quantify the effects. Of the remaining 35% (21 companies), 12 disclosed that the effects of adoption on opening 2018 equity were less than 2%, and nine companies quantified the effects as exceeding 2%.

Of the nine companies that quantified the effects of adoption on opening 2018 equity as exceeding 2%, four applied the full retrospective method in adopting the new revenue standard and five used the modified retrospective method (see below for discussion of transition methods).

FIGURE 6: THE EFFECTS OF ADOPTING THE NEW REVENUE STANDARD ON OPENING 2018 EQUITY

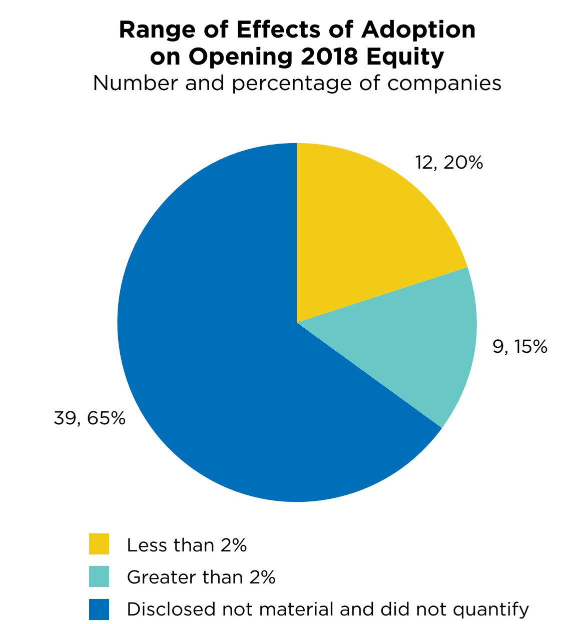
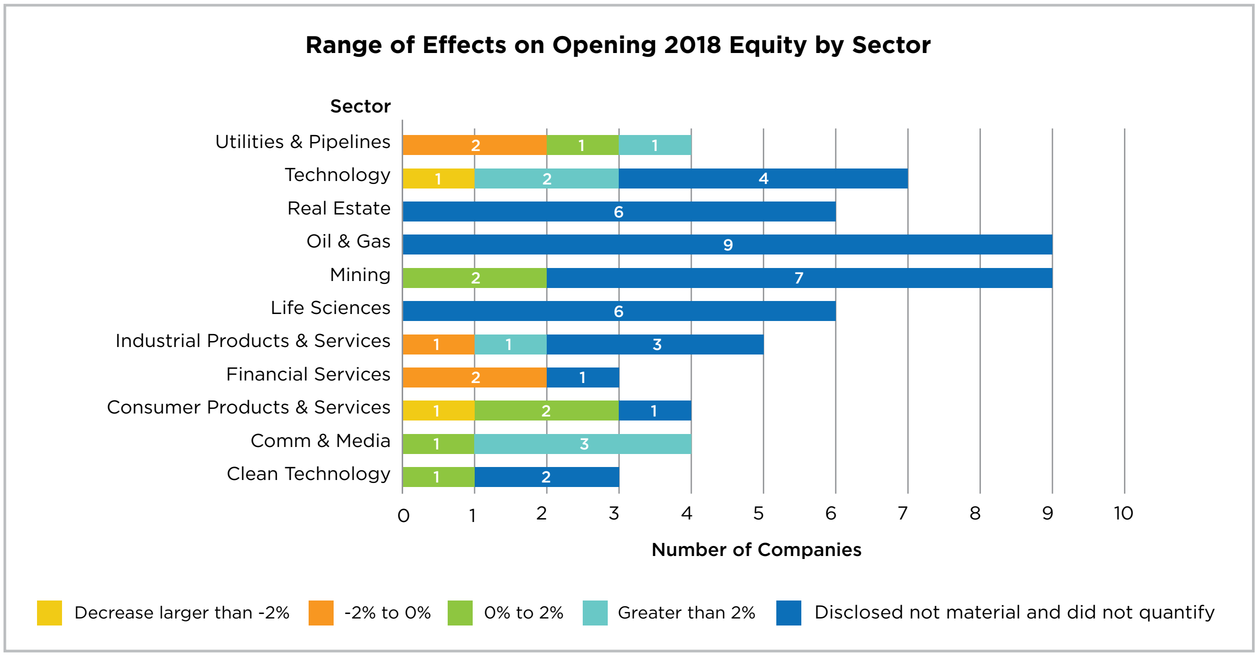


