

Heads Up

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Sales of real estate that are not part of a leaseback transaction will be subject to the derecognition requirements in the ASU, which are less prescriptive than existing guidance and may result in earlier profit recognition.

Recently Renovated

Accounting for Real Estate Sales Under the New Revenue Standard

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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 the guidance on real estate derecognition for most transactions.

This *Heads Up* discusses the framework of the new revenue model and highlights key accounting issues and potential challenges for entities that account for real estate disposals under U.S. GAAP. These issues and potential challenges apply to both real estate sales that are an output of an entity's ordinary activities (i.e., revenue transactions) and real estate disposals that are outside an entity's ordinary activities (i.e., gains or losses). For additional information about the new standard, see Deloitte's May 28, 2014, *Heads Up*.

Editor's Note: The ASU replaces the real estate sales guidance in ASC 360-20² except for sales that are part of a sale-leaseback transaction. Sales of real estate that are not part of a leaseback transaction will be subject to the derecognition requirements in the ASU, which are less prescriptive than existing guidance and may result in earlier profit recognition. Specifically, the ASU eliminates the requirements in ASC 360-20 for assessing (1) the adequacy of a buyer's initial and continuing investments and (2) the seller's continuing involvement with the property. When evaluating whether it can derecognize real estate under the new standard, an entity will need to assess whether it is "probable" that it will collect the consideration to which it will be entitled in exchange for transferring the asset(s) to the customer. In addition, rather than preventing derecognition, a seller's postsale involvement with the disposed asset may need to be accounted for as a separate performance obligation.

Background

The goals of the revenue recognition project are to clarify and converge the revenue recognition principles under U.S. GAAP and IFRSs and to develop guidance that would streamline and enhance revenue recognition requirements while also providing "a more robust framework for addressing revenue issues." The boards believe that the standard will improve the consistency of requirements, comparability of revenue recognition practices, and usefulness of disclosures.

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

² Formerly FASB Statement No. 66, *Accounting for Sales of Real Estate*. (For titles of FASB Accounting Standards Codification references, see Deloitte's "Titles of Topics and Subtopics in the FASB Accounting Standards Codification.")

Under the ASU, a nonmonetary exchange of real estate is accounted for as a sale of the real estate asset for noncash consideration.

The ASU outlines five steps to recognizing revenue:

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

The ASU states that the core principle of the new revenue recognition guidance 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.”

Editor’s Note: As a result of the ASU, entities will need to reassess their current accounting for real estate disposals and determine whether accounting changes are necessary. In addition, the ASU requires 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

The ASU significantly amends the derecognition requirements for real estate disposals. Some of the key accounting issues and potential challenges related to real estate disposals are discussed below.

Scope

Contributions of Real Estate

The ASU retains the current guidance in ASC 970 requiring an investor to generally record its contribution of real estate to a real estate joint venture at the investor’s cost (less related depreciation and valuation allowances) of the real estate contributed regardless of whether the other investors contribute cash, property, or services. However, if the transaction is an in-substance sale, it would be accounted for in accordance with the ASU’s guidance on derecognition of nonfinancial assets. For example, suppose that two investors form a real estate venture. Investor 1 contributes cash in exchange for a 50 percent interest in the venture; Investor 2 contributes real estate in exchange for the other 50 percent of the venture and receives the cash contribution made by Investor 1. If Investor 2 is not committed to reinvest the cash received from the venture, the substance of this transaction is a sale of a one-half interest in the real estate in exchange for cash.

Like-Kind Exchanges

Under the ASU, a nonmonetary exchange of real estate (typically structured for tax purposes) is accounted for as a sale of the real estate asset for noncash consideration. Accordingly, if the transaction meets the new criteria to be accounted for as a sale, the entity would measure the noncash consideration received in the transaction at fair value. The entity would recognize a gain or loss on the sale and record the acquired asset at its fair value. However, the entity would continue to apply the current guidance on nonmonetary exchanges in ASC 845 if (1) it receives a noncontrolling ownership interest in the purchaser entity in exchange for the real estate asset or (2) the exchange is between entities in the same line of business to help facilitate sales to potential customers.

