Accounting for revenue is changing

What's the impact on food, drink and consumer goods companies?

March 2017

The new revenue standard – effective from 1 January 2018 – is likely to affect the way you account for revenue. But it is more than just an accounting change.

It could impact:

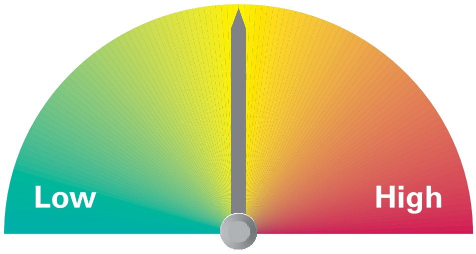
- timing of revenue recognition for:
  - trade incentives
  - contract manufacturing
  - licences and franchises
- treatment of payments to distributors and retailers
- systems and processes, including data collection

If you have:

- payments to distributors and retailers
- discounts, rebates and other incentives
- contract manufacturing arrangements
- warranties
- returns
- licences and franchises
- royalties

Engage with your stakeholders to build up expectations of how your KPIs or business practices may change.

Determining the impact



Payments to distributors and retailers

Potential impact

- Food, drink and consumer goods (FDCG) companies often make payments to their distributors and retailers – e.g. for product placement ('slotting fees'), promotion events or co-branded advertising. Currently, such amounts are 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 or the payment exceeds the fair value of the good or service provided, then the payment or the excess is a reduction of revenue.

Actions to consider

- 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.
- For many of these arrangements, this will require significant judgement and appropriate internal controls, and documentation to support that judgement.
- Develop or modify processes and adjust systems to capture relevant information for such arrangements.

Discounts, rebates and other incentives

Potential impact

- 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, incentives are accounted for as a reduction of revenue, as an expense, or as a separate deliverable (e.g. customer loyalty programmes) depending on the type of incentive.
- Under the new standard, trade incentives are treated as variable consideration. Variable consideration 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 new requirements may affect some FDCG companies.
- The guidance on customer loyalty programmes in the new standard is broadly similar to the current practice. However, the use of the residual approach to allocate consideration between the sales transaction and the award credits is restricted.

Actions to consider

- 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

Potential impact

- Currently, contract manufacturing arrangements – e.g. for the manufacture of 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 over time, then it recognises revenue over time – e.g. as the manufacturing takes place. This could result in a significant change for arrangements under which an FDCG company produces goods based on the customer's specification, because such arrangements may qualify for recognition of revenue over time.

Actions to consider

- 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.

Returns

Potential impact

- 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.

Actions to consider

- Review existing methodology to assess for compliance with the new requirements.

Warranties

Potential impact

- 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, similar to the current requirements.

Actions to consider

- 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.

Licences and franchises

Potential impact

- 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 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 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 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.

Actions to consider

- 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

Potential impact

- 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.

Actions to consider

- 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[1]

Potential impact

- IFRS 15 may be adopted retrospectively, by restating comparatives and adjusting retained earnings at the beginning of the comparative period.
- Alternatively, IFRS 15 may be adopted as of the application date, by adjusting retained earnings at the beginning of the first reporting year (the cumulative effect approach).

Actions to consider

- 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.

1. You can find more detailed information about IFRS 15 in our publications *Transition to the new revenue standard* and *Issues In-Depth*.

How KPMG can help

Assess the impacts → Design a tailored approach → Help implement a future state

A robust assessment phase is critical to laying the framework for a successful project, and it is important to start the assessment early to provide flexibility during the implementation phase. An assessment phase typically includes the following activities:

Activities	Actions	Deliverables
Accounting diagnostic	– Identify potential gaps to accounting policy and disclosures by reviewing current accounting policy and sample of contracts – Leverage your existing documents and knowledge	Gap matrix, heat map and contract review summaries
Process and information gap analysis	– Identify new information and process requirements – Trace requirements to existing sources or identify gaps	Business requirements document, process and information gap analysis report
Technology and broader impact evaluation	– Identify potential impact on IT, tax, controls, operations, FP&A, investor relations, etc. – Identify gaps and linkages across the organisation	Final gap matrix and heat map, implementation roadmap
Transition option assessment	– Determine how each option may impact financials and business – Assess readiness to elect the retrospective or cumulative effect option	Transition option assessment report

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.

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Publication name: *Accounting for revenue is changing: What's the impact on food, drink and consumer goods companies?*

Publication date: March 2017