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Contents

FASB Proposes Further Amendments to Revenue Standard

The FASB invited constituents to comment on a proposed Accounting Standards Update (ASU) intended to clarify the application of the new revenue standard with respect to the guidance on collectibility, the date to measure noncash consideration, presentation of sales taxes, and transition.[1] The comment deadline is November 16, 2015.

Key Facts

The FASB is proposing amendments to:

- Clarify when to recognize revenue for nonrefundable consideration received before collectibility of the entire amount to which the entity expects to be entitled is probable;
- Clarify the guidance on derecognition of an asset transferred to a customer;
- Specify for transition that a completed contract is one in which all (or substantially all) of the revenue has been recognized under current U.S. GAAP before the revenue recognition standard is adopted;
- Add a practical expedient that would not require the evaluation of each contract modification from contract inception through the date of adoption;
- Add a policy election to present taxes collected from customers on behalf of governmental authorities on a net basis; and
- Clarify that noncash consideration is measured at contract inception.

Key Impacts

- The FASB's objective with the proposed amendments is to make the standard more operational without significantly changing the underlying principles.
- The proposed FASB amendments are not expected to be considered by the IASB, which could result in differences between how the two Boards' revenue recognition standards are applied.[2]

[1] FASB Proposed Accounting Standards Update, Narrow-Scope Improvements and Practical Expedients, available at www.fasb.org.

[2] IFRS 15, Revenue from Contracts with Customers.

Collectibility

The proposals clarify when to recognize revenue when collectibility is not probable.

The revenue standard specifies that a contract does not exist for purposes of the revenue recognition model (Step 1) unless collectibility of the consideration to which the entity expects to be entitled is probable.[3] This determination is based on the customer's ability and intention to pay the amount when due. Because Step 1 is a gateway to the revenue recognition model, no revenue is recognized when an entity concludes that collectibility is not probable. This prohibition on revenue recognition also applies to any nonrefundable consideration received. If collectibility of the entire amount to which the entity expects to be entitled is never deemed probable of being collected, the entity does not recognize revenue until either (1) the entity has no remaining performance obligations and substantially all of the consideration has been received and is nonrefundable, or (2) the contract is terminated and all amounts received are nonrefundable. These criteria are referred to as the "alternate recognition model."

The FASB's proposed amendments would add a third event to the alternate recognition model. Under the proposed additional event, when collectibility of the entire amount to which the entity expects to be entitled is not probable, an entity would recognize revenue in the amount of nonrefundable consideration received when the entity has transferred control of the goods or services, the entity has stopped transferring additional goods or services and has no obligation to transfer additional goods or services, and the consideration received from the customer to date is nonrefundable.

The FASB's proposed amendments would include implementation guidance and examples to illustrate the objective and application of the collectibility threshold. The FASB also is proposing to amend Example 1 in the revenue standard to clarify that assets are derecognized when control of the asset transfers to the customer. This may precede the point when revenue is recognized. In that case, the entity would recognize a loss when the asset is derecognized.[4]

Completed Contracts at Transition

Completed contract is redefined for purposes of applying the transition requirements.

An entity that applies the cumulative-effect transition approach when adopting the revenue recognition standard will apply it to contracts that are not completed as of the initial application date. Additionally, the application of certain practical expedients available to an entity that applies the full retrospective approach is impacted by the definition of a completed contract for transition purposes.

The transition guidance currently states that a contract is completed if the entity has *transferred* all of the goods and services identified under current U.S. GAAP. While the transfer of goods and services is a new concept in the revenue standard, it differs from the earned and realized notion embedded in much of legacy U.S. GAAP. This difference in underlying concepts may create transition difficulties because an entity may have transferred all of the goods and services to the customer but not yet recognized all of the revenue. This might occur, for

[3] FASB Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, available at www.fasb.org. For additional examples on the proposed amendments and comparison to IASB's proposals, please see Defining Issues Nos.15-38, FASB to Clarify Revenue Standard's Collectibility and Completed Contracts Guidance, and 15-11, FASB and IASB to Propose Additional Revenue Clarifications, both available at www.kpmginstitutes.com.

[4] FASB ASC paragraphs 606-10-55-95 through 55-98, available at www.fasb.org.

example, when the amount due from the customer is not fixed or determinable at the date the goods and services were transferred to the customer.

The FASB's proposed amendments would redefine a completed contract for transition purposes as one for which all (or substantially all) of the revenue was recognized under legacy U.S. GAAP.

Example 1: Impact of Change in Definition of Completed Contract

A publicly traded, calendar year-end company sells products to distributors and regularly grants price concessions and accepts product returns. The company's accounting policy is to recognize revenue when the distributors sell the products to end customers (sell-through).

On December 15, 2017, the company delivers products to a distributor. On January 1, 2018, the company adopts the revenue standard using the cumulative-effect transition approach before the distributor has sold any products.

Absent the FASB's proposed amendments, the company likely would conclude that the contract is completed because control of the products has transferred to the distributor prior to the adoption date. As the distributor sells the products, the company receives cash. However, the standard is not clear on how the cash receipts should be accounted for. One interpretation would have required cash receipts to be recognized directly into equity.