Sale-Leaseback Transactions

Under current U.S. GAAP, the sale-leaseback guidance in ASC 840-40³ applies to a transaction involving real estate only if the transaction:

- Includes a “normal leaseback” under ASC 840-40.
- Includes “payment terms and provisions [that] adequately demonstrate the buyer-lessee’s initial and continuing investment in the property.”
- “[T]ransfer[s] all of the other risks and rewards of ownership as demonstrated by the absence of any other continuing involvement by the seller-lessee.”

If any of these three criteria are not met, the transaction is accounted for as a financing arrangement.

The ASU does not change these requirements. Although the new standard generally supersedes the real estate sales guidance in ASC 360-20, the FASB decided that if a sale of real estate (including property improvements and integral equipment) is part of a sale-leaseback transaction, the transaction would continue to be evaluated under ASC 360-20 until the FASB and IASB complete their joint project on leasing. However, the FASB amended the requirements for sale-leaseback transactions involving assets other than real estate (i.e., such sales transactions would be evaluated under the ASU).

Editor’s Note: The ASU supersedes the guidance in ASC 840-20-40-3 on the sale of property that is subject to an operating lease (or of property that is leased, or intended to be leased, by a third-party purchaser to another party). Accordingly, rather than focusing on whether the seller or any party related to the seller retains substantial risks of ownership in the leased property, entities would assess whether the purchaser has obtained control of the asset in their evaluation of whether the transaction should be treated as a sale.

If a sale of real estate is part of a sale-leaseback transaction, the transaction would continue to be evaluated under ASC 360-20 until the FASB and IASB complete their joint project on leasing.

Financing Arrangements (Existence of a Contract)

Under current guidance on the sale of real estate with financing, the seller must consider the buyer’s initial and continuing investments in the property to determine whether they constitute a stake sufficient to ensure that the risk of loss will motivate the buyer to honor its obligation to the seller. If the specified investment requirements are not met, the seller accounts for the sale by using the installment method, the cost recovery method, or the deposit method.

Under the ASU, collectibility of the sales price affects the evaluation of whether a contract “exists.” That is, the ASU requires an entity to determine whether a contract exists by assessing whether it is probable that the entity will collect the consideration to which it will be entitled (the collectibility threshold). However, the ASU does not include specific initial and continuing investment thresholds for performing this evaluation.

If a seller determines that a contract does not exist, it would account for any amounts received as a deposit (even if such payments are nonrefundable). In addition, the seller would continually evaluate the amounts received to determine whether the arrangement subsequently qualifies as a valid contract under the ASU’s criteria. Once it becomes probable that the seller will collect the consideration to which it will be entitled, the seller would evaluate the arrangement under the derecognition criteria in the ASU. If, instead, the contract is terminated, the seller would recognize any nonrefundable deposits received as a gain.

³ Formerly FASB Statement No. 98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases* — an amendment of FASB Statements No. 13, 66, and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11.

Under the ASU, if the arrangement includes ongoing involvement with the property, the seller must evaluate each promised good or service under the contract to determine whether it represents a “separate performance obligation,” constitutes a guarantee, or prevents the transfer of control.

Editor’s Note: The ASU includes an example⁴ of a real estate sale in which the buyer pays a 5 percent nonrefundable deposit for the property and the seller finances the remaining purchase price. The buyer’s ability to pay the outstanding purchase price is contingent solely on its ability to generate profits from the use of the real estate. On the basis of the facts and circumstances, the seller concludes that it should account for the arrangement as a nonrefundable deposit rather than a sale because the buyer’s intent and ability to pay the outstanding amount are in doubt.

Identifying the Performance Obligations

Often, a seller remains involved with property that has been sold. Under current guidance, profit is generally deferred if a seller has continuing involvement with the sold property. Sometimes, instead of accounting for the transaction as a sale, the seller may be required to (1) apply the deposit method to the transaction or (2) account for the transaction as a financing, leasing, or profit-sharing arrangement. The current guidance focuses on whether the seller retains substantial risks or rewards of ownership as a result of its continuing involvement with the sold property.

In contrast, under the ASU, if the arrangement includes ongoing involvement with the property, the seller must evaluate each promised good or service under the contract to determine whether it represents a “separate performance obligation,” constitutes a guarantee, or prevents the transfer of control.⁵ If a promised good or service is considered a separate performance obligation, an allocated portion of the transaction price should be recognized as revenue when (or as) the entity transfers the related good or service to the customer.

To be considered a separate performance obligation, a good or service needs to be distinct. A good or service is considered distinct (and therefore a separate performance obligation) 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” (the ASU provides specific indicators of this criterion).

