Addenda Summary-2014

Note: Due to the issuance of certain new accounting literature, changes in the status of ongoing projects during the past year, or evolution of practice, the following updates to the existing cases should be noted.

Case 4-8: DrugKing

In June 2014, the FASB issued ASU 2014-11[1], to respond to stakeholders' concerns about current accounting and disclosures for repurchase agreements and similar transactions. The amendments in this Update require that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty (a repurchase financing), which will result in secured borrowing accounting for the repurchase agreement. The amendments require an entity to disclose information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. In addition the amendments require disclosure of the types of collateral pledged in repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions and the tenor of those transactions.

For public business entities, the disclosure for certain transactions accounted for as a sale is required to be presented for interim and annual periods beginning after December 15, 2014, and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. For all other entities, both new disclosures are required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. The disclosures are not required to be presented for comparative periods before the effective date.

The amendments in this Update do not affect the conclusions in this case.

Case 9-2: Pharmgen Pharmaceutical Development

The FASB has issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and the IASB has issued

[1] FASB Accounting Standards Update 2014-11, *Transfers and Servicing (Topic 860)—Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*

IFRS 15, *Revenue from Contracts with Customers*. The issuance of these documents completes the joint effort by the FASB and the IASB to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and IFRS.

The scope of the new standards is limited to contracts with customers. For contracts with terms and provisions similar to the arrangement that is the subject of this case study, the counterparty to the contract might not be a customer but rather a collaborator or a partner that shares with the entity the risks and benefits of developing a product to be marketed. Such contracts are not expected to be in the scope of the new standards. Further evaluation of that scoping question is necessary before considering whether it is appropriate to apply the guidance in the new standards to this case study.

We encourage you to review the FASB and IASB websites for further details and developments. You can also review Deloitte.com for Deloitte publications on proposals and final standards as they are issued.

Case 9-6: UpBeat

The FASB published ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*, on June 12, 2014. ASU 2014-11 which makes limited amendments to the guidance in ASC 860 on accounting for certain repurchase agreements ("repos"). The ASU (1) requires entities to account for repurchase-to-maturity transactions[3] as secured borrowings (rather than as sales with forward repurchase agreements), (2) eliminates accounting guidance on linked repurchase financing transactions, and (3) expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically, repos, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings.

The ASU also amends ASC 860 to clarify that repos and securities lending transactions that do not meet all of the derecognition criteria in ASC 860-10-40-5 should be accounted for as secured borrowings. In addition, the ASU provides examples of repurchase and securities lending arrangements that illustrate whether a transferor has maintained effective control over the transferred financial assets.

Both public and nonpublic business entities would apply the ASU by using a cumulative-effect approach to account for transactions outstanding as of the beginning of the period of adoption. The ASU includes staggered effective dates for accounting and disclosure requirements that vary depending on whether the reporting entity is a public or a nonpublic business entity.

Case 9-8: Classified Information

FASB/IASB Joint Project on Financial Statement Presentation

In this project, the FASB and IASB considered taking a "fresh look" at the manner in which financial information is presented in an entity's statement of financial position, statement of comprehensive income, and statement of cash flows. However, in October 2010, the FASB and IASB halted deliberations on this project, reassessing it as lower-priority. The project has remained inactive and the FASB has not provided additional information regarding when further activity will commence. The delay in the project is expected to give the Boards time to perform and finalize additional outreach, address constituents' concerns, and further develop other convergence priorities.

On the basis of discussions and staff drafts released by the Boards prior to the projects suspension, it was anticipated that the revised financial statement format would be more cohesive and split between business (i.e., operating and investing) and financing activities. This format would largely resemble the current presentation in the statement of cash flows. The intent of requiring a single financial statement presentation is to enhance the usefulness of financial information and increase the comparability and consistency of financial statements within and across entities.

Specific changes proposed included the following:

- Statement of financial position — Requiring presentation of assets and liabilities by major activity within operating, investing, and financing categories.
- Statement of comprehensive income — Requiring a single statement of comprehensive income grouped by using the same categories as those in the statement of financial position; further disaggregation of line items in the statement would be required.
- Statement of cash flows — Requiring separate presentation of the main categories of cash receipts and cash payments for operating activities (i.e., direct method) rather than reconciliation of net income to net operating cash flows (i.e., indirect method). However, a reconciliation of operating income to net operating cash flows would be required in the notes to the financial statements.
- Notes to the financial statements — Requiring disclosure of the rationale used to classify assets and liabilities into categories and sections in the statement of financial position. In addition, an entity would be required to provide a reconciliation of beginning to ending balances of select assets and liabilities that management deems to be important to understanding the entity's financial position.

