Pwc revenue recognition guide asc 606

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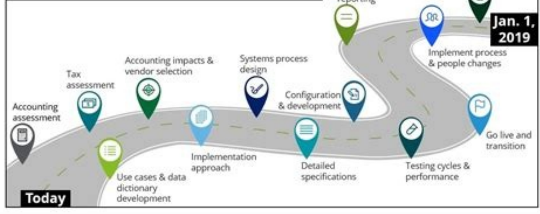

Revenue recognition asc 606 examples. Asc 606 revenue recognition explained. When to recognize revenue under asc 606.

PwC is pleased to offer our accounting and financial reporting guide for Revenue from contracts with customers. This guide summarizes the applicable accounting literature, including relevant references to and excerpts from the FASB's Accounting Standards Codification (the Codification). It also provides our insights and perspectives, interpretative and application guidance, illustrative examples, and discussion on emerging practice issues. The PwC guides should be read in conjunction with the applicable authoritative accounting literature. References to US GAAP Definitions, full paragraphs, and excerpts from the FASB's Accounting Standards Codification are clearly designated, either within quotes in the regular text or enclosed within a shaded box. In some instances, guidance was cited with minor editorial modification to flow in the context of the PwC Guide. The remaining text is PwC's original content. References to other PwC guidance This guide provides general and specific references to chapters in other PwC guides to assist users in finding other relevant information. References to other guides are indicated by the applicable guide abbreviation followed by the specific section number. The other PwC guides referred to in this guide, including their abbreviations, are: Business combinations and noncontrolling interests (BCG)Financial statement presentation (FSP)IFRS and US GAAP: similarities and differences (SD)Leases (LG)Not-for-profit entities (NP)Property, plant, equipment and other assets (PPE)Transfers and servicing of financial assets (TS) Summary of significant changes Following is a summary of the noteworthy revisions to the guide since it was last updated. Additional updates may be made to future versions to keep pace with significant developments. Revisions made in February 2022 Chapter 3, Identifying performance obligations RR 3.2.3 was added to expand the discussion of stand-ready obligations.RR 3.6.2 was updated to expand the discussion of exclusivity provisions.Figure RR 3-1 was added to RR 3.6.1 to illustrate the assessment of whether activities undertaken to fulfill a contract are separate performance obligations. Chapter 8, Practical application issues RR 8.3 was updated to clarify the difference between an assurance-type warranty and a guarantee. Chapter 9, Licenses RR 9.7.1.1 was added to include discussion of a license modification that includes a renewal and other changes. Chapter 10, Principal versus agent considerations Question RR 10-3 was added to RR 10.4 to address the income statement classification of shipping and handling costs. Copyrights This publication has been prepared for general informational purposes, and does not constitute professional advice on facts and circumstances specific to any person or entity. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication. The information contained in this publication was not intended or written to be used, and cannot be used, for purposes of avoiding penalties or sanctions imposed by any government or other regulatory body. PricewaterhouseCoopers LLP, its members, employees, and agents shall not be responsible for any loss sustained by any person or entity that relies on the information contained in this publication. Certain aspects of this publication may be superseded as new guidance or interpretations emerge. Financial statement preparers and other users of this publication are therefore cautioned to stay abreast of and carefully evaluate subsequent authoritative and interpretative guidance. The FASB Accounting Standards Codification® material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, and is reproduced with permission. 1. www.pwc.com/us/insurance New Revenue Recognition Rules How will they affect loyalty programs? 2. PwC 2 In May 2014, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) jointly issued a converged standard on revenue recognition. Almost all revenue- generating entities (e.g., public, non-public, not-for- profit) will be affected to some extent by the new standard. The accounting for loyalty programs, particularly for U.S. GAAP preparers, is likely to be one area of significant change. The new guidance will result in greater deferral of revenues, changes in balance sheet liabilities, and additional financial statement disclosures. Companies will need to account for points issued as a separate obligation, which involves developing more robust models to enable management to comply with these new accounting requirements. Specifically, companies will need to thoroughly consider concepts such as redemption curves, breakage estimates, and value of a point. This paper provides an overview of the accounting requirements in the new revenue recognition standard for loyalty programs. Although the effective date of the new revenue recognition standard is a couple of years away, the efforts required to ensure compliance for loyalty programs may be significant and will likely impact many systems, processes, and policies. General background Since 2002, the FASB and IASB have been working on a joint project to develop a new principles-based revenue standard that applies across all industries. The Boards have long recognized that current revenue