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More Fine-Tuning

FASB Continues to Clarify the New Revenue Standard

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Introduction

In May 2014, the FASB (jointly with the IASB) issued a new revenue standard[1] that will replace most current revenue recognition guidance. Since the standard's issuance, stakeholders have raised a number of implementation questions, many of which have been discussed by the joint transition resource group (TRG) on revenue recognition[2] at its three meetings.[3]

Tentative Decisions

The table below summarizes and compares the tentative decisions made at the boards' joint meeting on March 18, 2015. The appendix discusses the FASB staff's recommendations and the FASB's tentative decisions in greater detail. For more information, see the meeting materials on the IASB's Web site.

Topic	FASB's Tentative Decisions	IASB's Tentative Decisions	Comparison
Practical expedients upon transition — contract modifications and completed contracts	A practical expedient would be added to the standard that permits entities to use hindsight in determining contract modifications for transition purposes. A new term, "contract modification adjustment date" (CMAD), would be added to the standard and defined as the beginning of the earliest year presented upon initial adoption of the standard. Consequently, while an entity would need to assemble and analyze information to understand contract modifications throughout the term of a contract, it would not be required to recalculate the effect of such modifications sequentially as they occur. Instead, it would use hindsight with respect to the modifications as of the CMAD and perform a single analysis to determine the resulting transaction price, the satisfied and unsatisfied performance obligations, and the allocation of the transaction price to the performance obligations.	The use of hindsight would be permitted, and the term CMAD would be added to the standard, but entities would also be given the option to apply another practical expedient when using the full retrospective transition approach. Under the expedient, entities would, for transition purposes, be permitted to exclude the evaluation of any contract that was completed in accordance with current IFRSs as of the CMAD.	The boards' decisions diverge because entities reporting under U.S. GAAP would need to evaluate completed contracts when using a full retrospective transition approach. The IASB's tentative decision to allow the exclusion of completed contracts under the full retrospective transition approach is consistent with IFRS 1[4] (which has no equivalent under U.S. GAAP). However, it is unclear whether and, if so, when the IASB would make conforming changes to the new revenue standard.

[1] FASB Accounting Standards Update No. 2014-09 and IFRS 15, *Revenue From Contracts With Customers*.
[2] See the FASB's Web site for more information about the TRG.
[3] See Deloitte's July 2014, October 2014, and January 2015 *TRG Snapshot* newsletters for summaries of the meetings and links to relevant meeting materials.
[4] IFRS 1, *First-time Adoption of International Financial Reporting Standards*.

Topic	FASB's Tentative Decisions	IASB's Tentative Decisions	Comparison
Sales tax presentation — gross versus net	A practical expedient would be added to the standard that permits entities to present sales taxes on a net basis. The expedient's scope would apply to the same sales taxes as those under existing U.S. GAAP. In addition, while the Board rejected practical expedients to present sales taxes on a gross basis, an entity that instead applies the new revenue model may present sales taxes on a gross basis if it concludes that it is the principal with respect to the sales tax.	The IASB believes that the guidance on this topic is clear and that changes are not needed.	The decisions are different and likely to lead to diverse accounting; however, the extent of divergence that may result is unclear. U.S. companies and Form 20-F filers that report under IFRSs would not be permitted to use the practical expedient under U.S. GAAP.
Noncash consideration	The standard would be amended to clarify that (1) an entity should measure noncash consideration at contract inception and (2) the constraint would not apply to variability in the form of consideration. Thus, the constraint would apply **only** to variability resulting from reasons **other** than the form of consideration.	The IASB believes that the guidance on this topic is clear and that changes are not needed.	The decisions are different and will lead to divergence to the extent that an entity chooses under IFRSs to measure noncash consideration other than at contract inception.
Collectibility	The standard would be amended to clarify that (1) an entity would not simply assess the probability of collecting all the consideration in a contract. Rather, collectibility would be assessed on the basis of the amount to which the entity will be entitled in exchange for the goods or services that will transfer to the customer (i.e., not goods or service that will not transfer if the customer fails to pay) and (2) a contract is considered terminated if the entity has the ability to stop (or has actually stopped) transferring additional goods or services to the customer.	The IASB believes that the guidance on this topic is clear and that changes are not needed.	The decisions are different, but because the FASB's decision is intended to clarify the guidance, significant divergence is currently not expected.