Case 11-1: Polluter Corp.

In April 2014, the FASB added a project to its agenda to clarify certain aspects of ASC 230. Specifically:

> The project is intended to reduce diversity in practice in financial reporting by clarifying certain existing principles in Topic 230, Statement of Cash Flows, including providing additional guidance on how and what an entity should consider in determining the classification of certain cash flows. As part of the project, the staff will research potential additional disclosures that could result in increased relevance for users.

Moreover:

The staff is currently performing additional research and outreach about what would comprise the clarifying guidance and how it would provide useful information in the application of the principles within Topic 230.

Case 11-6: Lessee, Ltd.

Current Status of the FASB and IASB Convergence Project - As of May 2014

One of the more significant developments in lease accounting is the continued progress in the joint convergence efforts of the FASB and IASB. Under this project, the FASB and IASB have the objective that most assets and liabilities arising under lease arrangements are recognized on the balance sheet. The proposed guidance would affect almost all companies.

On May 16, 2013, the FASB and IASB issued a revised exposure draft, Leases. The ED, released by the FASB as a proposed Accounting Standards Update (ASU), defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." The ED proposes that when determining whether a contract contains a lease, entities should assess whether (1) the contract is based on an identified asset and (2) the lessee obtains the right to control the use of the asset for a particular period.

The ED introduced a new accounting model that addresses concerns about off-balance-sheet financing arrangements for lessees. This model brings substantially all leases from the lessee perspective, with the exception of short-term leases with a lease term of less than 12 months, on balance sheet by introducing the right-of-use asset approach. Under this approach, a lessee would record a ROU asset representing its interest in the underlying asset during the lease term and a corresponding lease liability.

The Boards have received a significant amount of critical feedback about the cost and complexity introduced by the May 2013 ED. While considering this feedback, the boards have commenced its redeliberations of certain key provisions of the proposed lease accounting model.

Status – Lessee Accounting
Under the ED, a lessee's subsequent accounting for a lease is based on the nature of the underlying leased asset (i.e., whether it is property or something other than property) and the terms of the lease (e.g., lease term, lease payments). A straight-line expense pattern (Type B lease) would generally be used to recognize property leases; all other leases would generally be recognized as the financing of the right-of-use (ROU) asset (Type A lease).

Redeliberations, however, shifted the focus from a dual-model based on whether the underlying asset being property or something other than property to two alternative approaches. The boards' discussions have focused on whether a lessee should subsequently apply dual model approach or a single model.

Under the dual-model approach discussed during redeliberations, a lessee would classify a lease by using criteria similar to the lease classification criteria in IAS 17. It is expected that most current capital leases would be accounted for as Type A (or finance-type) leases whereas most operating leases would be accounted for as Type B (or straight-line) leases. Those leases that are considered a Type A lease would be treated as a financing, similar to today's capital leases. That is, from the balance sheet standpoint the lessee would recognize an asset and lease liability separately on the balance sheet. As for the expense recognition pattern for a Type A lease, the lessee would recognize the asset amortization separately from interest expense, which in the aggregate would typically result in greater expense during the early years of the lease. For those leases that are considered Type B leases, a lessee would similarly record a right of use asset and related obligation on its balance sheet, but would account for the lease in a manner similar to current operating leases on the income statement– that is, would recognize the expense on a straight line line basis over the term of the lease.

The other model that is being discussed by the boards is a single-model approach under which lessees would account for all leases as Type A leases (or finance-type lease).

Note to professor:
Under the dual-model approach discussed during redeliberations, a lessee would account for a lease as a Type A lease if any of the following criteria are met at the commencement of the lease:

- "The lease transfers ownership of the underlying asset to the lessee by the end of the lease term."
- It is reasonably certain that a lessee will "exercise an option to purchase the underlying asset."
- "The lessee otherwise has the ability to obtain substantially all of the remaining benefits of the underlying asset as a result of the lease."

