

ASC 606 CONSIDERATIONS for Food and Beverage

STEP ONE: IDENTIFY THE CONTRACT

- ❑ Wholesalers that receive product shipments are generally considered the ASC 606 customer.
- ❑ An ASC 606 'contract' must be collectible. Consider a customer's ability and willingness to pay, especially for new or less stable customers. A letter of credit could offset this risk.
- ❑ A pricing arrangement with indirect customers (such as a buying organization or a distributor) usually does not create an ASC 606 contract.
- ❑ Evaluate if an ASC 606 'contract' exists if goods are delivered without a signed contract.

STEP TWO: IDENTIFY THE PERFORMANCE OBLIGATIONS

- ❑ Review contract terms for ASC 606 implications, particularly verbal or implicit promises in customary arrangements for significant customers.
- ❑ Evaluate promises made to the end customers (the customer of your customer) of your distributors, as these may be ASC 606 performance obligations. This includes explicit and implicit promises if they are 'distinct' (per ASC 606) from the other goods or services in the arrangement with the distributor.
- ❑ Free goods or services, if distinct and material at the contract level, are usually a separate performance obligation.
- ❑ Review customer options for additional products or services as they may be deemed to be a separate performance obligation. Certain options to purchase future goods at a discount may be a 'material right', which is a performance obligation. Review pricing plans for this possibility. Consult ASC 606 or Withum for details.



EXAMPLES: Distributor K sells its goods to Retailer R, and K promises to provide an extended warranty to all of R's customers for free. K reviews the promise, and determines that this extended warranty is distinct from the goods, and therefore rises to the level of a separate performance obligation.

STEP THREE: DETERMINE THE TRANSACTION PRICE

- ❑ Good-quality estimates of probable variable consideration (such as rights of return, rebates, coupons and volume discounts) are included in determining the total transaction price.
- ❑ Follow the ASC 606 guidance on variable consideration when accounting for breakage estimates for gift cards. Forecasted breakage should be estimated, and recognized as revenue over time, proportionately as the gift card is exercised. Retailers need to have robust evidence to support the amount of estimated breakage. Accumulating breakage data and developing historical redemption trends is a best practice. Consider escheat laws in your jurisdiction as you develop these estimates.
- ❑ Retrospectively applied discounts and warranties that provide for cash payments to the customer are typically considered to be variable consideration.

EXAMPLE: Retailer R extends price protection for 3 months to Customer C. Based upon similar experience, R estimates what it will ultimately reimburse C for, and records that amount as a contract liability (a reduction of revenue).

STEP FOUR: ALLOCATE THE TOTAL TRANSACTION PRICE TO ALL THE PERFORMANCE OBLIGATIONS

- ❑ This step only applies if there is more than 1 performance obligation.
- ❑ Customer loyalty programs (such as rewards points) are usually a separate performance obligation that receives an allocation of the total transaction price. Consider which entity is expected to honor the ultimate redemption of accrued customer loyalty rewards. In order to execute this allocation, companies will need to develop robust processes to calculate good quality estimates of the value of the awards likely to be redeemed.

EXAMPLE: Distributor K sells its goods to Retailer R. R offers a frequent buyers program whereby customers earn points towards a free future purchase, or a material discount on a future purchase, that D is expected to honor.

STEP FIVE: RECOGNIZE REVENUE FOR EACH PERFORMANCE OBLIGATION

- ❑ In a sell through model, evaluate when ASC 606 control of the product is transferred to the customer. Based upon this assessment, revenue may be recognized earlier or later than under current practices.
- ❑ In arrangements under synthetic FOB shipping (wherein transit losses are usually honored by the seller), determine when ASC 606 control of the goods has truly passed to the customer.
- ❑ Generally, an ASC 606 balance sheet will reflect a new asset for expected returns, at cost. However, since returned food and beverage items may usually not be restocked or resold, do not record an asset for expected returns.

EXAMPLE: A food and beverage company (FB) uses a distributor to distribute its goods to end customers. The distributor receives legal title, and is obligated to pay FB, but must also return any unsold products at the end of the contract term. FB must analyze the ASC 606 indicators of transfer of control in order to determine when to recognize revenue and the related returns.



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