

# Technical Line

FASB – final guidance

## The new revenue recognition standard – retail and consumer products

Retail and consumer products entities may need to change some aspects of their accounting.

### What you need to know

- ▶ The new revenue recognition standard is more principles-based than current revenue guidance and will require retailer and consumer products entities to exercise more judgment.
- ▶ The standard may affect retail and consumer product entities more than they think. For example, retail and consumer products entities may need to change the way they estimate returns and account for loyalty programs. They also may need to change how they present sales taxes.
- ▶ The standard is effective for public entities for fiscal years beginning after 15 December 2016, including interim periods within those years, and for nonpublic entities in fiscal years beginning after 15 December 2017 and interim periods within fiscal years beginning after 15 December 2018.

### Overview

Retail and consumer product entities may need to change certain revenue recognition practices as a result of the new revenue recognition standard jointly issued by the Financial Accounting Standards Board (the FASB) and the International Accounting Standards Board (the IASB) (collectively, the Boards). The new revenue recognition standard will supersede virtually all revenue recognition guidance in US GAAP and IFRS, including industry-specific guidance that retail and consumer product entities use today.



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The new standard provides accounting guidance 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 US GAAP requirements, such as the leasing literature). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate.

Our Technical Line, [A closer look at the new revenue recognition standard](#) (SCORE No. BB2771), provides an in-depth discussion of the new revenue standard. This publication summarizes the key implications for retail and consumer product entities.

Retail and consumer product entities also may want to monitor the discussions of the Boards' Joint Transition Resource Group for Revenue Recognition (TRG). The Boards created the TRG to help them determine whether more implementation guidance or education is needed. The TRG won't make formal recommendations to the Boards or issue guidance. 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 standard. The AICPA has not established a task force for the retail or consumer product industries. Any views discussed by the TRG or guidance produced by the AICPA is non-authoritative.

The views we express in this publication are preliminary. We may identify additional issues as we analyze the standard and entities begin to interpret it, and our views may evolve during that process. As our understanding of the standard evolves, we will update our guidance.

## Key considerations

The standard may not significantly change the amount and timing of revenue that retail and consumer products entities recognize, but they will need to carefully evaluate all of their contracts and exercise more judgment than they do today. Retail and consumer products entities will need to use more judgment when estimating returns and accounting for loyalty programs, reseller arrangements and licensing and franchising agreements. They also will need to report revenue net of sales taxes. We anticipate that entities will generally reach conclusions similar to those they reach today on accounting for warranties and gift card breakage.

### Rights of return

Retail and consumer products entities typically provide a right of return to customers. Under the new standard, a right of return creates variable consideration. The new standard requires an entity to estimate variable consideration and include in the transaction price amounts for which it is probable that a significant revenue reversal will not occur (i.e., they apply a constraint on variable consideration). In doing so, an entity will consider the products it expects to be returned to determine the amount to which it expects to be entitled (excluding the products expected to be returned). While the amounts that entities estimate for returns may not change significantly under the new guidance, entities may need to adjust their processes and documentation to appropriately apply the new guidance.

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

### **Customer options for goods or services (including loyalty programs)**

Retail and consumer products entities frequently give certain 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, competitor price matching programs aimed at only some customers, gift cards issued by a retailer as a promotion) and customer award credits (e.g., loyalty or reward programs). An option to acquire additional goods or services is a 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).

The assessment of whether a retail or consumer products entity has granted its customer a material right could require significant judgment and may result in a change in accounting from current practice. For example, under current US GAAP, retailers account for loyalty or reward programs using either a cost deferral method or a revenue deferral method. Under the new standard, loyalty or reward programs generally will provide a material right to the customer and therefore will be considered performance obligations. In those situations, entities will use a revenue deferral method similar to the one used today because the cost deferral method will not be acceptable under the new standard.

### **Reseller and distributor arrangements**

The new standard could change practice for retail and consumer products entities that sell their products through distributors or resellers (collectively, resellers). Today, some entities wait until the product is sold to the end customer to recognize revenue because they do not meet all of the criteria in Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) Topic 13 to recognize revenue when they deliver the product to the reseller.

Under the new standard, retail and consumer products entities will need to first evaluate when control of the product transfers to the customer. To do this, entities may need to first assess whether their contracts with resellers are consignment arrangements, under which control likely does not transfer (and thus revenue is not recognized) until the reseller sells the product to an end customer. This result is generally consistent with conclusions entities reach for consignment arrangements under today's guidance.

If an entity concludes that its contract with a reseller is not a consignment arrangement, the reseller will be considered the customer. The entity will recognize 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 recognize revenue earlier than it does today if it can determine that it is 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).

### **Licenses and franchise arrangements**

Retail and consumer products entities frequently enter into brand licensing or franchising arrangements. Entities will have to consider whether such contracts include distinct licenses of intellectual property (IP) in order to apply the guidance appropriately. The new guidance requires the use of judgment when analyzing whether a license of IP is a right to access the IP or a right to use it. This determination affects whether amounts allocated to the distinct license should be recognized as revenue over the license period (right to access) or at the time the license is provided (right to use). This determination depends on the facts and circumstances for licenses of IP, and we believe this may lead to interpretive questions.

In addition, the guidance requires entities to recognize sales- and usage-based royalties from licenses of IP generally when the sales 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 license and consulting or training services that would be provided over time and would affect the amount of royalties earned). The TRG has discussed a number of views, including whether the exception should apply solely to a license that is a separate performance obligation or whether it should apply regardless of whether the royalty also relates to a non-license good or service. It is not yet clear whether the Boards will provide additional guidance.

### **Amounts collected on behalf of third parties**

Under the new standard, the transaction price must exclude any amounts collected on behalf of third parties, such as sales taxes. Under today's guidance, entities can elect to include in revenue the sales taxes collected on behalf of third parties (gross basis) or exclude them (net basis).

### **Sales of nonfinancial assets (including real estate)**

Retail and consumer products entities may dispose of manufacturing facilities or other property following prescriptive real estate rules today. The new model for derecognizing nonfinancial assets (including real estate) differs significantly from the current guidance and follows several parts of the new revenue standard for measurement and recognition. As a result, gains on sales of these assets may be recognized sooner than they are today. Refer to our Technical Line that will discuss the effect of the new revenue standard on contracts in the real estate industry for more information.

Retail and consumer products entities will be required to report revenue net of sales taxes.

### **Next steps**

- ▶ Entities should perform a preliminary assessment on how they will be affected as soon as possible so they can determine how to prepare to implement the new standard. While the effect on entities will vary, some may face significant changes in revenue recognition. All entities will need to evaluate the requirements of the new standard and make sure they have processes and systems in place to collect the necessary information to implement the standard, even if their accounting results won't change significantly or at all.
- ▶ Entities may want to monitor the discussions of the Boards, the SEC staff and the TRG.
- ▶ Public entities also should consider how they will communicate the changes with investors and other stakeholders, including their plan for disclosures about the effects of new accounting standards discussed in SAB Topic 11.M. The SEC staff expects entities' disclosures to evolve in each reporting period as more information becomes available.

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