For example, assume that as part of a sale of land, the seller agrees to erect a building on the land in accordance with agreed specifications. If the sale of land and the construction of the building are considered separate performance obligations, the seller would be required to recognize an allocated portion of the total proceeds as each good or service is fulfilled or delivered. However, if the sale of land and the construction of the building are not considered separate performance obligations, the revenue related to the sale of the land would be deferred.

Another example illustrating an arrangement that potentially contains multiple performance obligations is a situation in which a community developer agrees to provide common areas (e.g., a community center, parks, or a golf course) as part of the development. The developer would need to consider whether the promise to provide these additional developments represents separate performance obligations.

Given that the accounting could vary significantly depending on whether an arrangement involves multiple distinct performance obligations, entities should analyze their sales contracts to determine whether any promises of goods or services represent distinct performance obligations.

⁴ ASC 606-10-55-95 through 55-98.

⁵ Certain forms of continuing involvement would not constitute a separate performance obligation. For example, an option or obligation to repurchase a property is specifically addressed by the ASU and may preclude derecognition of the property (see [Repurchase Agreements](#) below for more information). Further, a seller obligation that qualifies as a guarantee under ASC 460 would be outside the scope of the ASU.

The ASU requires entities to adjust the promised consideration in a contract for the time value of money when the arrangement provides either the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

Determining the Transaction Price

Variable Consideration

A sales contract may allow the seller to participate in future profits related to the underlying real estate. Under current U.S. GAAP, the amount of revenue recognized is generally limited to the amount that is not contingent on a future event (i.e., the price is no longer variable). Any additional revenue would be recorded only when the contingent revenue is realized. Under the ASU, some or all of the estimated variable consideration is included in the transaction price (and therefore eligible for recognition) to the extent that it is probable that the cumulative amount of the revenue recognized will not be subject to significant reversal (the “constraint”).

Accordingly, an entity will need to estimate the portion of the contingent (or variable) consideration to include in the transaction price, which may be recognized up front. As a result, revenue may be recognized earlier under the ASU than under current requirements.

Example

Company A sells land to a home builder for a fixed amount plus a percentage of the profits that will be realized on the sale of homes once constructed on the land by the home builder. Under current U.S. GAAP, participation in the profit would be delayed until the homes are sold, profits are realized, and Company A is under no obligation to refund any amounts received to date. Under the ASU, Company A would be required to (1) estimate the consideration expected to be received from the home builder and (2) recognize all or some of the amount as revenue up front when the land is sold. Determining the amount of revenue that is not subject to a significant revenue reversal could require significant judgment.

Significant Financing Component

The ASU requires entities to adjust the promised consideration in a contract for the time value of money when the arrangement provides either the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In such instances, the entity will be required to adjust the promised amount of consideration to reflect what the cash selling price would have been if the customer had paid cash for the promised goods or services at the time control was transferred to the customer. In calculating the amount of consideration attributable to the significant financing component, the entity should use an interest rate that reflects a hypothetical financing-only transaction between the entity and the customer. As a practical expedient, the ASU does not require entities to account for a significant financing component in a contract if, at contract inception, the expected time between substantially all of the payments and the transfer of the promised goods and services is one year or less.

Editor’s Note: Real estate entities may enter into contracts containing terms that give the customer the right to defer payments for a significant period from the transaction date or require an up-front deposit before the transaction date. An entity will need to determine whether a contract’s payment terms (1) give the customer or the entity a significant benefit of financing the transfer of the real estate or (2) are intended for other purposes (e.g., to ensure full performance by the entity or the customer).

Recognizing Revenue When (or as) Performance Obligations Are Satisfied

When evaluating whether the disposal of real estate qualifies for sale accounting under current U.S. GAAP, entities focus on whether the usual risks and rewards of ownership have been transferred to the buyer.

Under the ASU, a seller of real estate would evaluate whether a performance obligation is satisfied (and the related revenue recognized) when “control” of the underlying

Under the ASU, entities determine whether they can derecognize real estate by using a control-based model rather than the risks-and-rewards model under current U.S. GAAP.

assets is transferred to the purchaser.⁶ An entity must first determine whether control is transferred over time or at a point in time. If control is transferred over time, the related revenue is recognized over time as the good or service is transferred to the customer. If control is transferred at a point in time, revenue is recognized when the good or service is transferred to the customer.

