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Implementing the New Revenue Recognition Standard for the Restaurant and Retail Industries

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The far-reaching impact of the new revenue recognition standard will affect different industries in different ways. To be ready when the new guidance goes into effect, financial executives in the restaurant and retail industries need to understand the potential effects of the coming changes and determine the best way to implement the new guidance in their organizations.

In May 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued their much-anticipated converged standard on revenue recognition. The FASB issued Accounting Standards Update (ASU) No. 2014-09, and the IASB issued International Financial Reporting Standard (IFRS) 15, both titled "Revenue From Contracts With Customers." With only minor differences, the joint standard represents a single, global, principles-based revenue recognition model. The guidance will affect almost every entity that recognizes revenues from contracts with customers, so financial executives within the restaurant and retail industries will need to understand the significant changes from their current revenue recognition model.

On Aug. 12, 2015, the FASB issued ASU 2015-14, "Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date," which deferred the effective dates of the revenue recognition standard by one year. Although the standard gives organizations an additional year to evaluate the impact of the revenue recognition standard and put in place the systems and processes necessary for compliance, restaurant and retail industries entities should not postpone or slow down the development and execution of their implementation plans. The revised adoption dates are:

- Public entities: fiscal years beginning after Dec. 15, 2017, including interim periods within those fiscal years
- Nonpublic entities: fiscal years beginning after Dec. 15, 2018; interim periods beginning after Dec. 15, 2019
- Early application: permitted for fiscal years beginning after Dec. 15, 2016, including interim periods within those fiscal years

Since the FASB issued the new standard, it has been active in issuing ASUs. In addition to the original standard, companies should also assess the impact of these ASUs on their current revenue recognition model. Although the core principle has remained the same, additional clarification, practical expedients, and examples have been added by the following ASUs:

- ASU 2016-08 – "Revenue From Contracts With Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)"
- ASU 2016-10 – "Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing"
- ASU 2016-12 – "Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients"
- ASU 2016-20 – "Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers"

For many entities, the number of performance obligations identified in contracts with customers will change under the new standard, as will the allocation and timing of revenue recognition. The effort required for an entity to analyze and document revenue transactions is likely to increase, and the number of disclosures in its financial statements is likely to grow as well.

The Crowe webinar recording "New Revenue Recognition Standard – Consumer Products and Retail" includes a description of the five steps in the new revenue recognition model; an overview of revenue recognition over time or at a particular point in time; presentation and disclosure requirements, and transition and implementation considerations; and effective dates. To supplement that webinar recording, the following is a discussion of important issues for financial executives of restaurant and retail industries companies to consider when determining the impact the standard is likely to have on their organizations.

Four Areas of Impact

Four of the areas in which the new guidance could significantly affect revenue recognition for companies that operate in the restaurant and retail industries are customer options for additional goods or services, unexercised rights of customers (such as gift cards), sales tax, and the right of return.

Customer Incentives and Loyalty Programs

A customer's option to acquire goods or services for free or at a discount can come in many forms, such as:

- Sales incentives
- Customer award credits, for example, loyalty or point programs
- Contract renewal options
- Other discounts on future goods or services

Under the new standard, granting the option for customers to acquire additional goods or services may give rise to a performance obligation. For the contract to give rise to an additional performance obligation, the option must provide a material right to the customer that would not be available without entering into the contract and that right must be incremental to any other promotional campaign that is being offered to all customers. This material right requires companies to allocate a portion of the transaction price to the incentive and defer revenue until the related performance obligations are satisfied or expire.

The requirement to allocate a portion of the transaction price to the incentive could have a material effect on companies that are currently accounting for the issuance of incentives in accordance with the U.S. generally accepted accounting principles (GAAP) incremental cost method. Under the incremental cost accrual method, the company providing the incentive is not required to consider the issuance of the incentive as a revenue element. Following is an illustration of the impact of the new standard on customer options for additional goods or services:

FACT PATTERN	A retailer sells a sweater for $50 and at the time of the sale provides the customer with a coupon for $10 off the customer's next transaction if at least $50 is spent on additional items and the new transaction occurs within 30 days of the original transaction. This discount is significant to the transaction and provides the customer with a material right that would not have been given without the original transaction.
CURRENT GUIDANCE	Revenue generally is not deferred. The incremental costs relating to the coupon are accrued when probable and reasonably estimable, which in some cases may not occur until the coupon is redeemed.
NEW STANDARD	To compute the coupon's stand-alone selling price, the retailer estimates that there is a 50 percent likelihood that a customer will redeem the coupon. Therefore, the retailer's estimated stand-alone coupon value is $5 (a 20 percent discount of a future required $50 transaction – that is, $10 off a $50 transaction multiplied by a 50 percent likelihood of the coupon being used). The retailer allocates $4.55 – that is, $50 × ($5 ÷ ($5 + $50)) – of the transaction price to the coupon and recognizes revenue for the coupon when the customer redeems it. The retailer allocates $45.45 ($50 - $4.55) to the sweater and recognizes revenue at the point of sale. If the coupon is not redeemed, the retailer should consider the guidance related to changes in estimates of the pattern of customers' unexercised rights, as described in the following "Gift Cards" section.