These criteria are essentially the same as the existing lease classification criteria in IAS 17, although they are not identical to the requirements under current U.S. GAAP. As a result, an existing operating lease may be classified as a Type A lease, while an existing capital lease may be classified as a Type B lease.

For example, under this approach, a lessee would assess land and other elements separately unless the land element is clearly immaterial. This approach is consistent with IFRSs. Under U.S. GAAP, however, if a lease does not transfer ownership of the real estate or contain a bargain purchase option, a lessee would evaluate the lease classification for the land and other elements as a single unit unless the fair value of the land is 25 percent or more of the total fair value of the leased property at lease inception. This change may result in more bifurcation of real estate leases into separate elements and may affect the allocation of the lease payments to the various elements.

In addition, shifting to an IAS 17 approach effectively eliminates the bright-line rules under ASC 840 for assessing a lessee's ability to obtain substantially all the remaining benefits of the underlying asset — namely, whether the lease term is for 75 percent or more of the economic life of the asset or whether the present value of the lease payments (including any guaranteed residual value) is at least 90 percent of the fair value of the leased asset.

Status – Lessor Accounting

Under the ED, lessors would have been required to classify leases as either Type A or Type B by using the same approach prescribed for lessees (i.e., on the basis of the nature of the leased asset and the terms of the lease). Type A leases would have been accounted for under the receivable-and-residual approach (an approach similar in nature to accounting for capital leases under ASC 840), whereas Type B leases would have been accounted for like operating leases under existing GAAP.

Based on the feedback received from the respondents to the ED, the boards concluded that a wholesale change to lessor accounting was not warranted nor desired. Rather, they tentatively agreed to retain an approach similar to the existing capital/finance lease and operating lease models in ASC 840 and IAS 17 but decided to align the U.S. GAAP classification requirements with the criteria in IAS 17.

Next Steps

The FASB and IASB are expected to continue its redeliberations through much of 2014. While the Boards have not formally indicated when a final standard would be expected, there is a possibility it may be issued by the end of 2014, though a more reasonable expectation would be early 2015. Further, the Boards have not formally indicated when, once issued, the final standard would be effective.

We encourage you to check the FASB and IASB websites for further details and developments. You can also check Deloitte.com or Deloitte's US GAAP Plus web sites for Deloitte publications on the FASB and IASB redeliberations efforts and final standards as they are issued.

It is important to note that this case does not reflect the tentative decisions that the boards have reached.

Case 12-1: Provisions and Contingencies

Development-stage Entities

In February 2014, the FASB voted to remove the concept of a development-stage entity (DSE) from U.S. GAAP. In addition to removing ASC 915, *Development Stage Entities,* from the FASB Accounting Standards Codification, the FASB's decision will also result in the deletion of guidance in ASC 810 on how to assess whether a DSE has sufficient equity at risk when evaluating whether the DSE is a variable interest entity.

A final ASU is expected to be issued in the second quarter of 2014. The ASU must be applied retrospectively and will be effective for public business entities in interim and annual periods beginning after December 15, 2014. The requirements will be effective for nonpublic business entities for annual periods beginning after December 15, 2014, and interim and annual periods thereafter. However, both public and nonpublic entities will have additional time to adopt the amendments to ASC 810. All entities will be permitted to early adopt the standard.

The removal of the concept of a DSE from U.S. GAAP is not expected to affect the conclusions in this case.

We encourage you to check the FASB and IASB websites for further details and developments. You can also check Deloitte.com for Deloitte publications on proposals and final standards as they are issued.

Case 12-4: Hemo-Tech

Discussion of the FASB/IASB Joint Revenue Project Exposure Draft

In November 2011, the FASB and the IASB jointly issued a revised exposure draft (ED) on revenue recognition, with a 120-day comment period that ended on March 13, 2012. The revised ED outlines a single comprehensive model for accounting for revenue arising from contracts with customers and would supersede substantially all current revenue recognition guidance.

The core principle of the revised ED stipulates 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." In applying the revised ED's provisions to contracts within its scope, an entity would:

- “Identify the contract with a customer.”
- “Identify the separate performance obligations in the contract.”
- “Determine the transaction price.”
- “Allocate the transaction price to the separate performance obligations in the contract.”
- “Recognize revenue when (or as) the entity satisfies a performance obligation.”