recognition requirements in generally accepted accounting principles in the United States (U.S. GAAP) differ from those in International Financial Reporting Standards (IFRS), and both sets of requirements could be improved. While U.S. GAAP includes broad revenue recognition concepts, there are over 200 industry- specific and prescriptive guidelines resulting in different accounting for economically similar transactions. In contrast, IFRS has been criticized for not providing sufficient detail, which makes it difficult to apply the current guidance to complex transactions and to multiple-element arrangements. The goal of the joint project was to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and IFRS that clarifies the principles for recognizing revenue and that can be applied consistently across various transactions, industries, and capital markets. With the FASB's issuance of Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606), and the IASB's issuance of IFRS 15, Revenue from Contracts with Customers, such standardization should promote better understanding and comparability across these dimensions for financial statement users. An essential concept embedded in the new standard is the alignment of revenue recognition with the satisfaction of performance obligations. It requires that all the obligations of a contract with a customer (verbal, written, or implied) be separately identified to the extent they are distinct, with the price paid by the customer allocated to each of those performance obligations. Revenue is then recognized when each of the performance obligations is transferred to the customer. Depending on the initial goods and services being provided, the new guidance may or may not change the pattern of revenue recognition. For normal product sales in the retail and consumer markets for example, the timing of revenue recognition might not change significantly under the new standard as the transfer of control of the goods to the customer typically occurs at the same time as (or very close to) payment. Whatever the initial good or services being provided though, the consideration allocated to loyalty programs needs to be deferred as it relates to future products and/or services that will be purchased with an accumulation of earned credits or points. Another important concept included in the new standard is the requirement to use a "relative standalone selling price" to allocate the consideration to the loyalty program awards/points. 3. PwC 3 Current U.S. GAAP accounting for loyalty programs Under current U.S. GAAP, revenue recognition is broadly addressed under Staff Accounting Bulletin SAB 101: New Revenue Recognition Guidelines as well as SAB 104: Revenue Recognition. Under these guidelines, recognition of revenue is linked intrinsically to the completion of the earnings process as well as the transfer of the risks and rewards of ownership to the end customer. As there were no specific rules for loyalty programs, FASB's Emerging Issues Task Force (EITF) offered additional guidance with Issue No. 00-22, Accounting for "Points" and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future. A related EITF Issue (No. 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products) also provides guidance for GAAP recognition of revenue for customer loyalty programs. Under these guidelines, two dominant accounting approaches have emerged in the U.S. to recognize and measure loyalty program revenues and costs. Incremental Cost Model. Under this approach, a company immediately recognizes revenue at the time of the qualifying purchase (i.e., when points are earned). At the same time, the company records a liability for the cost associated with the company's future obligation to its customers. Divergent practices have emerged as to how this cost is determined, ranging from incremental to full-cost estimates. The program liability is reduced for customer's redemption, forfeiture, or expiration of accrued awards/points. Deferred Revenue or Multiple-Element Model. Under this alternative approach, the issuance of points is viewed as a separate component of a sale. Therefore, a company defers the recognition of a portion of its revenue, which is directly related to the earning of loyalty points, to a future period in which the customer either redeems the awards/points or they are subject to forfeiture or expiration. This approach often uses a fair value approach (versus incremental cost) to calculate the deferral amount. Aside from the different revenue recognition methodologies, both approaches establish a liability on the balance sheet – "program liability" under the incremental cost approach or "unearned program revenue" under the deferred revenue model – between the time points are earned by customers and the time points are redeemed, forfeited, or expired. The liability is established net of breakage under both approaches. The amount of the liability, and therefore the impact on a company's net income, is often larger under the deferred revenue approach as the revenue associated with rewards is typically greater than its costs, particularly if only incremental costs are considered. The new revenue standard is more consistent with the deferred revenue model. It will likely result in later revenue recognition for a portion of the transaction price for those currently using an incremental cost model – which happens to be the more prevalent practice in the United States. In addition, the