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Accounting for revenue is changing

The impact on food, drink and consumer goods companies

Have you planned for the effects on:

- payments to distributors and retailers?
- discounts, rebates and other incentives?
- contact manufacturing arrangements?
- warranties?
- returns?
- licences and franchises?
- royalties?
- transition options?

How could your business be affected?

Now that the IASB and FASB have published a new joint standard on revenue recognition, the real work for the food, drink and consumer goods (FDCG) companies is just beginning. IFRS 15 and FASB ASC Topic 606 *Revenue from Contracts with Customers* were issued in May 2014, replacing the existing IFRS and US GAAP revenue guidance, and introducing a new revenue recognition model.

The new standard will result in significant impacts across the FDCG sector, requiring companies to assess how their financial reporting, information systems and processes will be affected, and engage with their stakeholders to build up expectations of how their key performance indicators or business practices may change. In particular, FDCG companies will need to review their arrangements with distributors and retailers – e.g. trade incentives, warranties, returns and licences – to assess whether the amount or the timing of revenue recognised under the new standard will be affected.

The new standard takes effect in January 2017, although IFRS preparers can chose to apply it earlier. While the effective date may seem a long way off, decisions need to be made soon – namely, when and how to transition to the new standard. An early decision will allow you to develop an efficient implementation plan and inform your key stakeholders.

Determining the impact

	Potential impact	Actions to consider
Payments to distributors and retailers	• FDCG companies often make payments to their distributors and retailers – e.g. for product placement in the retailer's store ('slotting fees'), promotion events or co-branded advertising. Under current US GAAP, such amounts generally reduce revenue. Under current IFRS, in the absence of specific guidance, such amounts are either recognised as a reduction of revenue or as an expense depending on their nature. • Under the new standard, an FDCG company considers whether it receives a distinct good or service. If so, then it recognises such payments as expenses when the distinct good or service is consumed, if not, then it recognises such payments as a reduction of revenue. • If an FDCG company cannot estimate the fair value of the good or service received, then it recognises the payments as a reduction of revenue. If the payment to the distributor or retailer exceeds the fair value of the good or service provided, then any excess is a reduction of revenue.	• Review arrangements involving payments to distributors and retailers to determine if those payments are made in exchange for distinct goods or service or they represent a sale incentive. • Develop or modify processes and adjust systems to capture relevant information for such arrangements. • Carefully consider the terms of arrangements with distributors and retailers to determine the appropriate treatment of such payments under the new standard. For many of these arrangements, this will require significant judgement and appropriate internal controls, and documentation to support that judgement.
Discounts, rebates and other incentives	• Trade incentives provided by FDCG companies take many forms, including cash incentives, discounts and volume rebates, free or discounted goods or services, and customer loyalty programmes. Currently under IFRS, incentives are accounted for as a reduction of revenue, as an expense, or as a separate deliverable (as in the case of customer loyalty programmes) depending on the type of incentive. • Under the new standard, discounts, rebates, credits, price concessions, performance bonuses and similar incentives are treated as variable consideration. Variable consideration is included in the transaction price at the company's best estimate and is included in revenue to the extent it is highly probable that there will be no significant reversal of the cumulative amount of revenue when any pricing uncertainty is resolved. The requirements of the new standard may change the accounting for some FDCG companies. • The guidance on customer loyalty programmes in the new standard is broadly similar to the current IFRS guidance. However, the availability of the residual approach to allocate consideration between the sales transaction and the award credits is restricted under the new standard.	• Review arrangements involving trade incentives and determine their impact on the transaction price. • Consider whether the allocation method that is currently applied to account for customer loyalty programmes remains acceptable under the new standard.
Contract manufacturing arrangements	• Under the current requirements, contract manufacturing arrangements such as for the manufacture of drinks or other consumables are generally treated as product sales and an FDCG company recognises revenue when the manufactured goods are delivered to the customer. • Under the new standard, if an FDCG company determines that it satisfies a performance obligation to manufacture goods under the contract over time, then it recognises revenue over time – e.g. as the manufacturing takes place – rather than at a point in time – e.g. when the product is delivered. This could result in a significant change in recognition of revenue from contract manufacturing arrangements under which an FDCG company produces goods specifically for an individual customer based on the customer's specification, because such arrangements may qualify for recognition of revenue over time.	• Review contract manufacturing arrangements and the obligations under them to assess any potential impact. • Develop new processes and adjust systems to capture information for arrangements in which the performance obligation is satisfied over time.