The boards received approximately 350 comment letters on the proposal — significantly fewer than the nearly 1,000 they received on the original ED issued in June 2010. Although the feedback from most industries was similar and generally indicated support for the boards’ efforts to develop a single comprehensive revenue recognition standard, respondents expressed concerns about several aspects of the revised ED.

After contemplating the feedback received on the revised ED, the boards made refinements to the proposed comprehensive model for revenue recognition and are expected to issue a final standard in 2014. For updates on the revenue recognition project and other standard-setting developments, we encourage you to check the FASB and IASB websites for further details and developments and to register at Deloitte.com to receive audit and accounting publications by email.

Case 12-5: Aren’t We Done Yet

Addendum — FASB/IASB Joint Revenue Project

In May 2014, the FASB and IASB issued their final standard on revenue from contracts with customers. The standard, issued by the FASB as Accounting Standards Update (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 core principle of the revenue model is that “an entity recognizes 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.” In applying the revenue model to contracts within its scope, an entity will:

- Identify the contract with a customer.
- Identify the performance obligations in the contract.
- Determine the transaction price.
- Allocate the transaction price to the performance obligations in the contract.

- Recognize revenue when (or as) the entity satisfies a performance obligation.

For the latest information on this new ASU, we encourage you to visit USGAAP*Plus*.

Case 12-8: Going, Going, Gone

In August 2014, the FASB issued ASU 2014-152, which provides guidance about management's responsibilities in evaluating whether there is substantial doubt about an entity's ability to continue as a going concern and about related footnote disclosures. Under the new guidance, management is required to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued (or available to be issued for an entity that is neither an SEC filer nor a conduit bond obligor for debt securities that are traded in a public market). An entity would have to disclose uncertainties about such ability if there is "substantial doubt about an entity's ability to continue as a going concern," which is defined in the ASU using a probability threshold. The disclosure requirements in the ASU generally align with those under the auditing literature, however the ASU removes certain disclosure requirements, and adds the requirement for management to specifically disclose the statement that there is "substantial doubt about the entity's ability to continue as a going concern" when substantial doubt exists (and is not alleviated by management's plans3). When substantial doubt is alleviated by management's plans, the ASU requires similar disclosures as when substantial doubt exists, except the statement that there is substantial doubt (described above) is not required.

The guidance in the ASU applies to all entities, can be early adopted, and is effective for annual periods ending after December 15, 2016, and interim periods in annual periods beginning after December 15, 2016.

Case 12-10: Acquisition of a Legal Subsidiary in Bankruptcy

Pushdown Accounting Addendum — May 2014

Currently, there is limited U.S. GAAP guidance on determining when an acquiring entity can establish a new accounting and reporting basis in the acquired entity's stand-alone financial statements (commonly referred to as "pushdown" accounting). ASC 805-50-S99-1 through S99-4 contain pushdown accounting requirements for SEC registrants. Under this guidance, pushdown accounting is (1) **prohibited** when 80 percent or less of an entity's ownership is acquired, (2) **permitted** when between 80 percent and 95 percent is acquired, and (3) **required** when 95 percent or more is acquired. However, because only SEC registrants are required to apply this guidance, there is diversity in practice in whether nonpublic entities apply pushdown accounting. There is also diversity in practice when between 80 percent and 95 percent of an SEC registrant's shares have been acquired, because pushdown accounting is optional in such cases.

In April 2014, the FASB issued a proposed ASU in response to the consensus of the Emerging Issues Task Force on EITF Issue 12-F.[2] The proposal would give an acquired entity (whether public or private) the option of applying pushdown accounting in its stand-alone financial statements when a change-in-control event has occurred.

An acquired entity that elects to apply pushdown accounting in its stand-alone financial statements would recognize "the new basis of accounting established by the acquirer for the individual assets and liabilities of the acquired entity by applying [ASC] 805.[3]" The acquired entity would be required to recognize any goodwill that arose from the change-in-control transaction but would be prohibited from recognizing any bargain purchase gain. In addition, an acquired entity that elects to apply pushdown accounting would be required to disclose the effect of pushdown accounting on its financial statements by providing the applicable disclosures required by ASC 805. Subsequently, the acquired entity would apply other applicable GAAP to account for the new basis of its assets and liabilities.