transaction price allocated to the loyalty points could be different using the relative standalone selling price concept being introduced in the new standard, as explained later in this paper. Current IFRS accounting for loyalty programs For companies accounting under international rather the U.S. GAAP standards, IFRIC 13 was issued in 2007 (effective July 1, 2008) to provide more specific guidance and to bring greater consistency regarding the treatment of loyalty program liabilities. The two major concepts underlying the application of IFRIC 13 to loyalty program accounting are: The issuance of credits or points must be accounted for as a separate component of the sale (similar to the performance obligation concept in the new standard). In essence, this requires a deferred revenue approach, whereby the income statement immediately recognizes the portion of revenue related to the sale of a good or service and defers the remaining revenue allocable to the value of loyalty points. This deferred revenue is recognized when the loyalty points are redeemed, forfeited, or have expired. The process of calculating the amount of deferred revenue when issuing points must be based upon the fair value of those points to the customer. This guidance means that a company must defer the 4. PwC 4 value of the points according to the value that customers put upon them, using either the fair value (a residual method) or relative fair value of the points. Although similar to the deferred revenue alternative sometimes used under U.S. GAAP, IFRIC 13 additionally requires the use of a "fair value" concept in valuing loyalty awards/points. Because IFRS 15, Revenue from Contracts with Customers, is generally aligned with the principles- based concepts underlying IFRIC 13, transition to the new standard for loyalty programs under IFRS will not be as dramatic as it will be for some of the programs currently following U.S. GAAP. However, there could be differences in the allocation of the transaction price to the loyalty component based upon the "relative standalone selling price" compared to the guidance currently provided under IFRIC 13. For example, the use of a "residual value" approach allowed under IFRIC 13 would be severely limited under IFRS 15. New model Current U.S. GAAP Current IFRS An option to acquire additional goods or services gives rise to a separate performance obligation if the option provides a material right that the customer would not receive without entering into that contract. The revenue standard requires management to estimate the transaction price to be allocated to the separate performance obligations and to recognize a contract liability for the performance obligations that will be satisfied in the future. The customer is paying for the future goods or services to be received when the award credits are issued in conjunction with a current sale. The entity recognizes revenue for the option when those future goods or services are transferred to the customer or when the option expires. There is divergence in practice in U.S. GAAP in the accounting for loyalty programs. Two models commonly followed are an incremental cost accrual model and a deferred revenue model. Under the incremental cost model, revenue is typically recognized at the time of the initial sale and an accrual is made for the expected costs of satisfying the awards credits. The multiple-element model results in the transaction price being allocated to the products or services sold and to the award credits, with revenue recognized as each element is delivered. The incremental cost model is more prevalent in practice. Loyalty programs are accounted for as multiple-element arrangements. Some revenue, based on the fair value of award credits, is deferred and recognized when the awards are redeemed or expire. Revenue is allocated between the good or service sold and the award credits, taking into consideration the fair value of the award credits to the customer. The assessment of fair value includes consideration of discounts available to other buyers absent entering into the initial purchase transaction and expected forfeitures. Potential impact The new revenue standard is consistent with the deferred revenue or multiple-element model currently required under IFRS, so may have a greater impact on U.S. GAAP reporters. The transaction price is allocated between the product and the loyalty reward performance obligations based on a relative standalone selling price. The amount allocated to the loyalty rewards is recognized as a contract liability and revenue is recognized when the rewards are redeemed or expire. This will generally result in later revenue recognition for a portion of the transaction price for those currently using an incremental cost model. 