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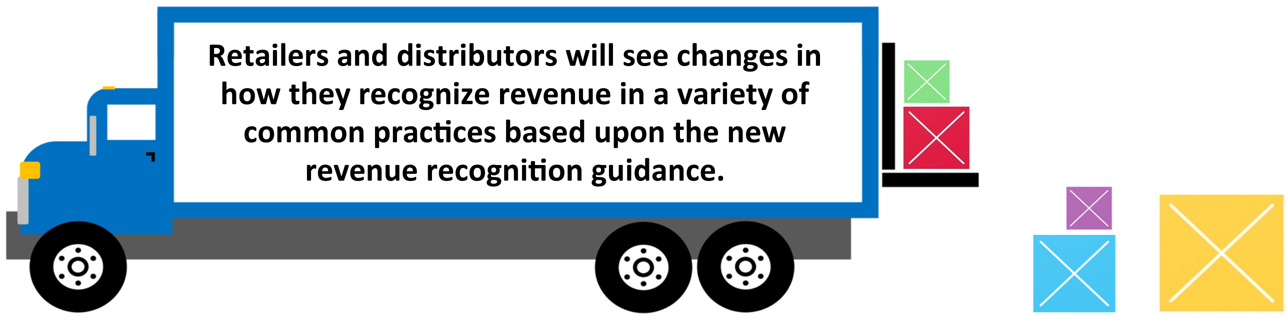
INDUSTRY OF IMPACT:

RETAIL AND DISTRIBUTION



This along with the following points warrant further consideration:

Timing of Revenue Recognition

Current Generally Accepted Accounting Principles (GAAP) treat sales by retailers and distributors as product sales recognized when goods are shipped or delivered to a customer (point in time). The new standard will also use the point in time criteria but will rely on the transfer of control of the goods rather than the transfer of risk and rewards criteria under current GAAP.

Loyalty and Rewards Programs

Under the current guidance, certain entities account for their loyalty and reward programs using the incremental cost method. This method states revenue can be recognized initially for the sale of the goods/services while simultaneously recording a liability for the estimated costs of the associated reward program. The new standard requires those entities to change their accounting to defer an allocated portion of revenue attributable to the rewards until they are redeemed.

Volume Discounts

Volume discounts can be applied towards future purchases or retrospectively. Retailers and distributors will need to review their sales agreements and any volume based discounts to determine whether a material right exists. Material rights are options provided to a customer only upon entering a contract and represent separate performance obligations under the contract.

Direct Response Advertising

While current GAAP allows capitalization of direct response advertising costs, the new standard changes this treatment. These costs will now be required to be expensed either as they are incurred or the first time the advertising takes place. The updated treatment is similar to how all other advertising costs are treated under current GAAP.

Up-Front Payments to a Customer

It is a common practice for retailers and distributors to make up-front payments to the customers for slotting fees, pay-to-play arrangements, and other transactions. In most cases, these should be treated as a reduction in the transaction price and, therefore, revenue, since these payments do not provide a distinct good, service, or any additional value to customers. If the up-front payment does relate to a good or service, consideration should be made if it should be treated as a separate performance obligation in the contract.

Rights of Return

Much of the new standard's requirements for rights of return are similar to current practices. One difference though involves entities now having to present a right of return asset (representing an estimated value of products they expect to receive back) and a refund liability. This will be a change in practice from current GAAP for many retailers and distributors.

Principal Versus Agent

As with current guidance, proper identification is required of all parties and their roles involved in transactions as principals (parties providing the goods or services themselves) or agents (parties providing services on behalf of another entity). The new standard's focus on which party can transfer control of the product will define whether the parties are principals or agents.

Gift Cards

Current GAAP does not contain specific, authoritative guidance on gift card breakage (the practice of recognizing revenue on gift cards). Retail entities, however, primarily practice two methods of recognizing gift card revenue: over the customers' estimated usage (redemption recognition method) or when the usage is considered remote (delayed recognition method). Under the new standard, entities will follow the variable consideration guidelines to determine breakage. Companies currently utilizing the redemption recognition method can expect similar accounting under the new guidance. For entities applying the delayed recognition method, while the method will still be allowed to be used, they should expect to see an acceleration in recognizing breakage.

Additional Resources

This is by no means a complete list of the new standard's effect on retail and distribution. Please consult your financial partners at Ellin & Tucker or one of our Distribution Services team members to review the impact of the new standard on your company. Visit us at ellinandtucker.com or call 410.727.5735.

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SUMMARY OF CHANGES TO REVENUE RECOGNITION

FASB Accounting Standards Update No. 2014-09

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, developed as part of the convergence initiatives of the FASB and International Accounting Standards Board (IASB) to align accounting standards, reduce industry specific complexities, and shift the thought process of recording revenue from a rules based process to a principles based approach. **This standard replaces nearly all existing revenue recognition guidance**.

The new standard will go into effect in calendar year 2018 for public business entities and calendar year 2019 for private companies. Implementation may also affect earlier periods.

MAIN PROVISIONS

The standard creates the following five steps for recognizing revenue:

1 IDENTIFY THE CONTRACT

A contract is an agreement between a customer and vendor for goods or services. It requires commercial substance, identification of the rights and obligations of each party, and has a high probability of fulfillment.

2 IDENTIFY THE CONTRACT'S SEPARATE PERFORMANCE OBLIGATIONS

These are the distinct goods or services to be delivered. A good or service is considered distinct if it is a separate line item in the contract and the customer can utilize it on a stand-alone basis. The goods or services should not depend on or significantly modify another deliverable.

3 DETERMINE THE TRANSACTION PRICE

The transaction price is the amount the vendor expects to be paid when the goods or services are delivered to the customer. The transaction price takes into account any discounts, financing components, variable and noncash consideration, as well as amounts payable to the customer.

4 ALLOCATE THE TRANSACTION PRICE OVER THE PERFORMANCE OBLIGATIONS

The total transaction price must be allocated to the distinct performance obligations. This is accomplished by accumulating the stand-alone prices of the deliverables and allocating the transaction price on a pro-rata basis. The normal selling price for the goods or services is used to determine stand-alone prices. If such price does not exist, a best estimate can be used.

5 RECOGNIZE REVENUE AS THE ENTITY SATISFIES PERFORMANCE OBLIGATIONS

Revenue is recognized as control of the deliverable passes from the vendor to the customer. This happens either at a point in time (buying groceries) or over time (construction project). Control is considered to have passed when the customer has the ability to use the goods or received benefit of the services. How this transfer takes place determines whether recognition occurs at a point in time or over time.

DISCLOSURES

Specifically, the new standard includes disclosure requirements for:

- Disaggregation of revenue
- Contract balance, including changes during the period
- Performance obligations
- Significant judgements
- Assets recognized to obtain or fulfill a contract, including changes during the period