Next Steps

The Board directed its staff to draft a proposed Accounting Standards Update (ASU) with a 45-day comment period that reflects the decisions made at this meeting. (Note that the staff is drafting a separate proposed ASU on the tentative decisions made at the Board's February 2015 meeting.[5])

Editor's Note: Potential deferral of the new revenue standard was not discussed at this meeting. The FASB indicated that it intends to address that topic at its April 2015 meeting.

[5] See Deloitte's February 19, 2015, *Heads Up* for more information.

Appendix — Additional Details About the FASB's Decisions

Practical Expedients Upon Transition — Contract Modifications and Completed Contracts

Summary of Implementation Issues and Staff Recommendations

The new revenue standard provides guidance on transition and contract modifications. The transition provisions allow an entity to apply either a full retrospective approach (with certain practical expedients) or a modified retrospective approach.[1] The standard defines the term "contract modification"[2] and notes that depending on the circumstances, a contract modification is accounted for as (1) a separate contract, (2) a termination of the old contract and creation of a new one, or (3) a cumulative catch-up adjustment.[3]

Given the high volume and long duration of customer contracts that some entities and their customers modify frequently, stakeholders have expressed concerns that applying the transition guidance will be challenging — if not impracticable[4] — regardless of the method used. Furthermore, some believe that the costs may exceed the benefits because of the limited usefulness in applying the contract modification guidance to periods before the date of initial application.

To address stakeholder concerns related to transition, the staff outlined for the boards the following three potential practical expedients that entities could apply to contract modifications:

- *Alternative A: The "frozen balances" expedient* — Entities would treat modified contracts as (1) terminations of existing contracts and (2) creations of new ones, and they would allocate consideration to unsatisfied performance obligations as of the CMAD on the basis of historical stand-alone selling prices.
- *Alternative B: The "use of hindsight" expedient* — Entities would be permitted to use hindsight to account for all modifications from contract inception through the CMAD (i.e., to determine the transaction price) and allocate the transaction price to all satisfied and unsatisfied performance obligations on the basis of historical stand-alone prices. In other words, while Alternative B would not remove an entity's need to assemble and analyze information to understand the modifications made throughout the term of a contract and the resulting performance obligations, the entity would no longer need to recalculate the effect of modifications sequentially as they occur. Instead, the entity would use hindsight with respect to the modifications as of the CMAD to perform a single analysis to determine the transaction price of the contract and the satisfied and unsatisfied performance obligations (i.e., the transaction price and performance obligations as of the CMAD that result from prior modifications). The entity would then allocate the transaction price over the satisfied and unsatisfied performance obligations.
- *Alternative C: The "completed contracts" expedient* — Entities that apply the full retrospective method of transition would be permitted an accommodation similar to the modified retrospective approach in ASC 606-10-65-1(h). That is, an entity electing the full retrospective approach would not be required to apply the new revenue standard (i.e., the modification guidance) to contracts that are completed (in accordance with current GAAP) as of the beginning of the earliest period presented.

The FASB staff recommended Alternatives B and C because they would provide "limited and targeted relief" by reducing costs and complexity without significantly affecting comparability. In addition, the staff recommended that the CMAD be defined as the beginning of the earliest year presented in the financial statements upon initial adoption of the new revenue standard.

FASB's Tentative Decisions

While certain FASB members believed that Alternative A would provide the most relief, the Board ultimately rejected Alternative A. The Board also rejected Alternative C because it believed that there should be no additional modifications to the full retrospective approach. Instead, the Board tentatively decided to incorporate Alternative B into the new revenue standard and require disclosures similar to those in ASC 606-10-65-1(g) (i.e., about the expedients the entity used and, to the extent possible, "a qualitative assessment of the estimated effect of applying each of those expedients").

The Board also tentatively agreed to define the CMAD as the beginning of the earliest year presented in the financial statements upon initial adoption of the new standard.

[1] ASC 606-10-65-1(d) and ASC 606-10-65-1(f); paragraphs C3 and C5 of IFRS 15. For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

[2] See ASC 606-10-25-10.

[3] See ASC 606-10-25-12 and 25-13 for more information about contract modifications.