5-Step process required by the new standard Identify the contract with the customer Identify the performance obligations Determine the transaction price Allocate the transaction price Recognize revenue 5. PwC 5 The core principle of the new revenue recognition guidance is that an entity should recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In order to achieve this matching of revenue with the transfer of promised goods or services to customers, an entity should apply the following five steps. It should be noted that while the revenue recognition standard prescribes accounting for an individual contract with a customer, it allows for application of the guidance to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio. This portfolio concept would likely apply to loyalty programs. Step 1: Identify the contract(s) with a customer Because the new standard applies only to contracts with customers, the first step in the model is to determine if a contract exist and whether that contract is with a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration (i.e., payment). A contract is an agreement between two or more parties that creates enforceable rights and obligations. In many loyalty programs, it is clear that a contract exists between an entity and its program members. In some situations involving more than two parties, however, it is less clear as to which counterparties are "customers" and whether any performance obligations exist. In fact, during the development of the new standard there was considerable debate with financial institutions about the implications for their credit card reward programs which involve the financial institution, the cardholder, and various merchants. Although the bank grants award credits to the cardholder based upon card usage (cardholder agreement), the banks' revenue actually comes from the merchants who separately pay a fee to the bank when a payment is made with a credit card (card acceptance agreements). This issue was addressed by the Transition Resource Group ("TRG") from a U.S. GAAP perspective with the consensus being that many of these arrangements would be outside the scope of ASC 606. Specific guidance on credit card fees exists in ASC 310 and the TRG concluded that if the fees are outside the scope of ASC 606, any associated loyalty points would also be outside the scope of ASC 606. Under IFRS however, no separate guidance exists in respect of credit card fees so we expect banks to continue to defer revenue in respect of credit card loyalty programs. Step 2: Identify the performance obligations in the contract A performance obligation is a promise in a contract with a customer to transfer a good or service to the customer. If an entity promises in a contract to transfer a bundle of goods or services to the customer, the entity should account for each promised good or service as a separate performance obligation if it is distinct. Loyalty programs typically result in a transaction whereby a customer buys goods or services and is also entitled to customer award credits. The customer can redeem the credits for awards such as free or discounted goods or services (e.g., hotel nights, flights, retail goods, etc.). The award credits are a distinct promise from the product or service initially purchased so represent a separate performance obligation. Step 3: Determine the transaction price The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. For loyalty programs, determining the overall transaction price for the performance obligations is relatively straightforward. Its allocation to the performance obligations within the contract (e.g., product and loyalty program awards) is more challenging, as discussed in the next step. Interestingly, loyalty programs often involve an implicit financing element, as the customer has paid in advance for goods or services. For example, there may be a significant delay between the payment (earning of 6. PwC 6 awards/points) and performance (award redemption). With particular relevance to loyalty programs, however, is a "practical expedient" – where an entity that is paid in advance for goods or services need not reflect the effects of the time value of money when the timing of transfer of those goods or services is at the customer's discretion. In such a case, it is understood that the main purpose of the loyalty program is not to provide a financing element. Step 4: Allocate the transaction price to the performance obligations in the contract To allocate an appropriate amount of consideration to each performance obligation, an entity must determine the relative standalone selling price at contract inception of the distinct goods or services underlying each performance obligation and allocate the transaction price in proportion to those standalone selling prices. A standalone selling price is defined as the price at which an entity would sell a promised good or service separately to a customer. The best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the standalone selling price of that good or services. If a standalone selling price is not directly observable, an entity can estimate it as an amount that would result in the allocation of the transaction price meeting the same allocation objective after considering all information (including market conditions, entity-specific factors, and information about the customer or class of customers) that is reasonably available to the entity. Suitable methods for estimating the standalone selling price of a good or service include, but are not limited to, the following: Adjusted market assessment approach, e.g., using competitor pricing, adjusted to reflect an entity's own costs and margins Expected cost plus a margin approach Residual approach – the total transaction price less the sum of the observable standalone selling prices of other goods or services. (This approach is only allowed, however, when the good or service has not previously been sold on a standalone basis or where the selling price is highly variable and not discernible from past transactions.) For many loyalty programs, the transaction price of the initial good or