

ASC 606 CONSIDERATIONS for Retail Companies

STEP ONE: IDENTIFY THE CONTRACT

- An essential element of a contract is that payment terms need to be identified.
- 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 or credible guarantee could offset this risk.
- A pricing arrangement with indirect customers usually does not create an ASC 606 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.
- 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 a separate performance obligation. Certain options to purchase future goods at a discount may be a 'material right', which is a performance obligation, not variable consideration (see Step 3). Review special offers and pricing plans for this possibility. Consult ASC 606 or Withum for details.
- Customer loyalty programs (such as rewards points) are usually a separate performance obligation.
- Evaluate warranties, both explicit and implicit, offered on goods or services. If the warranty is sold separately, this usually creates a separate performance obligation. Warranties that provide for cash payments to a customer are usually variable consideration (see Step 3). Implied warranties usually require further assessment.



EXAMPLES: Retailer R runs a promotion whereby its customers will receive a free box of product X if they buy 2 boxes of X. This is likely a material right, and therefore a separate performance obligation. A portion of the total transaction price will be allocated to a contract liability for this material right.

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.
- ❑ Since customer loyalty programs (such as rewards points) are usually a separate performance obligation, part of the transaction price will be allocated to them. Companies will need to develop robust processes to calculate good quality estimates of the value of the customer loyalty awards likely to be redeemed. This will require developing robust processes that consider redemption patterns, breakage estimates, and the ultimate value of the award points

EXAMPLE: A retailer offers a frequent buyers program whereby customers earn points towards a free future purchase, or a material discount on a future purchase.

STEP FIVE: RECOGNIZE REVENUE AS THE CUSTOMER ACHIEVES CONTROL OF THE GOODS OR SERVICES

- ❑ Generally, an ASC 606 balance sheet will reflect a new asset for expected returns, at cost. However, since return policies may vary or limit certain returns, consider that impact on the asset for expected returns. Also consider whether rework to restock is required which could affect the recorded cost of the return asset, such as packaging, repairs, and discounts for seasonal impacts.
- ❑ The accounting for consignment, "on approval", or layaway arrangements is substantially the same, however consider carefully when ASC 606 control of the good is passed from the retailer to the customer. A customer has control when it has the ability to direct the use of, and obtain the remaining benefits from, the product, even if it does not have physical possession of the product.

EXAMPLE: A retailer enters into a bill-and-hold arrangement with a customer. The contract has specific criteria about the delivery mode, date, and availability of the customer to receive the goods. The retailer cannot recognize revenue until all of the bill-and-hold criteria are met, and ASC 606 control of the goods has passed to the customer.



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