Control of a good or service (and therefore satisfaction of the related performance obligation) is transferred over time when at least one of the following criteria is met:

- “The customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs.”
- “The entity’s performance creates or enhances an asset . . . that the customer controls as the asset is created or enhanced.”
- “The entity’s performance does not create an asset with an alternative use to the entity . . . and the entity has an enforceable right to payment for performance completed to date.”

Editor’s Note: The ASU includes an example⁷ describing three cases in which a real estate developer enters into a contract to sell a specified condominium unit in a multifamily residential complex once construction is complete. The developer receives an up-front nonrefundable deposit when the customer enters into a binding sales agreement. The contract legally obligates the developer to complete construction of the asset and to transfer the specified unit to the customer. In Case A of the example, the developer does not have an enforceable right to payment for the performance completed to date; in Cases B and C, the developer has such a right.

While the developer may determine that its performance under the contract creates an asset that does not have an alternative use for the developer (i.e., the developer cannot use the asset or sell it to anyone else), the analysis focuses on whether the developer has an enforceable right to payment for its performance to date. The example indicates that the developer should consider the legal precedent in the particular jurisdiction to determine whether the rights and obligations under the contract are enforceable.

The example further indicates that if the developer determines that its rights and obligations are legally enforceable (which may not be the case in many jurisdictions), the entity would recognize revenue over time. Alternatively, the developer would be required to recognize revenue at the point in time at which control of the specified unit is transferred to the customer. This guidance may delay the recognition of revenue for developers of multifamily condominium complexes.

If a performance obligation does not meet any of the three criteria for recognition over time, the performance obligation is deemed satisfied at a point in time. Under the ASU, entities would consider the following indicators in evaluating the point in time at which control of an asset has been transferred to a customer and when the revenue allocated to the related performance obligation should be recognized:

- “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.”

Under the ASU, entities determine whether they can derecognize real estate by using a control-based model rather than the risks-and-rewards model under current U.S. GAAP.

⁶ ASC 606-10-25-25 (added by the ASU) states that “[c]ontrol of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset” and “includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.”

⁷ ASC 606-10-55-173 through 55-182.

Although a seller of real estate would evaluate legal title and physical possession to determine whether control has transferred, it should also consider its exposure to the risks and rewards of ownership of the property as part of its “control” analysis under the ASU.

However, the FASB decided to include “significant risks and rewards” as a factor for entities to consider in evaluating the point in time at which control of a good or service is transferred to a customer. Accordingly, although a seller of real estate would evaluate legal title and physical possession to determine whether control has transferred, it should also consider its exposure to the risks and rewards of ownership of the property as part of its “control” analysis under the ASU.⁸

Repurchase Agreements

Under existing guidance, an obligation or option (held by either the seller or the buyer) to repurchase a property that is the subject of a sales agreement would preclude the seller from recognizing profit by using the full accrual method and instead would require the seller to account for the transaction as a financing, leasing, or profit-sharing arrangement.

Under the ASU, entities would account for repurchase agreements in the following manner:

- If the seller has an obligation or option to repurchase a property it has sold (a forward or call option), it should account for the sale as (1) a lease if the repurchase amount is less than the original selling price or (2) a financing arrangement if the repurchase price is more than the original selling price.
- If the buyer has an option to require the seller to repurchase the property (a put option), the seller would determine whether to account for the transaction as a lease, a sale with a right of return, or a financing arrangement by performing the analysis below:
 - If the repurchase price under the option is lower than the original selling price, the seller would need to consider at contract inception whether the buyer has a significant economic incentive to exercise its option. If the buyer has such an incentive, the contract should be treated as a lease (unless the transaction involves a leaseback and would result in a lease-leaseback transaction, in which case the entire transaction should be treated as a financing). Otherwise, the transaction should be accounted for as a sale with a right of return.
 - If the repurchase price under the option is equal to or greater than the original selling price, the seller should treat the contract as a financing arrangement unless the expected fair value of the asset is greater than the repurchase price and the buyer does not have a significant economic incentive to exercise the option, in which case the transaction should be accounted for as a sale with a right of return.

Editor’s Note: If the seller of real estate is required to treat a transaction as a financing arrangement, it would continue to recognize the property and record a liability for the consideration received from the buyer. The difference between the amount of consideration received from the buyer and the amount paid under the repurchase agreement should be recorded as interest over the term of the arrangement. If the seller is required to treat the transaction as a lease, it would account for the arrangement in accordance with ASC 840.