[4] As used in ASC 250 and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Sales Tax Presentation — Gross Versus Net

Summary of Implementation Issues and Staff Recommendations

The core principle of the new revenue standard 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."[5] The new revenue standard does not prescribe how amounts collected on behalf of third parties (e.g., tax authorities) should be presented. However, the transaction price should exclude "amounts collected on behalf of third parties (for example, some sales taxes)."[6]

Consequently, there are inconsistent views on when sales taxes should be presented as revenue or as reductions of costs under the new revenue standard. The analysis is further complicated by the entity's requirement to apply the principal-versus-agent guidance on a jurisdiction-by-jurisdiction basis (and to include all taxation levels in both domestic and foreign governmental jurisdictions), especially for entities that operate in a significant number of jurisdictions.

The staff noted that the FASB could allow one of the following three alternatives along with disclosure of the related accounting policy: (1) gross presentation of all "in-scope" sales taxes, (2) net presentation of all in-scope sales taxes, or (3) a policy election to present sales taxes on either a gross or net basis. However, if gross presentation is elected under the third alternative, an entity would also be required to disclose amounts of sales taxes presented within gross amounts, if significant. Essentially, accounting under the third alternative would be similar to that under current U.S. GAAP.

The FASB staff did not recommend an alternative. While no staff members recommended gross presentation, their views were split between permitting entities to present sales taxes on a net basis and permitting them to make a policy election.

FASB's Tentative Decisions

The Board tentatively agreed to amend the new revenue standard to add a practical expedient that would permit entities to present sales taxes on a net basis. The expedient's scope would apply to the same taxes as those under existing U.S. GAAP.[7]

Editor's Note: The Board rejected practical expedients for gross presentation of sales taxes. However, it noted that instead of applying the practical expedient for net presentation of sale taxes, an entity would be able to present sales taxes on a gross basis if it does not elect the practical expedient and, in applying the new revenue standard, the entity determines that it is the principal with respect to the related sales tax.

Noncash Consideration

Summary of Implementation Issues and Staff Recommendations

The new revenue standard indicates that when consideration is in a form other than cash (i.e., noncash), an entity should determine the transaction price by measuring the noncash consideration at fair value.[8] Stakeholders have noted the following two issues associated with applying the guidance on noncash consideration:

- *Issue 1* — There are different interpretations of the guidance on measuring noncash consideration. The measurement date for noncash consideration has been variously viewed as (1) the time of contract inception (View A), (2) the time at which the noncash consideration is received or is receivable (View B), and (3) the earlier of (a) when the noncash consideration is received (or is receivable) or (b) when the related performance obligation is satisfied, or as the performance obligation is satisfied if satisfied over time (View C). The staff recommended View A because it is more consistent with the new revenue model than the other views, it more clearly depicts the consideration negotiated between the parties in the arrangement, and it is more likely to be the least costly to apply.
- *Issue 2* — The revenue standard is unclear on how to apply the guidance on constraining variable consideration in the transaction price when there is variability in the fair value of noncash consideration. The staff noted that it is aware of two views. One view is that the constraint would apply to all variability — that is, it would apply because of variability in the form of consideration and for reasons other than the form of consideration. Examples of such variability include changes in (1) the price of a share that an entity is entitled to receive from a customer and (2) the exercise price of a share option because of the entity's performance. The other view is that the constraint **only** would apply to variability that is attributable to reasons other than the form of consideration. The FASB staff recommended the second view because it more closely aligns with the boards' intent (as described in paragraph BC25 of the standard).

[5] ASC 606-10-05-3; paragraph IN7 of IFRS 15.
[6] ASC 606-10-32-2; paragraph 47 of IFRS 15.
[7] See ASC 605-45-15-2(e).
[8] ASC 606-10-32-21 and 32-22; paragraphs 66 through 69 of IFRS 15.

FASB's Tentative Decisions

The Board tentatively agreed with the staff's recommendations and voted to amend the new standard to clarify that:

- The measurement date for noncash consideration is at contract inception (View A).
- The constraint applies only to variability from sources other than those related to the form of the consideration. In addition, the FASB instructed the staff to update Example 31 in the standard (ASC 606-10-55-248) because it is subject to different interpretations.

