

Consumer Products Spotlight

Rebranding Revenue Recognition

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The ASU outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance.

The Bottom Line

- On May 28, 2014, the FASB and IASB issued their final standard on revenue from contracts with customers. The standard, issued by the FASB as [ASU 2014-09](#),¹ outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance.²
- The ASU will require consumer products entities to reconsider many of their existing accounting policies and practices. For example, variable consideration that may be created by sales incentives such as volume discounts or customer rebates will need to be estimated and may be constrained.
- The timing of revenue recognition could significantly change under the ASU. For example, entities that currently defer revenue related to goods shipped with “synthetic FOB destination” terms might instead be required to recognize revenue associated with those goods upon shipment. In contrast, revenue may be deferred longer than under current practice when a material right is identified as a performance obligation and the allocated transaction price is recognized when (or as) the material right is exercised.
- The new standard requires significantly more extensive disclosures than current revenue standards. Therefore, consumer products entities may need to modify their systems and processes to gather information about contracts with customers that is not otherwise readily available.

¹ FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*.

² The SEC has indicated that it plans to review and update the revenue recognition guidance in SEC Staff Accounting Bulletin (SAB) Topic 13, “Revenue Recognition,” in light of the ASU. The extent to which the ASU’s guidance will affect a public entity will depend on whether the SEC removes or amends the guidance in SAB Topic 13 to be consistent with the new revenue standard.

Beyond the Bottom Line

This *Consumer Products Spotlight* discusses the framework of the new revenue model and highlights key accounting issues and potential challenges for consumer products entities that recognize revenue under U.S. GAAP or IFRSs. For additional information about the new standard, see Deloitte's May 28, 2014, *Heads Up*.

Background

The goals of the ASU are to clarify and converge the revenue recognition principles under U.S. GAAP and IFRSs while (1) streamlining, and removing inconsistencies from, revenue recognition requirements; (2) providing "a more robust framework for addressing revenue issues"; (3) making revenue recognition practices more comparable; and (4) increasing the usefulness of disclosures. The ASU states that the core principle for revenue recognition is that an "entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."

The ASU indicates that an entity should perform the following five steps in recognizing revenue:

- "Identify the contract(s) with a customer" (step 1).
- "Identify the performance obligations in the contract" (step 2).
- "Determine the transaction price" (step 3).
- "Allocate the transaction price to the performance obligations in the contract" (step 4).
- "Recognize revenue when (or as) the entity satisfies a performance obligation" (step 5).

As a result of the ASU, entities will need to comprehensively reassess their current revenue accounting and determine whether changes are necessary.

Thinking It Through

As a result of the ASU, entities will need to comprehensively reassess their current revenue accounting and determine whether changes are necessary. Entities are also required to provide significantly expanded disclosures about revenue recognition, including both quantitative and qualitative information about (1) the amount, timing, and uncertainty of revenue (and related cash flows) from contracts with customers; (2) the judgment, and changes in judgment, used in applying the revenue model; and (3) the assets recognized from costs to obtain or fulfill a contract with a customer.

Key Accounting Issues

Discussed below are some key accounting issues associated with the new guidance. Although the ASU may not significantly change the way consumer products entities recognize revenue for typical product sales, a number of its requirements may alter current practice.

Promotional Programs, Options for Additional Goods or Services, and Sales Incentives

Consumer products entities are often involved in promotional programs with their customers and may offer customers a variety of sales incentives. In accounting for these activities under the ASU, consumer products entities will need to assess (1) whether to treat promotional programs as a cost (expense) or as a reduction of revenue, (2) whether an option for an additional good or service is a separate performance obligation, and (3) the impact of sales incentives on the transaction price.

Promotional Programs

Consumer products entities may pay (or offer certain allowances to) the customer in exchange for specified promotional benefits (e.g., co-op advertising, specific shelf space,

Although the ASU supersedes certain industry-specific guidance in U.S. GAAP on accounting for vendor allowances, the new guidance is not expected to significantly change the income statement characterization of many common types of allowances.

special promotions). The ASU provides guidance on determining when these benefits represent a separate good or service provided by the customer (i.e., a cost) as opposed to an adjustment to the transaction price (i.e., a reduction of revenue). Specifically, the ASU requires entities to treat the benefit received from a customer as a cost only if it constitutes a distinct good or service. Under the revenue model, a good or service is distinct if both of the following criteria are met:

- *Capable of being distinct* — “The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.”
- *Distinct within the context of the contract* — “The entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.”