If finalized, the proposal would apply prospectively to change-in-control events occurring after the effective date; however, the EITF and FASB have yet to determine an effective date. Comments on the proposal are due by July 31, 2014. We encourage you to check the FASB and IASB websites for further details and developments. You can also check Deloitte.com for Deloitte publications on proposals and final standards as they are issued.

This case does not reflect the guidance in the proposed ASU.

Case 14-1: Bringing Students Together

Addendum — Standard Setting Update

Consolidation Project: Principal-Versus Agent Analysis

In November 2011, the FASB issued a proposed ASU that would provide guidance on assessing whether a decision maker is acting as a principal or an agent when performing a consolidation analysis. The guidance would apply to all entities, including partnerships subject to the guidance in ASC 810-20. The FASB is currently redeliberating the feedback received on the proposed ASU.

The Principal-Versus-Agent project may have an impact on the solutions in this case as consideration should be given as to whether the decision-maker is acting as a principal or an agent in the assessment of the primary beneficiary.

[2] EITF Issue No. 12-F, "Recognition of New Accounting Basis (Pushdown) in Certain Circumstances."
[3] FASB Accounting Standards Codification Topic 805, *Business Combinations*.

ASU 2014-07, Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements – a consensus of the Private Company Council (PCC)

Under ASU 2014-07, a private-company lessee is not required to apply the VIE guidance in ASC 810 to a lessor entity under common control if certain criteria have been satisfied. A private company that elects this alternative would be required to disclose certain specified information in lieu of applying the VIE guidance in ASC 810. ASU 2014-07 is effective for annual reporting periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015; early application is permitted.

ASU 2014-07 is not expected to affect the conclusions in this case.

Development-stage Entities

In February 2014, the FASB voted to remove the concept of a development-stage entity (DSE) from U.S. GAAP. In addition to removing ASC 915, *Development Stage Entities,* from the FASB Accounting Standards Codification, the FASB's decision will also result in the deletion of guidance in ASC 810 on how to assess whether a DSE has sufficient equity at risk when evaluating whether the DSE is a variable interest entity.

A final ASU is expected to be issued in the second quarter of 2014. The ASU must be applied retrospectively and will be effective for public business entities in interim and annual periods beginning after December 15, 2014. The requirements will be effective for nonpublic business entities for annual periods beginning after December 15, 2014, and interim and annual periods thereafter. However, both public and nonpublic entities will have additional time to adopt the amendments to ASC 810. All entities will be permitted to early adopt the standard.

The removal of the concept of a DSE from U.S. GAAP is not expected to affect the conclusions in this case.

We encourage you to check the FASB and IASB websites for further details and developments. You can also check Deloitte.com for Deloitte publications on proposals and final standards as they are issued.

Case 14-3: Coconut Telegraph

Issuance of ASU 2014-09 and IFRS 15

In May 2014, the FASB and the IASB jointly issued ASU 2014-09 and IFRS 15, respectively. The new standard, *Revenue from Contracts with Customers*, 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 new standard represents a broad reconsideration of how an entity recognizes and reports information about revenue resulting from contracts with customers. It supersedes most of the current guidance on revenue recognition in U.S. GAAP, with certain exceptions, doing away with the volumes of industry-specific guidance that many have been using for years. The project's core principle is recognition of revenue that depicts the transfer of goods or services to customers in amounts that reflect the consideration to which an entity expects to be entitled in exchange for those goods or services. Application of that principle would require an entity to (1) identify the contract with a customer, (2) identify the separate performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the separate performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies performance obligations.

The new standard also provides specific guidance on contract combinations and modifications. Specifically, an entity would be **required** to combine two or more contracts entered into at or near the same time with the same customer (or related parties) if certain criteria are met. Additionally, an entity would be required to consider the changes to both the promised goods or services and the consideration under a contract modification to determine if the modification would be accounted for as a separate contract. If the modification is not accounted for as a separate contract, the entity would be required to determine whether it would account for the modification (1) as the termination of the old contract and the creation of a new contract (i.e., prospective accounting), (2) by updating the measure of progress toward complete satisfaction of the performance obligation and recording a cumulative catch-up adjustment (i.e., retrospective accounting), or (3) as a combination of both of the above methods.

ASU 2014-09 will be effective for nonpublic entities in 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);
- For annual periods beginning after December 15, 2016 (excluding interim reporting periods);
- For annual periods beginning after December 15, 2017 (including interim reporting periods).