Gift Cards

At times, restaurants and retail companies experience unexercised portions (breakage) of nonrefundable prepayments associated with a customer's right to receive a good or service in the future – for example, gift cards. If an entity expects to be entitled to a breakage amount in a contract liability, the entity should recognize an expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. If an entity does not expect to be entitled to a breakage amount, the entity should recognize the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote.

Under the current guidance, companies are entitled to use one of two methods: the redemption method or the expiration method. The new standard is similar to the redemption method in which revenue is recorded based on historical customer patterns if that information is objectively verifiable. Under the expiration method, an entity recognizes revenue when the right to receive goods or services expires. Under the new standard, it is less likely that entities will wait until expiration to recognize revenue, although facts and circumstances still will need to be considered.

As a result, the new standard could have a significant impact on companies that sell goods or services in advance. Following is an illustration of the impact of the new standard on customers' unexercised rights:

FACT PATTERN	A pet food retailer sells five $100 gift cards for a total price of $500. The gift cards expire 12 months from the date of the purchase. Based on experience, the pet food retailer knows that 20 percent of the gift card value will not be used by the expiration date of the gift cards. This estimate is based on objective information supported by historical transactions.
CURRENT GUIDANCE	Based on facts and circumstances, the pet food retailer can use either the redemption method or the expiration method, in which revenue would be recognized as the gift cards are redeemed and/or any unused gift cards expire.
NEW STANDARD	The pet food retailer will recognize 20 percent of the total transaction of $500, or $100 ($500 × 20%), pro rata over the period from the date of purchase to the expiration date of the gift cards as an estimate of the breakage revenue to be received.

Sales Tax

Under the current revenue recognition guidance, companies make an accounting policy election to report sales tax either gross (included in revenue and costs) or net (excluded from revenue).

The new revenue standard excludes amounts collected on behalf of third parties from the transaction price definition. As a result, companies will need to consider on a jurisdiction-by-jurisdiction basis which amounts should be reported gross and which should be reported net based upon principal versus agent guidance.

This part of the implementation of the new guidance could be very costly for retail entities based on the number of jurisdictions in which they are operating and the variation in tax laws among federal, state, and local jurisdictions. In order to avoid this time-consuming and expensive process, companies can make an accounting policy election to exclude amounts collected from customers for all sales (and other similar) taxes from the transaction price.

Right of Return

Rights of return are fairly common in the restaurant and retail industries, and their treatment will not be very different under the new standard.

Under current revenue recognition rules, revenue would be recognized when goods are sold if future returns can be reasonably estimated. An allowance would be established for estimated returns with an offset against revenue. If potential returns cannot be reasonably estimated, revenue cannot be recognized on the product until the right of return ends.

Under the new standard, companies will be required to make this assessment under step three when determining the transaction price. The impact of returns will need to be estimated using either the probability-weighted approach or the most likely outcome approach. This estimate will need to be evaluated and updated at each reporting date. Once the estimate is determined, companies will be required to record an asset for estimated cost of inventory, less any expected costs to recover and any decline in value. A corresponding liability also will need to be established for estimated refunds to customers. In addition, restocking fees associated with any expected returns should be included in the transaction price when control is transferred (as the associated restocking costs should also be accrued based on a transfer of control based on historical experience).

As always, revenue should only be recognized when it is probable that a significant reversal of revenue will not occur in the future.

Next Steps

The American Institute of CPAs (AICPA) has released its first installment of *Revenue Recognition – Audit and Accounting Guide* (“the *Guide*”). This publication addresses key accounting implementation issues related to Accounting Standards Codification (ASC) Topic 606, “Revenue From Contracts With Customers,” and related updates through FASB ASU 2016-12. At its completion, the guide will include 16 industry-specific F chapters that address accounting implementation issues, and provide industry- specific illustrative examples of how to apply the new standard. It will also provide in-depth coverage of audit considerations from risk assessment and planning to execution of the audit. In 2016 and to date in 2017, the AICPA has released industry issues for public comment, some of which were finalized and included in the first installment of the *Guide*. The AICPA is expected to issue more issues for public comment and issue additional installments of the *Guide* in the coming months. Companies should monitor issues presented by the AICPA task forces for applicability to the restaurant and retail industries.

The questions that arise with the new standard are where to begin and what steps need to be performed to comply with the new standard. Crowe has developed an implementation framework that outlines the key steps companies will need to go through to verify they are ready to recognize revenue under the new standard. The following six-step model can be used to implement the standard:

- Understand the new standard
- Gather information including customer agreements, performance obligations, and pricing information
- Evaluate the impact of the standard
- Select a transition approach
- Design your solution
- Implement and monitor

Further detail of these steps is explained in the Crowe webinar recording “New Revenue Recognition Standard – Consumer Products and Retail.” Please visit the Crowe Revenue Recognition Resource Center at www.crowe.com/revenue-recognition.

The views offered in this article do not necessarily reflect all of the implementation issues that have been identified or are yet to be identified. As more entities implement the standard, the stakeholders in the process likely will identify new issues related to how the guidance is to be applied in specific situations and additional guidance may be made available through updates to the AICPA’s *Revenue Recognition – Audit and Accounting Guide*, which is expected to be updated early in 2017. The FASB issued additional related ASUs in 2016 and could issue additional guidance in the future.

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