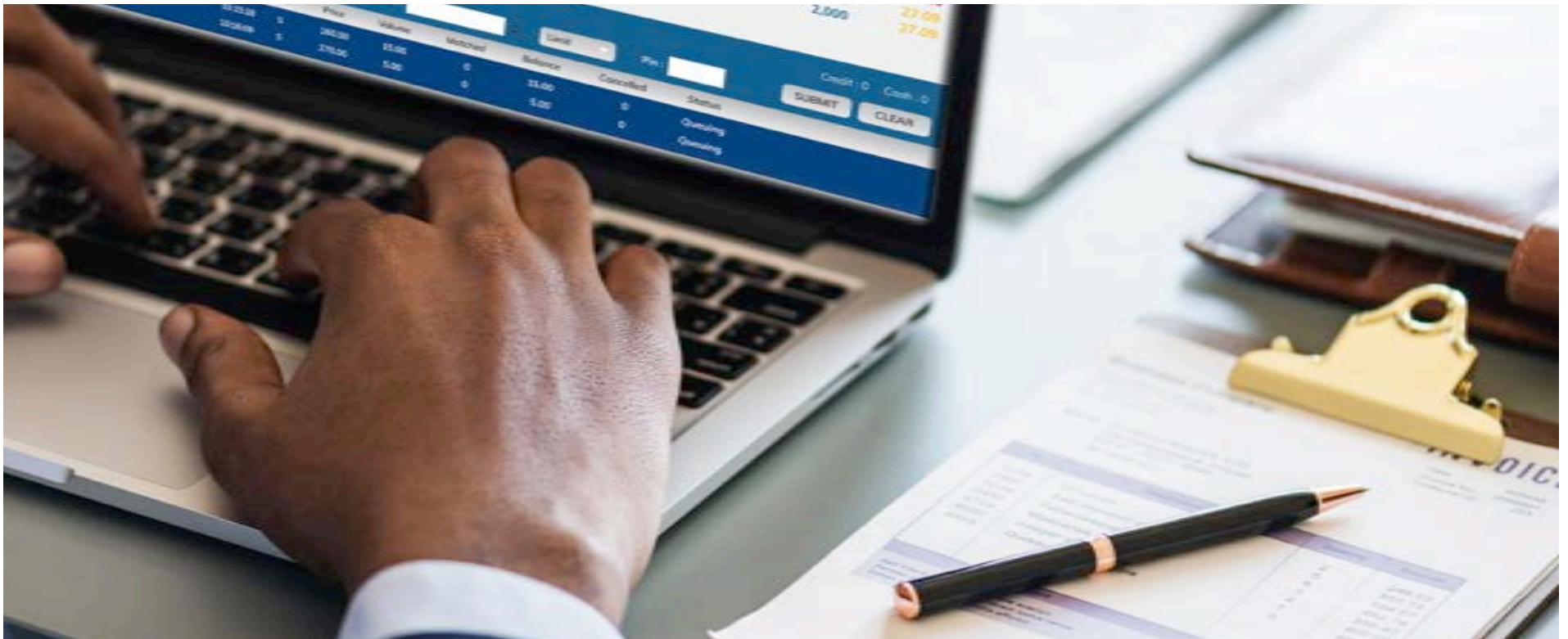


Revenue Recognition in Complex Business Structures

How the updated ACS 606 guidelines affect the cannabis industry



7/10/2018

About Me

Education

M.B.A. (2005)
University of Missouri
B.S. in Computer
Engineering (2003)
B.S. in Computer
Science (2003)
University of Missouri



Senior Director Forensic & Litigation Consulting

San Francisco, CA
Office: 415.283.4257
Alex.Arnote@fticonsulting.com

About

Based in San Francisco, Alexander Arnote is a Senior Director at FTI Consulting. As a Data & Analytics expert, Mr. Arnote specializes in complex, data-intensive cases, including government / regulatory investigations, class action suits, financial / accounting investigations, bankruptcies and other cases requiring complex modeling or information sharing. Mr. Arnote co-leads FTI Consulting's Cannabis practice and his extensive experience with the banking, cannabis, and retail industries give him a deep understanding of the challenges facing companies today. He has over thirteen years of database development & data analysis experience and eleven years of regulatory compliance and litigation support experience with an emphasis on government regulatory compliance, fraud investigations, and disputes.