Alternatively, IFRS 15 will be effective for both public and nonpublic entities in annual reporting periods beginning on or after January 1, 2017.

Early application of the new revenue guidance is prohibited for entities that report under U.S. GAAP. IFRS permits early application.

Students are encouraged to read Deloitte's May 28, 2014 *Heads Up* and to refer to usgaapplus.com for additional publications on the new revenue standard as they are issued.

Case 14-9: O.T.T. Incorporated: Financial Instruments – Other-Than-Temporary Impairment

Current Status of the Boards' Impairment Projects — May 2014

In December 2012, the FASB issued a proposed ASU, Financial Instruments — Credit Losses on its current expected credit loss (CECL) model for accounting for the impairment of financial assets. The comment period on the proposal ended on May 30, 2013. The CECL model is the third impairment model the FASB has exposed for comment (this proposal and the first model were FASB-only, and the second model was a supplementary document published jointly with the IASB in January 2011). The IASB issued its exposure draft on Expected Credit losses in March 2013.
The impairment models most recently proposed by the boards differ in many significant aspects. However, both incorporate the notion of recognizing some level of expected credit losses, which is a departure from today's incurred loss model The boards are expected to separately issue final standards in 2014.

We encourage you to check the FASB and IASB websites for further details and developments. You can also check usgaapplus.com for Deloitte publications on proposals and final standards as they are issued.

Case 14-10: In-process Research & Development

New Revenue Recognition Guidance – Issuance of ASU 2014-09 and IFRS 15

In May 2014, the FASB and the IASB jointly issued ASU 2014-09 and IFRS 15, respectively. The new standard, *Revenue from Contracts with Customers*, 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 new standard represents a broad reconsideration of how an entity recognizes and reports information about revenue resulting from contracts with customers. It supersedes most of the current guidance on revenue recognition in U.S. GAAP, with certain exceptions, doing away with the volumes of industry-specific guidance that many have been using for years. The project's core principle is recognition of revenue that depicts the transfer of goods or services to customers in amounts that reflect the consideration to which an entity expects to be entitled in exchange for those goods or services. Application of that principle would require an entity to (1) identify the contract(s) with a customer, (2) identify the performance obligations, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations, and (5) recognize revenue when (or as) the entity satisfies performance obligations.

ASU 2014-09 will be effective for public entities for annual reporting periods beginning after December 15, 2016 (including interim reporting periods within that annual reporting period) and for nonpublic entities in 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);
- For annual periods beginning after December 15, 2016 (excluding interim reporting periods);
- For annual periods beginning after December 15, 2017 (including interim reporting periods).

IFRS 15 will be effective for annual reporting periods beginning on or after January 1, 2017.

Early application of the new revenue guidance is prohibited for entities that report under U.S. GAAP. IFRS permits early application.

Students are encouraged to read Deloitte's May 28, 2014 Heads Up and to refer to usgaapplus.com for additional publications on the new revenue standard as they are issued.

Application to this case

ASU 2104-09 and IFRS 15 principally establish guidance on revenue recognition, that is, for contracts with customers. Additionally, both new standards also amended the guidance for the sale of nonfinancial assets (for example, property, plant and equipment, real estate, and intangible assets, such as IPR&D assets). Specifically, ASU 2014-09 created a new Subtopic, 610-20, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets*, and IFRS 15 made amendments to IAS 16, *Property, Plant and Equipment*, IAS 38, *Intangible Assets*, and IAS 40, *Investment Property,* that require the derecognition of nonfinancial assets to use the guidance in the revenue model. Specifically, the new revenue guidance on derecognition and measurement is applicable as follows:

1. To determine when a nonfinancial asset shall be derecognized:
    a. Existence of a contract (Step 1).
    b. Transfer of control by determining when an entity satisfies a performance obligation (Step 5).

2. To determine the amount of consideration to be included in the calculation of a gain or loss recognized upon the derecognition of a nonfinancial asset
    a. Determining the transaction price (Step 3).

Recognition
Using the new guidance, first an entity would need to assess the criteria in Step 1 regarding identifying a contract, including the criterion in 606-10-25-1(e) [IFRS 9(e)], that "it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer."