Collectibility

Summary of Implementation Issues and Staff Recommendations

The new revenue standard requires an entity to assess collectibility at contract inception. If collectibility is not probable, the entity would be precluded from recognizing revenue until certain conditions are met.[9] Questions have arisen about how to recognize revenue if a contract does not meet the collectibility threshold's "probability" requirement (often after contract inception) and the entity receives some consideration from the customer for the entity's performance to date. In particular, some stakeholders have remarked that the prohibition against recognizing any revenue is punitive when a portion of the consideration is collected and (1) the contract is legally valid and (2) the entity has the ability to reduce its credit risk exposure (e.g., the entity may cease providing goods or services if the customer does not pay). In addition, there have been questions about to how to determine when a contract has been terminated.

To address stakeholder concerns, the staff outlined three potential alternatives (A, B, and C), each of which would amend the standard's guidance differently. The FASB staff rejected Alternative A, which would have required an entity to "recognize revenue for the lesser of (a) the non-refundable consideration received from the customer and (b) the amount that would have been allocated to a satisfied performance obligation"[10] because that alternative would represent a significant change to the model.

Alternatives B and C would make clarifying amendments to the guidance on collectibility and the termination of a contract. Under those alternatives, an entity would not perform the collectibility assessment on the basis of the expected consideration for all goods and services promised in the contract but rather on the basis of the amount of consideration to which it expects to be entitled in exchange for goods or services that will be transferred to the customer. In other words, it is a "forward-looking" assessment. For example, if an entity stops transferring goods or services because the customer fails to pay, the entity would limit its assessment of collectibility to the amount of consideration for transferred goods or services (and thus would not assess collectibility for goods or services that have not been transferred).

Further, the updated guidance would specify that a contract is terminated when "the entity (i) has the ability (under the contract or the law) to stop transferring additional promised goods or services to the customer and (ii) has actually stopped transferring goods or providing services to the customer."[11]

The staff recommended a combination of Alternatives B and C, noting that they are not mutually exclusive or likely to result in significant changes to the model.

FASB's Tentative Decisions

The Board agreed to amend the new revenue standard in a manner consistent with the staff's recommendation.

Editor's Note: The Board followed the staff's recommendation and specifically rejected Alternative A. Notwithstanding the clarifications the Board agreed to make regarding the collectibility threshold, when the threshold's "probable" requirement is not met, the guidance prohibiting the recognition of any revenue until the entity has no remaining obligations under the contract (or the contract is terminated) will still apply. That is, even when nonrefundable consideration is received from the customer and the other criteria for recognizing revenue in the new standard have been met, an entity would be precluded from recognizing any revenue until the entity has no remaining obligations under the contract, the contract is terminated, or the probable requirement (collectibility threshold) is met. This may significantly affect entities that currently recognize revenue on a cash-basis of accounting when collectibility is not reasonably assured.

[9] If collectibility is not probable, revenue can be recognized only if (1) the entity has fully performed under the contract and has received all or substantially all consideration that it expects to receive and such consideration is not refundable, (2) the contract is terminated and consideration received is not refundable, or (3) collectibility was later determined to be probable. Further, consideration received before any of these three conditions are met should be recorded as a liability. For additional information, see ASC 606-10-25-6 through 25-8; paragraphs 14 through 16 of IFRS 15.

[10] Quoted text is from meeting Memo No. 1.

[11] See footnote 10.

Research Update — Principal Versus Agent

Under the new revenue standard, the determination of whether an entity is a principal or an agent depends on the nature of the entity's promise to a customer and who controls the promised good or service before it is transferred to the customer.[12] During an education session (in which no tentative decisions were made), the staff updated the Board on the progress of its research project on gross versus net revenue reporting. The staff is researching (1) implementation issues related to the principal-agent analysis and (2) how an entity can estimate a transaction's gross revenue if the entity is the principal but is unaware of the amounts being charged directly to the end customer by an intermediary to the transaction. The staff discussed existing practice issues as well as potential issues under the new standard. Certain Board members were skeptical about the Board's ability to make fundamental improvements to existing GAAP and the new revenue standard by issuing updates to guidance because of the significant judgment an entity must often use in determining whether it is acting as a principal or an agent. As a result, this topic is expected to be discussed again at a future meeting.

[12] ASC 606-10-55-36 through 55-40 (paragraphs B34 through B38 of IFRS 15) indicate that an entity is a principal to the transaction if its promise is "a performance obligation to provide the specified goods or services" but that the entity is an agent if the nature of its promise is to arrange for another party to provide the specified goods or services. In addition, the guidance lists certain indicators of when an entity is an agent.

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