If these criteria are met, the benefit acquired represents a separate good or service, and any amounts paid or payable to the customer would be recognized as a cost (expense). In addition, amounts paid (or expected to be paid) for the distinct good or service would be limited to the fair value of the distinct good or service received. Any consideration paid to the customer (or offered in allowances) above the fair value of the distinct good or service received would be recognized as a reduction of revenue.

Thinking It Through

Although the ASU supersedes certain industry-specific guidance in U.S. GAAP on accounting for vendor allowances, the new guidance is not expected to significantly change the income statement characterization of many common types of allowances. However, consumer products entities will need to carefully examine the facts and circumstances of their promotional activities in the context of the standard’s more principles-based model.

Options for Additional Goods or Services

Under the ASU, an incentive that gives a customer the option to acquire additional goods or services (potentially at a discount) may represent a separate performance obligation if it provides a “material right” to the customer that it would not have received without entering into the contract. If an incentive is deemed a separate performance obligation, an entity would allocate a portion of the transaction price to the incentive on a relative stand-alone selling price basis and recognize revenue when control of the goods or services underlying the incentive is transferred to the customer (provided that the customer exercises its right to the incentive) or when the incentive expires.

Thinking It Through

Under the ASU, an entity may need to use significant judgment when determining whether an option to acquire additional goods or services gives the customer a material right that it would not have received without entering into the contract. In addition, an entity should use judgment when allocating the contract consideration between (1) goods or services initially sold and (2) any option to acquire additional goods or services. Consumer products entities currently applying the cost accrual model to future purchase options would be required to reassess their accounting policies in accordance with the standard’s requirements.

Example 49 of the ASU (ASC 606-10-55-336 through 55-339³), which is reproduced below, illustrates the application of the revenue recognition requirements to a discount voucher that gives the customer a material right related to future purchases.

Example

An entity enters into a contract for the sale of Product A for \$100. As part of the contract, the entity gives the customer a 40 percent discount voucher for any future purchases up to \$100 in the next 30 days. The entity intends to offer a 10 percent discount on all sales during the next 30 days as part of a seasonal promotion. The 10 percent discount cannot be used in addition to the 40 percent discount voucher.

Because all customers will receive a 10 percent discount on purchases during the next 30 days, the only discount that provides the customer with a material right is the discount that is incremental to that 10 percent (that is, the additional 30 percent discount). The entity accounts for the promise to provide the incremental discount as a performance obligation in the contract for the sale of Product A.

To estimate the standalone selling price of the discount voucher in accordance with paragraph 606-10-55-44, the entity estimates an 80 percent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase \$50 of additional products. Consequently, the entity's estimated standalone selling price of the discount voucher is \$12 (\$50 average purchase price of additional products × 30 percent incremental discount × 80 percent likelihood of exercising the option). The standalone selling prices of Product A and the discount voucher and the resulting allocation of the \$100 transaction price are as follows:

Performance Obligation	Standalone Selling Price
Product A	\$ 100
Discount voucher	<u>12</u>
Total	<u>\$ 112</u>

Performance Obligation	Allocated Transaction Price	
Product A	\$ 89	$(\$100 \div \$112 \times \$100)$
Discount voucher	<u>11</u>	$(\$12 \div \$112 \times \$100)$
Total	<u>\$ 100</u>	

The entity allocates \$89 to Product A and recognizes revenue for Product A when control transfers. The entity allocates \$11 to the discount voucher and recognizes revenue for the voucher when the customer redeems it for goods or services or when it expires.

Entities will need to use judgment in determining whether the expected value or the most likely amount is more predictive of the amount of consideration in the contract.

Sales Incentives

Sales incentives, such as volume discounts, rebates, or price concessions, may create variability in the pricing of the goods or services offered to the customer. Under the ASU, if the transaction price is subject to variability, an entity would be required to estimate the transaction price by using either (1) the "expected value" approach (i.e., a probability-weighted amount) or (2) the "most likely amount" approach (i.e., management's best estimate), "depending on which method the entity expects to better predict the amount of consideration to which the entity will be entitled." Therefore, entities will need to use judgment in determining whether the expected value or the most likely amount is more predictive of the amount of consideration in the contract.