	Potential impact	Actions to consider
Warranties	• Product warranties are commonly supplied with the sale of a product. The new standard distinguishes between two types of warranty. • If a customer can purchase the warranty separately or receives a service over and above guaranteeing compliance with agreed-upon specifications ('service-type warranty'), then an FDCG company accounts for such warranty as a separate performance obligation – i.e. it allocates the transaction price to the product and the warranty, and recognises revenue in respect of the warranty over the warranty period rather than at the point of sale of the product. • If a warranty only covers the compliance of the product with agreed-upon specifications ('assurance-type warranty'), then it is accounted for as a cost accrual under relevant IFRS or US GAAP guidance, similar to the current requirements.	• Review warranty arrangements to assess the nature of the warranty provided. • Assess any changes to existing billing or financial systems that are required to be able to separately account for warranties that represent separate performance obligations.
Returns	• Under the current requirements, an FDCG company adjusts revenue for expected returns. The new standard's approach of adjusting revenue for the expected level of returns and recognising a refund liability is broadly similar to current guidance. However, the detailed methodology for estimating revenue may be different for some companies.	• Review existing methodology to assess for compliance with the new requirements.
Licences and franchises	• Licences of intellectual property (e.g. franchise rights) are a common practice in FDCG sector. Under the new standard, an FDCG company first needs to determine whether to apply the new standard's specific guidance on licence revenue. • Under this guidance, revenue is recognised either over time if the licence grants the customer a right to access to the intellectual property, or at a point in time if it grants the customer a right to use the intellectual property. Although these outcomes may be similar to accounting for licences under current IFRS guidance, an FDCG company needs to review each distinct licence to assess its nature under the new standard. It is possible that revenue recognition may be accelerated or deferred compared with current practice. • If the new standard's specific guidance on licences does not apply, then the licence is accounted for together with the other promised goods or services in the performance obligation. • This is an area of future developments as the IASB and FASB are considering amending to clarify the licence guidance.	• Evaluate existing arrangements involving licences to identify whether any licences should be accounted for separately. • Review the nature of licences that represent separate performance obligations to determine if revenue related to them should be recognised over time or at a point in time. • Assess any required changes to existing billing or financial systems to be able to capture required information.
Royalties	• Under the new standard, revenue for sales- or usage-based royalties relating to intellectual property is recognised when the sale or usage takes place or, if later, when the performance obligation to which the royalty has been allocated has been partially or fully satisfied. Similar to current practice, there is no requirement to estimate such amounts on transfer of the licence to the customer. • Other types of royalties are accounted for as variable consideration under the new standard.	• Evaluate existing arrangements to identify whether the sales- or usage-based exemption applies. • Develop the processes and controls for arrangements not covered by the exemption and make the required estimates and forecasts.
Transition options	• The new standard may be adopted retrospectively, by restating comparatives and adjusting retained earnings at the beginning of the earliest comparative period. • Alternatively, the new standard may be adopted as of the application date, by adjusting retained earnings at the beginning of the first reporting year (the cumulative effect approach).	• Quantify and evaluate the effects of the different transition options, including the available practical expedients under the retrospective approach. • Perform a historical analysis of key contracts. Consider whether existing systems provide the data required to produce comparative information if the new standard is applied retrospectively.

You can find more detailed information about IFRS 15 in our publications Transition to the New Revenue Standard and Issues In-Depth.

How we can help

KPMG's Consumer Markets practice

KPMG's Consumer Markets practice is dedicated to supporting consumer markets companies globally in understanding industry trends and business issues. Member firms offer customised, industry-tailored services that can lead to value-added assistance for your most pressing business requirements. Our extensive network of professionals combines in-depth industry knowledge with extensive experience helping clients managing accounting transitions with what they entail.

For those affected by the new revenue recognition requirements, the impact will be felt far beyond accounting change. The following are just a few examples of how our cross-functional team of experts has helped clients across various sectors – including Consumer Markets – with the accounting and operational challenges.

- Performing an overall impact assessment to identify the key revenue streams that may be impacted by IFRS 15.
- Performing a detailed accounting diagnostic to identify and prioritise the impacts on accounting policies and disclosures, including information gaps.
- Reviewing key accounting policies and accounting manuals.
- Identifying and analysing key contracts under the IFRS 15 lens.
- Assisting in redrafting contract documentation.
- Identifying the impacts to internal management reporting, including key financial measures and ratios.
- Assisting in developing clear communication with stakeholders regarding the impact of IFRS 15 on earnings.
- Mapping information requirements to existing sources and defining required information that is not currently available in your existing systems.
- Identifying data collection needs to meet the new disclosure requirements.
- Assisting in changing systems and processes to meet the new requirements.
- Providing training to finance teams.
- Identifying corporate and indirect tax implications and impact on distributable reserves.

Starting now will allow you to assess the impact and design an appropriate response plan that allows time for unanticipated complexity.

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