service is likely to be directly observable (i.e., the price paid by the member for a hotel room, flight, etc.). However, the standalone selling price of the loyalty awards might require some estimation (which could change over time) to consider potential customer discounts, breakage, variability/change in costs, etc. Even when an entity sells points directly to customers for cash, these rarely represent a standalone selling price. This is because points sold for cash are typically intended to allow customers to top-up their balance to obtain their desired redemption, so they are usually priced at a premium and volumes available for sale are generally restricted. In the allocation process, the sum of the standalone selling prices for the promised goods or services almost always exceeds the contract's total consideration, implying a discount is embedded in the arrangement because customers who are loyalty program members very rarely pay extra to obtain their points. The discount should be allocated to the separate performance obligations based on relative standalone selling prices, so that the discount is allocated proportionately to all performance obligations. Breakage One very important aspect of determining the standalone selling price of loyalty program awards/points is to consider the likelihood that the option will be exercised or "cashed in." In developing the standalone selling price of loyalty program awards/points, the standard indicates that it should reflect "breakage," that is, the proportion of the total earned points that will not be redeemed due to point expiration, point balances below the minimum reward level, and dormant or cancelled members. Breakage can be a significant component in the calculation of program obligations and is often estimated on an aggregate level using actuarial methods based upon historical redemption patterns. Breakage is factored into the standalone selling price of the points. The greater the expected breakage, the lower the value of the points to the customer, which leads to more consideration being allocated to the initial goods or services. Anticipated breakage arising from points not expected to be utilized is recognized as revenue in proportion to the pattern of rights exercised by the customer provided that the entity can reliably estimate breakage and pass the variable consideration constraint. 7. PwC 7 The assessment of breakage should be updated each reporting period. Changes in breakage estimates should be accounted for by way of a cumulative catch up adjustment to revenue. Step 5: Recognize revenue when (as) the entity satisfies a performance obligation An entity should recognize revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer. In a loyalty program, the majority of the revenue associated with the initial product purchased is recognized immediately, and the value of the loyal awards/points is deferred until redeemed, forfeited, or expired. The example to the right, from FASB's Topic 606, was created for Customer Loyalty Programs to illustrate the five steps to conform to this standard. Example 52 of FASB Topic 606, Revenue from Contracts with Customers An entity has a customer loyalty program that rewards a customer with one customer loyalty point for every $10 of purchases. Each point is redeemable for a $1 discount on any future purchases of the entity's products. During a reporting period, customers purchase products for $100,000 and earn 10,000 points that are redeemable for future purchases. The consideration owed by the customers is fixed, and the standalone selling price of the purchased products is $100,000. The entity expects 9,500 points to be redeemed. The entity estimates a standalone selling price of $0.95 per point (totaling $9,500) on the basis of the likelihood of redemption. The points provide a material right to customers that they would not receive without entering into a contract. Consequently, the entity concludes that the promise to provide points to the customer is a performance obligation. The entity allocates the transaction price ($100,000) to the product and the points of a relative standalone selling price basis as follows: Product: $91,324 [$100,000 x ($100,000 standalone selling price/$109,500)] Points: $8,676 [$100,000 x ($9,500 standalone selling price/$109,500)] At the end of the first reporting period, 4,500 points have been redeemed, and the entity continues to expect 9,500 points to be redeemed in total. The entity recognizes revenue for the loyalty points of $4,110 [(4,500 points/9,500 points) x $8,676] and recognizes a contract liability of $4,566 ($8,676 - $4,110) for the unredeemed points at the end of the first reporting period. At the end of the second reporting period, 8,500 points have been redeemed cumulatively. The entity updates its estimate of the points that will be redeemed and now expects that 9,700 points will be redeemed. The entity recognizes revenue for the loyal points of $3,493 {[(8,500 total points redeemed/9,700 total points expected to be redeemed) x $8,676 initial allocation] - $4,110 recognized in the first reporting period}. The contract liability balance is $1,073 ($8,676 initial allocation - $7,603 of cumulative revenue recognized). 