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FASB Finalizes Narrow-Scope Improvements for Revenue Standard

The FASB recently issued an Accounting Standards Update (ASU) that strives to make the revenue standard more operational and clearer without changing its core principles.[1]

Key Facts

- Revenue may be recognized in limited circumstances when an arrangement does not qualify as a contract with a customer (e.g., when collectibility is not probable).
- The definition of a completed contract has been clarified to make transition more operational.
- Accounting for modifications that take place before adoption has been simplified.
- Sales taxes and other similar taxes may be presented on a net basis.
- The fair value of noncash consideration is measured at contract inception.

Key Impacts

- The amendments and practical expedients aim to simplify the transition to the new standard, to provide practical expedients for transition and sales taxes, and to clarify certain aspects of the standard.
- The amendments primarily relate to U.S. GAAP only and, therefore could result in differences between U.S. GAAP and IFRS.

Contents

[1] FASB Accounting Standards Update No. 2016-12, Narrow-Scope Improvements and Practical Expedients; and FASB Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, both available at www.fasb.org.

Collectibility

The alternate recognition model applies when *nonrefundable consideration* is received but the arrangement does not meet the criteria to qualify as a contract with a customer. This could occur, for example, when an entity receives a portion of the transaction price but determines that it is not probable that it will collect *substantially all* of the consideration to which it expects to be entitled. The ASU adds a new set of circumstances under which an entity may recognize revenue when a contract does not exist. An entity may also recognize revenue in the amount of nonrefundable consideration received if the entity has:

- Transferred control of goods or services to the customer;
- Stopped transferring additional goods or services to the customer; and
- No obligation to transfer additional goods or services to the customer.

Completed Contracts at Transition

For purposes of applying the transition guidance in the revenue standard, the FASB redefined a *completed contract* as a contract for which an entity recognized all (or substantially all) of the revenue under current U.S. GAAP before the date of its initial application of the standard. Further, an entity that adopts the standard using the cumulative-effect transition approach may elect to apply the standard to all contracts, or to only those contracts that are not completed at the initial application date.

The completed contract definition also will affect how an entity applies certain practical expedients under the retrospective transition approach. For example, an entity that retrospectively adopts the standard can elect not to restate completed contracts that begin and end within the same annual reporting period. It also can elect to use the actual transaction price for completed contracts, instead of estimating variable consideration, in comparative reporting periods under the retrospective adoption method.

Transition Practical Expedients

In transition to the new standard, an entity will not be required to evaluate each contract modification from contract inception through the date on which it adopts the standard. An entity that elects this practical expedient to account for modified contracts will:

- Identify all satisfied and unsatisfied performance obligations from inception of the original contract to the Contract Modification Adjustment Date (CMAD);
- Determine 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;
- Allocate the transaction price to the performance obligations at the CMAD based on the stand-alone selling price of each good or service; and
- Account for modifications that take place after the CMAD using the contract modifications guidance in the standard.

Contract Modification Adjustment Date

Retrospective Transition Approach. Beginning of the earliest period presented. For example, January 1, 2016, for a public business entity that adopts the standard on January 1, 2018.

Cumulative-Effect Transition Approach. Beginning of the year of adoption. For example, January 1, 2018, for a public business entity that adopts the standard on January 1, 2018.

An entity that elects the retrospective transition approach will not need to disclose the effects of adopting the standard for the period of adoption. Previously, this disclosure would have required an entity to account for contracts under the new revenue standard and current U.S. GAAP in the period of adoption when using the retrospective transition method. However, this disclosure is still required for an entity that uses the cumulative-effect transition method.

IFRS does not allow a policy election for presenting taxes on a net basis, nor does it prescribe the measurement date for noncash consideration.

Sales Tax Presentation: Gross versus Net

The ASU includes a practical expedient that allows an entity to elect an accounting policy to exclude from the transaction price amounts collected from customers for sales (and other similar) taxes collected from customers on behalf of governmental authorities. The scope of this practical expedient includes taxes that are imposed on and concurrent with a specific revenue-producing transaction, and collected by the entity from a customer. Examples include sales, use, value-added, and some excise taxes.

Noncash Consideration

The standard requires an entity to measure noncash consideration at fair value or, in the absence of a reasonable estimate of fair value, to refer to the estimated selling price of the goods or services promised to the customer. The ASU requires an entity to measure the fair value of noncash consideration at contract inception, and states that the constraint on variable consideration applies to only the variability caused by reasons other than the form of the consideration (e.g., the number of shares of the customer's stock that the entity receives changes).

Next Steps

The FASB has completed its redeliberations on the substantive amendments to the revenue topic, and recently issued two ASUs: principal versus agent considerations and identifying performance obligations and licenses.[2]

For additional information, refer to our second edition of *Revenue: Issues In-Depth* that provides more of our insights and more extensive examples.

During the second quarter we expect the FASB to issue an exposure draft proposing technical corrections to the new revenue standard.

At the March 3, 2016, EITF meeting, and formalized by the FASB in ASU 2016-11, the SEC staff announced that it is rescinding the following SEC staff observer comments upon the adoption of the revenue standard:[3]

- Revenue and expense recognition for freight services in process;[4]
- Accounting for shipping and handling fees and costs;[5]
- Accounting for consideration given by a vendor to a customer (including reseller of the vendor's products);[6] and
- Accounting for gas-balancing arrangements (i.e., use of the *entitlements method*).[7]

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Earlier editions are available at: http://www.kpmg.com/us/frn

[2] KPMG's Defining Issues Nos. 16-10, FASB Finalizes Amendments to Principal-Agent Guidance in New Revenue Standard, March 2016; and 16-13, FASB Amends Performance Obligations and Licensing Guidance in Revenue Standard, April 2016. Also see FASB Accounting Standards Update No. 2016-10, Identifying Performance Obligations and Licensing; and FASB Accounting Standards Update No. 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net).

[3] FASB Accounting Standards Update No. 2016-11,Rescission of SEC Guidance Because of Accounting Standards Update 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 ETIF Meeting, available at www.fasb.org.

[4] FASB paragraph 605-20-S99-2, available at www.fasb.org.

[5] FASB paragraph 605-45-S99-1, available at www.fasb.org.

[6] FASB paragraph 605-50-S99-1, available at www.fasb.org.

[7] FASB paragraph 932-10-S99-5, available at www.fasb.org.