Regardless of which approach is used to estimate the transaction price, entities would include the estimated consideration in the transaction price only if it is "probable" that any subsequent changes in the estimate would not result in a significant reversal of revenue. Accordingly, entities may have to recognize some or all of the probability-weighted amount or most likely amount.

³ For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

The ASU specifically requires an entity to recognize separately on its balance sheet both a refund liability (for the amount it expects to refund the customer) and an asset (for its right to recover the product from the customer, subject to any potential impairment).

Thinking It Through

Entities should consider factors that could indicate that an estimate of variable consideration is subject to significant reversal, such as susceptibility to factors outside the entity's influence (e.g., subsequent third-party sales, volatility in a market, weather conditions), limited experience with similar types of contracts, long period before uncertainty is resolved, practices of providing concessions, or a broad range of possible consideration amounts. If it is probable that a change in the entity's estimate of variable consideration would result in a significant reversal of revenue, the entity would include in the transaction price some or all of an estimate of variable consideration for which a significant revenue reversal is not probable (this is commonly referred to as the "constraint guidance"). The ASU requires this estimate to be updated in each reporting period to reflect changes in facts and circumstances.

Right of Return

To ensure customer satisfaction, consumer products entities often grant customers the right to return a product. In a manner consistent with current practice, the ASU allows an entity to recognize revenue from the sale of goods subject to a right of return (i.e., the entity's stand-ready obligation to accept a return is not deemed a separate performance obligation). However, the ASU's guidance on estimating the transaction price may differ from current practice. Under existing guidance in ASC 605-15, an entity can recognize revenue when a right of return is granted if it meets certain criteria, including an ability to "reasonably estimate" the amount of future returns. Under the ASU, however, an entity must apply the new guidance on estimating and constraining variable consideration to estimate the amount of consideration to which it expects to be entitled.

Thinking It Through

The ASU's guidance on revenue recognition for a sale with a right of return is largely consistent with current practice under U.S. GAAP. However, the overall principle of the constraint guidance (no significant revenue reversal) may result in different conclusions in certain instances. Accordingly, entities should carefully assess their facts and circumstances.

In addition, the ASU specifically requires an entity to recognize separately on its balance sheet both a refund liability (for the amount it expects to refund the customer) and an asset (for its right to recover the product from the customer, subject to any potential impairment). Entities that do not currently show those amounts separately on the balance sheet will be required to do so (subject to potential impairment if any indicators of impairment exist).

Warranties

Consumer products entities often sell products with warranties that assure customers that the products comply with agreed-upon specifications. In some cases, entities may also offer more extensive warranties (e.g., warranties that provide services for a fixed period after the initial warranty period has expired).

The ASU allows entities to continue to use a cost accrual model to account for warranty obligations (in accordance with ASC 460), but only for warranties ensuring that the good or service complies with agreed-upon specifications. To the extent that a warranty provides a service beyond ensuring that the good or service complies with agreed-upon specifications, it would be accounted for as a performance obligation (consideration would be allocated to this obligation and recognized as it is satisfied). Further, if the customer has the option to purchase the warranty separately, it would also be accounted for as a performance obligation.

Product liabilities, such as compensation paid by an entity for harm or damage caused by its product, do not represent a performance obligation in the contract and

would continue to be accounted for in accordance with the existing literature on loss contingencies in ASC 450-20.

Thinking It Through

The ASU should not change the accounting for most warranties (i.e., typical warranties assuring that the good or service complies with agreed-upon specifications), which are generally accounted for under a cost accrual model. However, consumer products entities may want to reassess all of their warranties to ensure that the warranties are not providing any services beyond assuring the customer that the product complies with agreed-upon specifications.

Licenses

The granting of licenses to customers (e.g., for the use of images or brand names) is common in the consumer products industry. The ASU provides guidance on how an entity would account for the licensing of its intellectual property.