FIGURE 7: THE EFFECTS OF ADOPTING THE NEW REVENUE STANDARD ON OPENING 2018 EQUITY BY SECTOR



Companies in the Communications & Media sector were most affected as three of four companies disclosed that the effects increased opening 2018 equity by more than 2%.

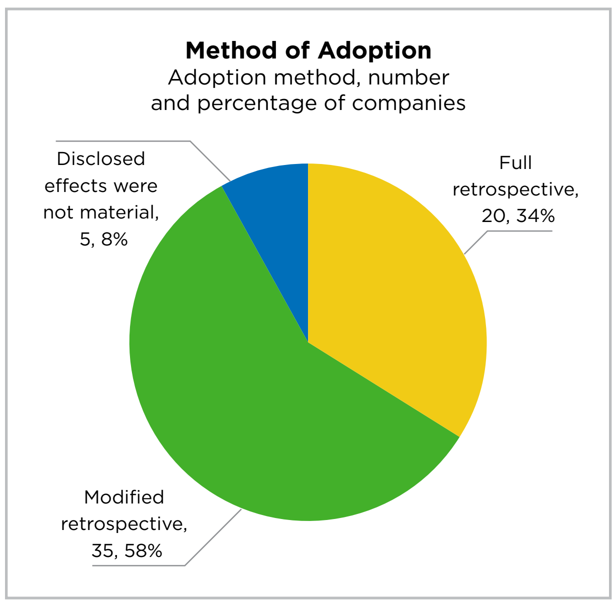
Method of Adoption of the New Revenue Standard

The new revenue standard permits two methods of adoption:

1. a full retrospective approach which requires adjusting all prior periods presented to reflect the new requirements
2. a modified retrospective approach where comparatives are not restated and the cumulative effects of adopting the new revenue standard are included in opening equity.

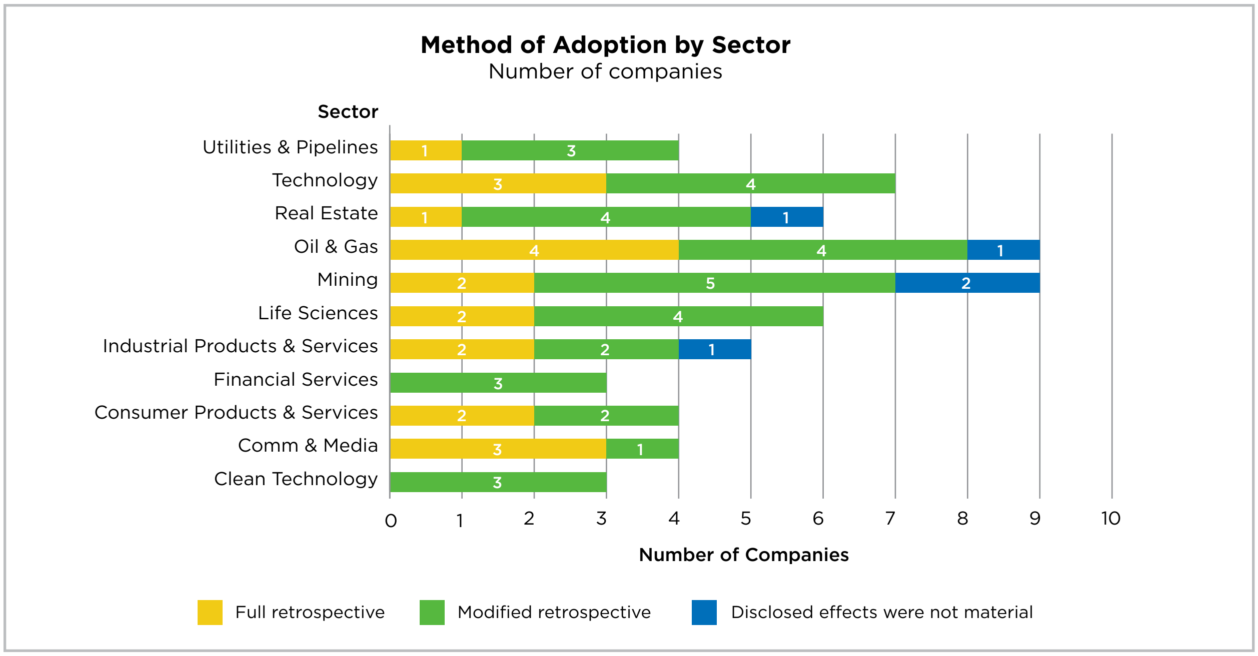
Fifty-eight per cent of companies (35 companies) adopting the new revenue standard opted for the modified approach while 34% (20 companies) applied the full retrospective method. Eight per cent (five companies) did not disclose the method of