Prior to joining FTI Consulting, Mr. Arnote worked at

Deloitte as part of the Analytic and Forensic Technology and Enterprise Risk Services groups. His previous work experience includes Sarbanes Oxley (SOX) and Foreign Corrupt Practices Act (FCPA) compliance work, due diligence and financial audits, computer forensics collections, and application development.

FTI Consulting: Experts with Impact


FTI Consulting is an independent global business advisory firm dedicated to helping organizations manage change, mitigate risk and resolve disputes. Due to our unique mix of **EXPERTISE, CULTURE, BREADTH OF SERVICES** and **INDUSTRY EXPERIENCE**, we have a tangible impact on our clients' most complex opportunities and challenges.

Definitive Expertise

- Most experts on Who's Who Legal: Arbitration - Expert Witnesses, *Law Business Research Ltd.* (2011 - 2018)
- #1 Global Risk & Investigations services provider, *The National Law Journal* (2017)
- #1 Restructuring Advisor, *The Deal* (2007-2017)
- #1 Crisis Management Services Firm, *National Law Journal* (2017)

Comprehensive Services

- Financial
- Legal
- Operational
- Transactional
- Political & Regulatory
- Reputational

| | | |
|---|---|---|
| 4,600+ Employees Worldwide | 460+ SMDs | \$2.1B Market Cap. ⁽¹⁾ |
| 76 Cities |  | 27 Countries |
| Advisor to 96 of the world's top 100 law firms | 53 of Fortune Global 100 corporations are clients | Advisor to 8 of the world's top 10 bank holding companies |

A Culture That Delivers

- **Practical** in our communication and approach to outcomes
- **Judicious** in complex, multi-party situations
- **Collaborative** with clients and colleagues
- **Professional** in our commitment to work with the highest caliber

Industry Experience

- Construction
- Energy Power & Products
- Financial Institutions
- Healthcare & Life Sciences
- Insurance
- Mining & Mining Services
- Real Estate & Infrastructure
- Retail & Consumer Products
- Telecom, Media & Technology

Our Global Reach

With offices in every major financial center and every corner of the globe, we successfully serve our clients wherever challenges and opportunities arise.



1. Affiliate



Gross Revenue vs. Net Revenue

■ **Gross vs. Net**

- Principal vs. Agent

■ **Guidance**

- ASC 606 - Revenue from contracts with customers
- ASC 606 - Update 2016-08: Principal versus Agent Considerations



ASC 606 - Background

- In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (Topic 606)
 - Public Co. effective date – annual reporting periods beg. after Dec. 15, 2017
 - Private Co. effective date – annual reporting periods beg. after Dec. 15, 2018

- Principle vs. Rules Based

- Topic 606 is intended to replace the numerous industry and transaction-specific revenue recognition standards that currently exist in US GAAP

- The objective of Topic 606 - provide a “*comprehensive and standardized revenue recognition model for all contracts with customers in order to improve comparability of reporting among entities both within and across industries”*”



ASC 606 - High Level Overview

Step 1

- Identify the customer contract(s) to be accounted for

Step 2

- Identify what has been promised to the buyer. Group those promises into Performance Obligations by determining which are distinct in the context of the contract

Step 3

- Determine the Transaction Price by considering the payment(s) to be received, including variable consideration, in exchange for performance under the contract