The entity must first assess whether a license is distinct, as defined by the ASU, from other promised goods or services in the contract (see [Promotional Programs](#) above for a discussion of the criteria used to determine whether a good or service is distinct). If the license is not distinct, it should be combined with other promised goods or services and accounted for as a performance obligation. Conversely, if the license is a distinct performance obligation, the entity must assess the nature of the promised license (i.e., whether the license gives the customer a “right to access the entity’s intellectual property as it exists throughout the license period” or a “right to use the entity’s intellectual property as it exists at the point in time at which the license is granted”). A license gives the customer access to an entity’s intellectual property (and, therefore, control of the license is transferred, and revenue is recognized, over time) when the following criteria are met:

- “The contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights.”
- “The rights granted by the license directly expose the customer to any positive or negative effects of the entity’s activities identified in [the sentence above].”
- “Those activities do not result in the transfer of a good or a service to the customer as those activities occur.”

If the license does not meet these criteria, it would represent a transfer of a right to use the entity’s intellectual property as it exists at a point in time (and, therefore, control of the license would be transferred, and revenue would be recognized, at a point in time).

The ASU’s constraint guidance constitutes an exception to revenue recognition under the standard’s model that would preclude an entity from recognizing consideration for an estimate of sales- or usage-based royalties to be paid in exchange for a license of intellectual property. Consideration from arrangements involving such royalties is recognized as revenue only when the customer’s subsequent sales or usage occur.

Thinking It Through

When a license is distinct and deemed to be transferred at a point in time, the ASU may require up-front recognition of license revenue unless some or all of the transaction price is subject to the general constraint guidance or is in the form of a sales- or usage-based royalty. Therefore, an entity may need to recognize nonrefundable up-front license fees and future minimum license fees (not subject to sales indexing) as revenue upon transferring a license to a customer. Meanwhile, any sales-based royalty payments would not be recognized as revenue until the subsequent sales occur.

If a license does not meet the ASU’s “right to access” criteria, it would represent a transfer of a right to use the entity’s intellectual property as it exists at a point in time.

Under the ASU, entities are required to recognize revenue by using a control-based model rather than the risk-and-rewards model of current U.S. GAAP.

Shipping Terms

Consumer products entities may ship goods “FOB shipping point” but have arrangements with their customers under which the seller continues to bear risk of loss or damage (either explicitly or implicitly) that is not covered by the carrier while the product is in transit. If damage or loss occurs under these circumstances, the seller is obligated to provide (or has a practice of providing) the buyer with replacement products at no additional cost. The seller may insure this risk with a third party or “self-insure” the risk. Such shipping terms are often called synthetic FOB destination shipping terms because the seller has retained the risk of loss or damage during transit. Under these terms, all risks and rewards of ownership have not been substantively transferred to the buyer, and it would not be appropriate to recognize revenue before the goods are ultimately delivered to the buyer under current U.S. GAAP.

Under the ASU, entities are required to recognize revenue by using a control-based model rather than the risk-and-rewards model of current U.S. GAAP. Accordingly, entities would consider the following indicators in evaluating the point at which control of an asset has been transferred to a customer:

- “The entity has a present right to payment for the asset.”
- “The customer has legal title to the asset.”
- “The entity has transferred physical possession of the asset.”
- “The customer has the significant risks and rewards of ownership of the asset.”
- “The customer has accepted the asset.”

Thinking It Through

Under the ASU, arrangements involving synthetic FOB destination shipping terms may give rise to two performance obligations: (1) sale of a product and (2) protection against the risk of loss during transit. Instead of deferring all revenue recognition, consumer products entities would need to allocate the transaction price to each identified performance obligation and assess the satisfaction of each performance obligation separately. In those cases, revenue recognition could be accelerated depending on the determination of when control related to the underlying performance obligations is transferred.

Sell-Through Arrangements

Consumer products entities often enter into arrangements in which they deliver products to a distributor or dealer (“intermediary”), which then sells the product to the customer. Under existing guidance, revenue at times may be deferred until the intermediary has subsequently sold the goods to the customer, often because the sales price may not be fixed or determinable until final sale to the customer. The ASU precludes an entity from recognizing revenue for a good physically transferred to a third party on consignment until control of that good is transferred to the third party. However, if the arrangement between the entity and the intermediary is not a consignment arrangement, an analysis of the control indicators for determining at what point in time control is transferred (see [Shipping Terms](#) above) is critical to determining when revenue may be recognized.

The ASU requires entities to disclose both quantitative and qualitative information that enables “users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.”

Thinking It Through

Consumer products entities will need to assess the terms of their arrangements with intermediaries and use judgment to determine when control of the underlying assets is transferred to the customer.