FIGURE 8: THE METHOD OF ADOPTION APPLIED



adoption — these companies all disclosed the effects were not material. The full retrospective method was most commonly used in these three sectors: Oil & Gas (four companies), Communications & Media (three companies), and Technology (three companies).

FIGURE 9: THE METHOD OF ADOPTION APPLIED BY SECTOR



Assessing Nature of Disclosures Leading up to the Effective Date of the New Standard

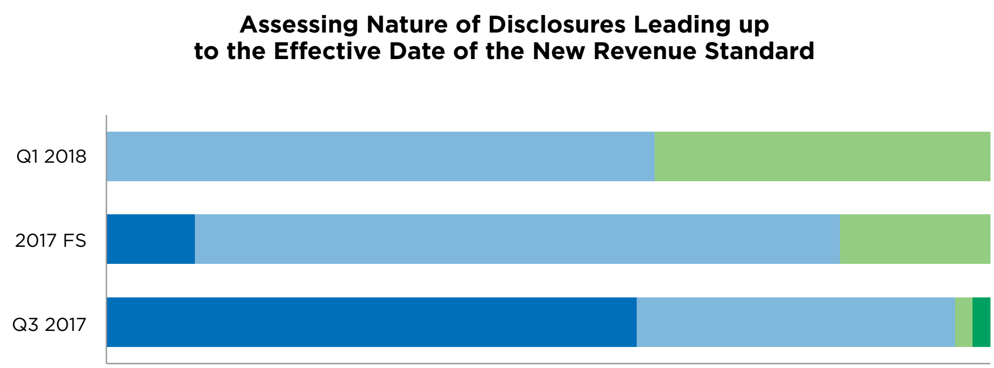
Leading up to the adoption of a new standard, companies should take into consideration the required disclosures needed to help users understand the potential effects and progress of transition to the new standard. For instance, paragraph 28 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* includes disclosures to explain the nature and effect of the change in accounting policy as the new standard is first applied.[2] Canadian securities regulators have also stated that companies should provide increasingly detailed disclosure about the expected effects of the new revenue standard as they make progress in their implementation efforts.[3]

2 PwC. In Brief: A look at current financial reporting issues. *Disclosures required in interim financial statements on the initial adoption of IFRS 15*. April 2018. www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-15/initial-adoption-of-ifrs-15.pdf

3 OSC Staff Notice 52-723 — Office of the Chief Accountant Financial Reporting Bulletin. November 2016. www.osc.gov.on.ca/en/SecuritiesLaw_sn_20161124_52-723_financial-reporting-bulletin.htm

To assess the nature of disclosures leading up to the effective date of the new revenue standard, see Figure 10.

FIGURE 10



	Q3 2017	2017 FS	Q1 2018
Assessment not complete	60%	10%	0%
Stated not material	36%	73%	62%
Effects quantified	2%	17%	38%
Stated effects would be material but did not quantify	2%	0%	0%

The category "Stated not material" includes only those companies which explicitly stated that the effects of adopting the new revenue standard were not material or insignificant and did not quantify the effects.