8. PwC 8 Principal vs. Agent Determining whether an entity is either a principal or agent in a loyalty program transaction is also important in determining the appropriate accounting. An entity usually recognizes revenue on a gross basis if it is the principal in the arrangement and on a net basis if it is an agent. An entity is typically the principal in an arrangement if it obtains control of the goods or services of another party in advance of transferring control of those goods or services to a customer. The entity is an agent if its performance obligation is to arrange for another party to provide goods or services. Points obligation resides with seller An entity that issues loyalty points that it is responsible for satisfying needs to evaluate whether it is an agent or principal. Principals record gross revenue while agents record only a net commission. Based on the latest decisions by the Boards, the new guidance will require entities to consider whether they are the primary obligor, whether they bear inventory risk, and whether they have latitude to determine prices. Points obligation resides with another entity In other cases, a seller may issue another entity's loyalty points as part of a sales transaction in return for paying the other entity a portion of the consideration it receives from the transaction. In this scenario the seller is not responsible for providing redemptions and its only obligation is to issue the points. Here the seller is only acting as an agent of the entity who stands behind the points obligation, and the seller receives a commission for issuing the points. The fair value of the points issued will typically be higher than the amount of consideration passed on to the other entity, with the difference representing the commission. In practice, the seller usually satisfies its performance obligation relating to the issuance of the points at the same time as it provides the initial good or service to the end customer. In this case the seller recognizes all revenue on the same date and records the payment to the other entity for the points issued as a deduction from revenue. Customer options – loyalty points redeemable with another party A retailer offers a customer loyalty program in partnership with an airline that awards one air travel point for each dollar a customer spends on goods purchased from the retailer. Program members can redeem the points for air travel with the airline. The transaction price allocated to each point based on its relative estimated standalone selling price is $0.01. The retailer pays the airline $0.009 for each point redeemed effectively retaining a commission of $0.001. The retailer sells goods totaling $1 million and grants one million points during the periods. The retailer allocates $10,000 of the transaction price to the points, calculated as the number of points issued (one million) multiplied by the allocated transaction price per point ($0.01). The retailer concludes that it is an agent in this transaction in accordance with the guidance in the new revenue standard. How should the Retailer account for points issued to its customers? Analysis The retailer measures its revenue as the commission it retains for each point issued because it concluded that it is an agent in the transaction. The commission is $1,000, which is the difference between the transaction price allocated to the points ($10,000) and the $9,000 paid to the airline. The retailer will recognize its commission when it transfers the points to the customer (upon purchase of goods from retailer) because the retailer has satisfied its performance obligation by transferring control of the air travel points to the customer. 9. PwC 9 New disclosures The new revenue recognition standard requires additional qualitative and quantitative information about loyalty programs regarding its contracts with customers and significant judgments and changes in judgments. Some entities already include information about their loyalty programs within their financial statement footnotes such as a description of the program, recent changes, accounting policy, deferred income, and information about the movement in the number of points outstanding throughout the year. The new standard has extensive new disclosure requirements. The disclosures likely to be most applicable to entities with loyalty programs are: Detailed information as to how the loyalty points liability has moved during the year. Quantitative information is required, so entities may determine that the most appropriate way of complying with this requirement is to reconcile the liability from the opening to closing balance sheet carrying amounts. In addition to the above, the standard specifically requires information about how much revenue recognized in a period was included within deferred income at the previous year end, and the amount of current year revenue that relates to performance obligations satisfied in previous years. This latter requirement will be particularly relevant where an entity makes revenue adjustments due to changes in breakage estimates. An estimate of the timing of satisfaction of the loyalty points liability. This disclosure can be either quantitative or qualitative. A disaggregated analysis of revenue recognized during the year. Many programs have a wide range of redemption partners which may lead to additional line items in this analysis. Entities are also required to provide a qualitative description of the items they have promised to transfer to satisfy their performance obligations, highlighting arrangements in which they are an agent. Information about the methods, inputs and assumptions used for estimating the stand alone selling