If control is deemed to pass at the point in time when goods are supplied to the intermediary, revenue may be recognized earlier than under current practice. In such a situation, the sales price could be variable because of the entity’s pricing terms with the intermediary. Accordingly, the entity would be required to estimate the transaction price to which it expects to be entitled and to consider the constraint guidance, specifically the probability of future revenue reversals (see [Sales Incentives](#) above), before recognizing revenue.

If control of the goods or services delivered by an entity has been transferred, the entity should assess whether the ASU’s guidance on rights of return (see [Right of Return](#) above) is applicable.

Disclosures

The ASU requires entities to disclose both quantitative and qualitative information that enables “users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.” The ASU’s disclosure requirements, which are significantly more comprehensive than those in existing revenue standards, include the following (with certain exceptions for nonpublic entities):

- Presentation or disclosure of revenue and any impairment losses recognized separately from other sources of revenue or impairment losses from other contracts.
- A disaggregation of revenue to “depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors” (the ASU also provides implementation guidance).
- Information about (1) contract assets and liabilities (including changes in those balances), (2) the amount of revenue recognized in the current period that was previously recognized as a contract liability, and (3) the amount of revenue recognized in the current period that is related to performance obligations satisfied in prior periods.
- Information about performance obligations (e.g., types of goods or services, significant payment terms, typical timing of satisfying obligations, and other provisions).
- Information about an entity’s transaction price allocated to the remaining performance obligations, including (in certain circumstances) the “aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied)” and when the entity expects to recognize that amount as revenue.
- A description of the significant judgments, and changes in those judgments, that affect the amount and timing of revenue recognition (including information about the timing of satisfaction of performance obligations, the determination of the transaction price, and the allocation of the transaction price to performance obligations).
- Information about an entity’s accounting for costs to obtain or fulfill a contract (including account balances and amortization methods).
- Information about the policy decisions (i.e., whether the entity used the practical expedients for significant financing components and contract costs allowed by the ASU).

Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in the ASU.

The ASU requires entities, on an interim basis, to disclose information required under ASC 270 as well as to provide annual disclosures (described above) about (1) the disaggregation of revenue, (2) contract asset and liability balances and significant changes in those balances since the previous period-end, and (3) the transaction price allocated to the remaining performance obligations.

Nonpublic entities can use certain practical expedients under the ASU to avoid providing some of the disclosures required of public entities. For additional information about the disclosure relief provided, see Appendix C of Deloitte’s May 28, 2014, *Heads Up*.

Effective Date and Transition

For public entities, the ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016. Early application is not permitted (however, early adoption is optional for entities reporting under IFRSs).

The effective date for nonpublic entities is annual reporting periods beginning after December 15, 2017, and interim reporting periods within annual reporting periods beginning after December 15, 2018. Nonpublic entities may also elect to apply the ASU as of any of the following:

- The same effective date as that for public entities (annual reporting periods beginning after December 15, 2016, including interim periods).
- Annual periods beginning after December 15, 2016 (excluding interim reporting periods).
- Annual periods beginning after December 15, 2017 (including interim reporting periods).

Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in the ASU:

- *Full retrospective application* — Retrospective application would take into account the requirements in ASC 250 (with certain practical expedients).
- *Modified retrospective application* — Under the modified approach, an entity recognizes “the cumulative effect of initially applying [the ASU] as an adjustment to the opening balance of retained earnings . . . of the annual reporting period that includes the date of initial application” (revenue in periods presented in the financial statements before that date is reported under guidance in effect before the change). Under the modified approach, the guidance in the ASU is only applied to existing contracts (those for which the entity has remaining performance obligations) as of, and new contracts after, the date of initial application. The ASU is not applied to contracts that were completed before the effective date (i.e., an entity has no remaining performance obligations to fulfill). Entities that elect the modified approach must disclose an explanation of the impact of adopting the ASU, including the financial statement line items and respective amounts directly affected by the standard’s application. The following chart illustrates the application of the ASU and legacy GAAP under the modified approach for a public entity with a calendar year-end:

January 1, 2017	2017	2016	2015
Initial Application Year	Current Year	Prior Year 1	Prior Year 2
New contracts	New ASU		
Existing contracts	New ASU + cumulative catch-up	Legacy GAAP	Legacy GAAP
Completed contracts		Legacy GAAP	Legacy GAAP

Thinking It Through

The modified transition approach provides entities relief from having to restate and present comparable prior-year financial statement information; however, entities will still need to evaluate existing contracts as of the date of initial adoption under the ASU to determine whether a cumulative adjustment is necessary. Therefore, entities may want to begin considering the typical nature and duration of their contracts to understand the impact of applying the ASU and to determine the transition approach that is practical to apply and most beneficial to financial statement users.