Presentation and Disclosure

The new revenue standard includes, among other things, the requirement to disclose a breakdown of revenue (i.e., a disaggregation of revenue recognized from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors). This disclosure must include sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue and revenue information disclosed for each reportable segment. Sixty-two per cent of companies (37 companies) did not provide any additional information.

Thirty-eight per cent of companies (23 companies) provided a greater breakdown of revenue in the notes as a result of adopting the new revenue standard. Many of these companies included a breakdown of the revenue in each segment (e.g., by product/service, by sales channel or by distinguishing between revenue earned at a point in time vs. revenue earned over time). A few companies found some amounts they classify as revenue were not within the scope of the new revenue standard and so disclosed them separately.

Conclusion

The new revenue standard introduced a significantly different accounting model for revenue recognition. However, for most companies, the effects of adopting the new revenue standards in Q1 2018 were either disclosed as not material (and not quantified) or, if quantified, the effects were less than 2% of revenue, net income and opening equity.

In 2019, IASB and FASB accounting standards for leases will become effective. These will affect a large proportion of companies and will often require changes to systems, processes and controls. Companies are reminded of the importance of timely disclosures about new accounting standards. Auditors should also focus on evaluating the adequacy of these disclosures and related controls.

Appendix A: Scope and Methodology

The findings of this report are based on a sample of 60 Canadian publicly traded companies' financial statements for the third quarter 2017, full year 2017, and first quarter 2018.

Company Selection

The 60 companies reviewed represent approximately 35% of the market capitalization of the S&P/TSX Composite Index (TSX) and S&P/TSX Composite Venture Index (TSXV) across the 11 major industry sectors.[4] Companies were selected to ensure representation of small-cap (<$2B), mid-cap ($2B-$10B) and large-cap (>$10B) organizations (see Table A1). Table A2 summarizes the number of companies reviewed per industry.

TSX Sample Selection

At least three companies in each sector with fiscal year ends of either December 31, 2017, or January 28, 2018 were selected based on their market capitalization. Additional companies were selected to ensure a broad range of companies was reviewed.

TSX Venture Sample Selection

Three companies in each of the oil and gas, mining and technology sectors were selected based on their market capitalization. Additional companies were selected to ensure a broad range of companies was reviewed. Companies that reported no revenue were excluded from the sample.

TABLE A1: COMPANIES SELECTED BY MARKET CAP

Company Size	# of Companies
Large Cap (>$10B)	26
Mid Cap ($2B-$10B)	9
Small Cap (<$2B)	25

4 Market capitalization percentage calculated as of May 30, 2018

TABLE A2: COMPANIES SELECTED BY SECTOR

Sector Name	Number of Companies Selected
Clean Technology	3
Communications and Media	4
Consumer Products & Services	4
Financial Services	3
Industrial Products & Services	5
Life Sciences	6
Mining	9
Oil & Gas	9
Real Estate	6
Technology	7
Utilities & Pipelines	4
Total	60

TABLE A3: COMPANIES SELECTED BY EXCHANGE

Exchange	# of Companies
S&P/TSX Composite Index	45
S&P/TSX Composite Venture Index	15

TABLE A4: COMPANIES SELECTED BY SECTOR AND BASIS OF ACCOUNTING

Sector	Basis of Accounting		Total # of Companies
	IFRS	U.S. GAAP	
Clean Technology	3		3
Communications and Media	4		4
Consumer Products & Services	3	1	4
Financial Services	3		3
Industrial Products & Services	2	3	5
Life Sciences	5	1	6
Mining	9		9
Oil & Gas	8	1	9
Real Estate	6		6
Technology	5	2	7
Utilities & Pipelines	2	2	4
Total	**50**	**10**	**60**

CHARTERED
PROFESSIONAL
ACCOUNTANTS
CANADA

277 WELLINGTON STREET WEST
TORONTO, ON CANADA M5V 3H2
T. 416 977.3222 F. 416 977.8585
WWW.CPACANADA.CA