Under the FASB's proposed amendments, the company concludes that the contract is not completed at the date of adoption because substantially all of the revenue had not been recognized under legacy U.S. GAAP. The company would apply the standard retrospectively to the contract. The new standard would result in revenue being recognized on December 15, 2017, after giving effect to the constraint on variable consideration. Therefore, the company would recognize a cumulative catch-up to equity on the date of adoption.

The FASB's proposed amendments also specify that an entity using the cumulative-effect transition approach would be permitted, but not required, to apply that transition approach to all contracts whether completed or not at the date of transition.

The IASB has not proposed similar amendments to IFRS 15. If the IASB and FASB do not remain converged on this transition topic, multi-national companies adopting the standard using the cumulative-effect approach could have different populations of contracts to which they apply the new standard. This could result in incremental efforts to adopt the standard for multi-national companies. Differences between a company's U.S. GAAP and IFRS financial statements could occur for a period of time even though the guidance in the standards is largely converged.

Practical Expedients upon Transition

The revenue standard requires that contract modifications are accounted for either prospectively or through a cumulative catch-up adjustment depending on the specific circumstances of the modification.

The FASB has proposed a practical expedient that would not require an evaluation of each contract modification from contract inception through the date of adoption. For an entity electing the practical expedient, modified contracts would be accounted for during transition by:

- Identifying all satisfied and unsatisfied performance obligations from inception of the original contract to the Contract Modification Adjustment Date (CMAD);
- Determining the transaction price based on the information available at the CMAD using total consideration to which the entity is entitled for all performance obligations (satisfied and unsatisfied) in the contract; and
- Allocating the transaction price to the performance obligations at the CMAD based on the historic stand-alone selling price of each good or service.

The beginning of the earliest period presented would be the CMAD under the retrospective transition approach. The date of initial application would be the CMAD under the cumulative-effect transition approach. Modifications occurring after the CMAD would be accounted for using the standard's contract modifications guidance.

The FASB's proposed amendments would not require an entity electing the retrospective transition approach to disclose the current period impacts of adopting the standard, which would have required an entity to account for contracts under both the standard and current U.S. GAAP in the period of adoption. This change would align the standard with IFRS.

Sales Tax Presentation: Gross versus Net

The standard supersedes current U.S. GAAP guidance that allows a policy election to present taxes collected from customers on behalf of governmental authorities either gross or net.[5] The standard requires a company to evaluate each tax in each jurisdiction in which it operates to determine whether taxes are amounts collected on behalf of third parties that would be excluded from the transaction price.

The FASB has proposed a practical expedient that would allow an entity to elect an accounting policy to present these taxes on a net basis. If the entity does not elect to apply the practical expedient, it would be required to analyze whether an individual tax should be included in the transaction price. An entity would be required to disclose its use of this practical expedient. The FASB decided to use the same scope that is in ASC paragraph 605-45-15-2(e), which includes sales, use, value added, and some excise taxes.

[5] FASB ASC paragraphs 605-45-50-3 and 50-4, available at www.fasb.org.

Noncash Consideration

The revenue standard requires that noncash consideration be measured at fair value. If an entity cannot reasonably estimate the fair value of noncash consideration, it is measured indirectly by reference to the selling price of the goods or services promised to the customer. However, the standard does not specify *when* to measure noncash consideration at fair value. This differs from current U.S. GAAP where the measurement date of equity-based consideration is the earlier of the vesting date or the performance commitment date.[6]

The FASB's proposed amendments specify that noncash consideration be measured at contract inception. This is generally consistent with the measurement of the transaction price when it consists of cash consideration. The FASB is proposing to update Example 31 in the standard to be consistent with its decision on the measurement date.[7]

The FASB is also proposing that the constraint applies only to variability caused by reasons other than the form of the consideration. Determining whether a change in fair value was caused by the form of the noncash consideration or other reasons and deciding how to allocate changes between these reasons may be challenging.

Example 2: Application of the Constraint to Noncash Consideration

On January 1, 2018, Company A enters into a contract to provide services to Customer Z for one year. In exchange, Company A will receive 1,000 common shares of Customer Z on December 31, 2018. If Company A achieves a performance milestone, it will be entitled to an additional 200 shares.

Company A considers the factors associated with the constraint on variable consideration in determining whether it expects to be entitled to the additional shares. However, changes in the share price subsequent to the measurement date of January 1, 2018, is not variable consideration. Therefore, the constraint is not applied to those changes (i.e., variation due to the form of noncash consideration).

Next Steps

Companies should evaluate the FASB's proposed amendments and consider submitting a comment letter by the November 16, 2015, deadline.

[6] FASB ASC paragraph 505-50-30-18, available at www.fasb.org.

[7] FASB ASC paragraph 606-10-55-247, available at www.fasb.org.

Separately, the FASB previously issued its exposure draft on principal versus agent guidance with comments due by October 15, 2015.[8]

The FASB is expected to discuss the comment letters on its exposure draft on licenses and performance obligations in early October.[9]

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[8] FASB Proposed Accounting Standards Update, Principal versus Agent Considerations (Reporting Revenue Gross versus Net), August 31, 2015, available at www.fasb.org.

[9] FASB Proposed Accounting Standards Update, Identifying Performance Obligations and Licensing, May 12, 2015, available at www.fasb.org.