Considerations and Challenges for Consumer Products Entities

Increased Use of Judgment

Management will need to exercise significant judgment in applying certain aspects of the ASU's requirements, including those related to the identification of performance obligations and allocation of revenue to each performance obligation. It is important for consumer products entities to consider how the ASU specifically applies to them so that they can prepare for any changes in revenue recognition patterns.

Retrospective Application

The ASU allows entities to apply the standard retrospectively and use certain optional practical expedients at their discretion. As a result, consumer products entities may need to review contracts that commenced several years before the ASU's effective date. In addition, consumer products entities will most likely be required to perform dual tracking of revenue balances during the retrospective period given the potential difficulty of retroactively recalculating revenue balances when the new ASU becomes effective.

Systems, Processes, and Controls

To comply with the ASU's new accounting and disclosure requirements, consumer products entities will have to gather and track information that they may not have previously monitored. The systems and processes associated with such information may need to be modified to support the capture of additional data elements that may not currently be supported by legacy systems. Consumer products entities with large volumes of sales deals may find it operationally challenging to assess each sales deal to categorize and account for customer incentives in accordance with the ASU. Such entities may need to make substantial system modifications to facilitate this process.

Consumer products entities may also face challenges when they recognize as an asset certain costs of obtaining or fulfilling a contract (as opposed to recognizing such costs as expenses immediately, if the amortization period is one year or less). In such cases, consumer products entities may need to revise their accounting practices and make appropriate system modifications to track data on contract duration, contract costs, and periodic amortization and impairment testing of capitalized costs.

Further, to ensure the effectiveness of internal controls over financial reporting, management will need to assess whether additional controls should be implemented. Consumer products entities may also need to begin aggregating essential data from new and existing contracts since many of these contracts will most likely be subject to the ASU.

Note that the above are only a few examples of changes consumer products entities may need to make to their systems, processes, and controls. Consumer products entities should evaluate all aspects of the ASU's requirements to determine whether any other modifications may be necessary.

Income Taxes

Federal income tax law provides both general and specific rules for recognizing revenue on certain types of transactions (e.g., long-term contracts and arrangements that include

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Additional record keeping will be required when entities are not permitted to use the ASU's revenue recognition method for tax purposes.

advance payments for goods and services). These rules are often similar to the method a taxpayer uses for financial reporting purposes and, if so, the taxpayer employs the revenue recognition method it applies in maintaining its books and records (e.g., cash basis, U.S. GAAP, IFRSs). Although the Internal Revenue Code (IRC) does not require entities to use any particular underlying financial accounting method to determine their taxable income (such as U.S. GAAP), entities must make appropriate adjustments (on Schedule M) to their financial accounting pretax income to determine taxable income under the IRC.

The ASU may change the timing of revenue recognition and, in some cases, the amount of revenue recognized for entities that maintain their books and records under U.S. GAAP or IFRSs. These changes may also affect taxable income. Thus, it will be important for tax professionals to understand the detailed financial reporting implications of the standard so that they can analyze the tax ramifications and facilitate the selection of any alternative tax accounting methods that may be available.

If a change in a tax accounting method is advantageous or expedient (including circumstances in which the book method has historically been used), the taxpayer will most likely be required to obtain approval from the relevant tax authorities to use the method. Similar implications may arise in foreign jurisdictions that maintain statutory accounting records under U.S. GAAP or IFRSs. Additional record keeping will also be required when entities are not permitted to use the ASU's revenue recognition method for tax purposes.

Thinking Ahead

Although the ASU is not effective until annual reporting periods beginning after December 15, 2016 (with a maximum deferral of one year for nonpublic entities that apply U.S. GAAP), consumer products entities should start carefully examining the ASU and assessing the impact it may have on their current accounting policies, procedures, systems, and processes.

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