Step 4

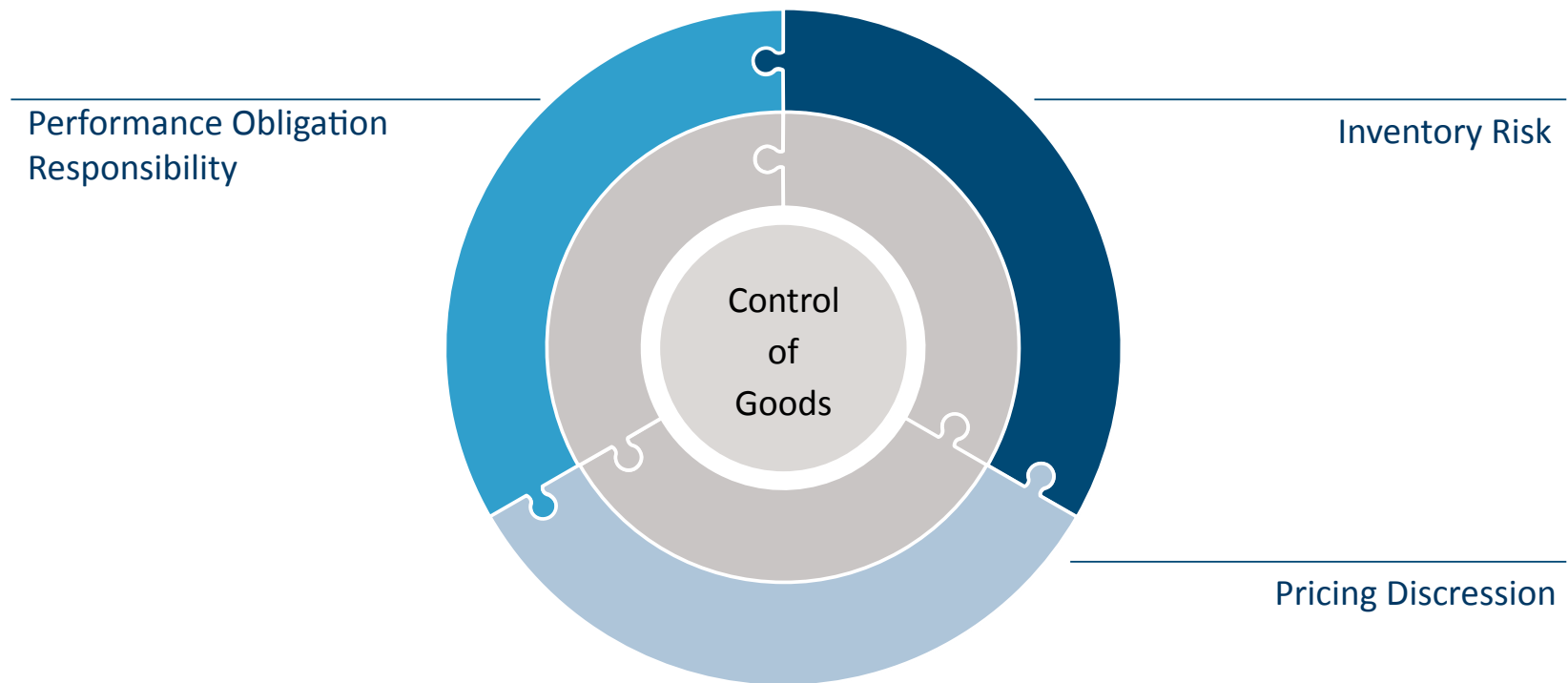
- Allocate the Transaction Price (determined in Step 3) to the Performance Obligations (identified in step 2) utilizing Standalone Selling Price (SSP)

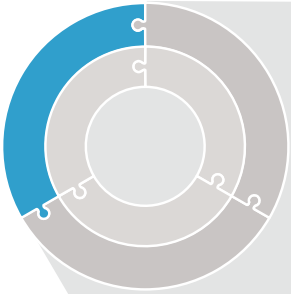
Step 5

- Recognize revenue when (or as) the vendor satisfies each Performance Obligation by transferring control of the promised goods or services to the customer

ASC 606 - Update 2016-08

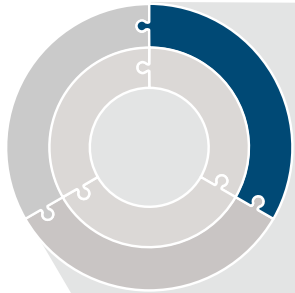
Amended ASC 606 to clarify the implementation guidance on Principal vs. Agent considerations (gross vs net) with control over the goods being the primary tenet.





Performance Obligation Responsibility

- Is the entity primarily responsible for fulfilling the promise to provide the goods?
- If another party is used, is the entity obliged to provide goods if the other party fails?
- Does the entity have the ability to direct the use of goods?



Inventory Risk

- Does the entity control inventory of goods?
- Does the entity has inventory risk before and after the sale?
- Which entity handles returns and/or customer credits?



ASC 606 - Update 2016-08 (cont.)



Pricing Discretion

- Does the entity have discretion in establishing pricing?



ACS 606 - What Does this Really Mean?

■ **Function matters over form**

- Complex business relationships require auditors to gain a deep understanding of how the parties interact during the course of business.

■ **No hard rules**

- Because the 606 methodology is new and relies on nuance, companies and auditors will need to determine their acceptable risk thresholds.

■ **Minor changes can have a significant effect**

- Companies working to change from one state to the other should find an external expert who can work with their auditor.

IRS Code Section 280e

Expenditures in connection with the illegal sale of drugs:

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

Unanswered Questions

- Does having an Agent that files under 280e automatically make the principle subject to 280e?
- Can companies subject to IRS 280e reduce their tax liability by being Agents?

EXPERTS WITH IMPACT™