Then, an entity would need to determine when control transfers to the buyer of the IPR&D. The new standard defines control as "the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset." Rather than define a good and a service, the Boards require an evaluation of whether or not a performance obligation is satisfied over time (typically a service) or at a point in time (typically a good). First, an entity must determine whether control of a good or service is transferred over time. If it is determined that control of the IPR&D transfers over time, an entity would recognize revenue by measuring the obligation's progress toward completion in a manner that best depicts the transfer of goods or services to the customer. If not, control of the good or service is transferred at a point in time. To determine the point in time in which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the new standard provides five indicators (none of which are individually determinative and should be considered with all other relevant information), as follows:

1. The entity has a present right to payment for the asset.
2. The customer has legal title to the asset.
3. The entity has transferred physical possession of the asset.
4. The entity has the significant risks and rewards of ownership of the asset.
5. The customer has accepted the asset.

Measurement
In the case presented above, the transaction price[4] included both fixed and variable (contingent) consideration. Accordingly, an entity would determine the transaction price using the guidance on estimating and constraining estimates of variable consideration. A transaction price that is subject to variability would be estimated by using an "expected value" (probability-weighted approach) or a "most likely amount" approach, whichever is more predictive of the amount to which the entity will be entitled. In addition, the Boards clarified that under the new standard, an entity must include some or all of an estimate of variable (or contingent) consideration in the transaction price only to the extent that the entity

[4] The transaction price is defined as, "the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties."

concludes that it is probable that changes in its estimate of such consideration will not result in significant reversals of revenue in subsequent periods.

In addition, the new standard includes measurement guidance on significant financing components (that is, an adjustment for the effect of time value of money when significant), noncash consideration, and consideration payable to the customer.

Additionally, ASU 2014-09 includes the following example:

> > *Sale of a Nonfinancial Asset*

> > > Example 1—Sale of a Nonfinancial Asset for Variable Consideration
An entity sells the rights to in-process research and development that it recently acquired in a business combination and measured at fair value of $50 million in accordance with Topic 805 on business combinations. The buyer of the in-process research and development agrees to pay a nonrefundable amount of $5 million at inception plus 2 percent of sales of any products derived from the in-process research and development over the next 20 years. The entity concludes that the sale of in-process research and development is not a good or service that is an output of the entity's ordinary activities.

Topic 350 on goodwill and other intangibles requires the entity to apply the guidance on existence of a contract, control, and measurement in Topic 606 on revenue from contracts with customers to determine the amount and timing of income to be recognized as follows:

a. The entity concludes that the criteria for identifying a contract in paragraph 606-10-25-1 are met.

b. The entity also concludes that on the basis of the guidance in paragraph 606-10-25-30, it has transferred control of the in-process research and development asset to the buyer as of contract inception. This is because as of contract inception the buyer can use the in-process research and development's records, patents, and supporting documentation to develop potential products and the entity has relinquished all substantive rights to the in-process research and development asset.

c. In estimating the consideration received, the entity applies the guidance in Topic 606 on determining the transaction price, including estimating and constraining variable consideration. The entity estimates that the amount of consideration that it will receive from the sales-based royalty is $100 million over the 20-year royalty period. However, the entity cannot assert that it is probable that recognizing all of the estimated variable consideration in other income would not result in a significant reversal of that consideration. The entity reaches this conclusion on the basis of its assessment of factors in paragraph 606-10-32-12. In particular, the entity is aware that the variable consideration is highly susceptible to the actions and judgments of third parties, because it is based on the buyer completing the in-process research and development asset, obtaining regulatory approval for the output of the in-process research and development asset, and marketing and selling the output. For the same reasons, the entity also concludes that it could not include any amount, even a minimum amount, in the estimate of the consideration. Consequently, the entity concludes that the estimate of the consideration to be used in the calculation of the gain or loss upon the derecognition of the in-process research and development asset is limited to the $5 million fixed upfront payment.

At inception of the contract, the entity recognizes a net loss of $45 million ($5 million of consideration, less the in-process research and development asset of $50 million). The entity reassesses the transaction price at each reporting period to determine whether it is probable that a significant reversal would not occur from recognizing the estimate as other income and, if so, recognizes that amount as other income in accordance with paragraphs 606-10-32-14 and 606-10-32-42 through 32-45.ASU 2014-09, paragraph 149]