price of performance obligations (i.e. loyalty points), and hence allocating the transaction price. When designing systems and processes to handle the accounting model required by the new guidance, entities should also be mindful of the disclosure requirements. The reqired disclosures are likely to require entities to gather more disaggregated data than may have been needed in the past. Effective date and transition Due to the pervasiveness of the standard and the importance of reported revenues, the FASB and IASB adopted a longer than typical transition period. Under U.S. GAAP, public companies and non-public entities will start applying the new revenue recognition rules in 2018 and 2019 respectively. U.S. GAAP reporters are permitted to early adopt up to one year early. The revenue standard is effective for entities that report under IFRS beginning in 2018. IFRS has permitted early adoption from the date that the standard was issued. The Boards also allowed two alternative methods for the initial reporting under the revenue standard: 1. Full Retrospective Method – Retrospectively to each prior reporting period presented, subject to certain practical expedients. For public companies, this approach would require application of the new revenue recognition standard to all contracts after January 1, 2018, restatement of all contracts in 2016 and 2017, and a cumulative adjustment (to opening retained earnings) shown as of January 1, 2016. 2. Modified Retrospective Method – Retrospectively with the cumulative effect of initially applying the revenue recognition standard recognized at the date of initial application. For public companies, this approach would also require application of the new revenue recognition standard to all contracts open at January 1, 2018, with a cumulative adjustment shown as of January 1, 2018; however, it would not require restatement of 2016 and 2017 figures. Companies taking this relief would also need to disclose the effect on 2018 figures of applying the new revenue recognition standard for each financial statement line item affected (i.e. disclose 2018 revenue under old GAAP). If accurate and consistent trending data is important over the years, the full retrospective approach might be the preferred approach as prior years' financials would be presented on a consistent basis with the current period. 10. PwC 10 While the modified retrospective transition method is intended to reduce the time and effort in transition for preparers, its requirement to disclose the impact to each financial statement line item effectively results in an entity applying both the new revenue standard and the previous revenue guidance in the year of initial application. A further complication of the modified retrospective method is that the original text only permitted contracts that were not complete from a revenue accounting perspective under previous GAAP to be adjusted on transition. This would have resulted in entities who previously accounted for loyalty programs as cost accruals under U.S. GAAP being unable to adjust the cost accrual to a revenue deferral on transition, because under ASC 605 all revenue had been recognized. Consequently, old points would have remained cost accruals with new points issued being revenue deferrals. The FASB has decided to amend the standard to give entities the option to consider all revenue contracts at transition under the modified retrospective approach, not just those that were incomplete under previous GAAP. Failure to elect this option though will leave entities accounting for legacy points differently to new points resulting in confusion as to whether redemptions satisfy the old cost accrual or result in revenue recognition. This issue does not arise under IFRS because IFRIC 13 already requires revenue deferral so revenue contracts containing unredeemed loyalty points are not complete under previous IFRS guidance. Regardless of which method is used, an entity needs to perform the calculations in order to compute the cumulative catch-up entries. 11. PwC 11 Conclusion Although the effective date of the new revenue recognition standard is a couple of years away (2018), companies with significant loyalty programs may need to consider the impact of the new standard on their processes soon as the efforts required to ensure compliance for loyalty programs may be significant. In fact, depending on which transition rule is selected, some information will need to be collected starting in 2016. For many U.S. GAAP reporters, it is expected that the deferral of loyalty program revenue is likely to increase. Changes to this top-line metric for a company can affect many other financial and operational elements (e.g., key performance indicators, profits for distribution, liabilities, commissions, bonus plans, income taxes, debt covenants, etc.) and may require re-examination of certain agreements. Public companies need to begin communicating with analysts and shareholders about the potential impact of the new authoritative accounting guidance that has been issued but not yet implemented. Getting an early start on understanding and evaluating the impact of the new revenue recognition standard will greatly ease transition issues and allow management to be proactive with its program rather than reactive. For example, it may identify prospective changes in the structure or provisions of their loyalty programs. 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