In-Substance Nonfinancial Assets

Currently, entities account for the sale of real estate in the form of a financial asset by applying the real estate sales guidance in ASC 360 rather than the deconsolidation guidance in ASC 810 if the sale involves an investment that is considered in-substance real estate (e.g., an equity interest in an entity whose sole asset is a single property). In addition, they evaluate the disposal of equipment attached to real estate assets in accordance with ASC 360 if the equipment is considered integral equipment.

⁸ An entity would not consider parts of a contract that are accounted for under guidance outside the ASU (e.g., guarantees within the scope of ASC 460) when determining whether control of the remaining goods and services in the contract has been transferred to a customer.

The ASU expands the concept of in-substance real estate to include all in-substance nonfinancial assets.

The ASU expands the concept of in-substance real estate to include all in-substance nonfinancial assets. Accordingly, an entity would apply the deconsolidation guidance in ASC 810 only when the transfer or sale of a subsidiary or business is not considered the sale of in-substance nonfinancial assets. While the ASU does not define in-substance nonfinancial assets, a transaction that historically has been outside the scope of ASC 360 may be within the scope of the ASU (rather than ASC 810) if the entity substantially comprises nonfinancial assets other than real estate and integral equipment.

Accounting for Partial Sales

Under ASC 360 and ASC 970, a sale is considered a partial sale if the seller retains an equity interest in the property (or the buyer). Profit (the difference between the sales price and the proportionate cost of the partial interest sold) is recognized only for the portion sold if the buyer is independent of the seller (i.e., not a consolidated subsidiary of the seller) and if certain other requirements are met. While the ASU does not carry forward the current guidance in ASC 360 on partial sales, it retains the guidance in ASC 970 on partial sales.

A partial sale typically results when an equity interest is sold in an entity that is considered in-substance real estate. When evaluating whether a partial sale qualifies as a sale, the seller needs to determine whether control of the real estate is transferred to the customer. However, the ASU does not provide guidance on the appropriate unit of account for performing this evaluation. Specifically, the ASU does not indicate whether the evaluation should focus on the transfer of control of the interest in the entity (as it would for the sale of an undivided interest) or on the transfer of control of the underlying asset held by the entity. The focus of the evaluation could significantly affect an entity's determination of whether control has been transferred.

Editor's Note: The FASB is currently evaluating its guidance on partial sales or transfers of nonfinancial assets as part of its project to clarify the definition of a business. However, if the FASB does not complete this project by the time the ASU becomes effective, diversity in practice may evolve since entities may apply different approaches to determine how to account for partial sales of real estate in accordance with the ASU.

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). Nonpublic entities can use the same effective date as public entities (regardless of whether interim periods are included) or postpone adoption for one year from the effective date for public entities.

Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in the ASU. Retrospective application would take into account the requirements in ASC 250 (with certain practical expedients). 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" (transactions in periods presented in the financial statements before that date are reported under guidance in effect before the change). Under the modified approach, the guidance in the ASU is only applied to existing contracts (those that are not completed) 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. Entities that elect the modified approach must disclose the impact of adopting the ASU, including the financial statement line items and respective amounts directly affected by the standard's application.

Editor's Note: Transition under the modified 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.

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.

Challenges for Entities That Account for Real Estate Transactions

Increased Use of Judgment

Management will need to exercise significant judgment in applying certain 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 entities to consider how the standard specifically applies to them so that they can prepare for any changes in revenue recognition patterns.

Retrospective Application

The ASU allows retrospective application, with certain optional practical expedients available to entities at their discretion. This aspect of the standard may require entities to gather data and assess contracts that commenced several years before the standard's effective date. Entities also 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 ASU becomes effective.

Systems, Processes, and Controls

To comply with the ASU's new practice and disclosure requirements, 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. Further, to ensure the effectiveness of internal controls over financial reporting, management will want to assess whether it should implement additional controls. 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 entities may need to make to their systems, processes, and controls; 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 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.

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

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 new method. Similar requirements 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 standard's revenue recognition method for tax purposes.

Thinking Ahead

Although the ASU is not effective until reporting periods beginning after December 15, 2016 (with a maximum deferral of one year for nonpublic entities that apply U.S. GAAP), 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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