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FASB Issues Proposed Revenue ASU to Make Narrow-Scope Amendments and Provide Practical Expedients

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On September 30, 2015, the FASB issued a proposed ASU[1] that would amend certain aspects of the Board's May 2014 revenue standard, ASU 2014-09.[2] The proposal's effective date and transition provisions would be aligned with the requirements of ASU 2014-09. Comments on the proposed ASU are due by November 16, 2015.

> **Editor's Note:** On August 12, 2015, the FASB issued ASU 2015-14,[3] which defers the effective date of ASU 2014-09 by one year for all entities and permits early adoption on a limited basis. For more information, see Deloitte's August 13, 2015, journal entry.

The amendments, which (1) are being proposed in response to feedback received by the FASB–IASB joint revenue recognition transition resource group (TRG) and (2) would clarify, rather than change, ASC 606's[4] core revenue recognition principle, include the following:

- *Collectibility* — The assessment of collectibility would be clarified with respect to determining when an entity would recognize as revenue consideration it receives if the entity concludes that collectibility is not probable.
- *Presentation of sales tax and other similar taxes collected from customers* — Entities would be permitted to present revenue net of sales taxes collected on behalf of governmental authorities (i.e., to exclude sales taxes that meet certain criteria from the transaction price).
- *Noncash consideration* — In determining the transaction price for contracts containing noncash consideration, an entity would include the fair value of the noncash consideration to be received as of the contract inception date. Further, subsequent changes in the fair value of noncash consideration after contract inception would be subject to the variable consideration constraint only if the fair value varies for reasons other than its form.

[1] FASB Proposed Accounting Standards Update, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*.
[2] FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*.
[3] FASB Accounting Standards Update No. 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*.
[4] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

- *Contract modifications and completed contracts at transition* — The proposal would add a practical expedient for contract modifications at transition and would define completed contracts as those for which all (or substantially all) revenue was recognized under the applicable revenue guidance before the new revenue standard was initially applied.
- *Transition technical correction* — Entities that elect to use the full retrospective transition method to adopt the new revenue standard would no longer be required to disclose the effect of the change in accounting principle on the period of adoption (as is currently required by ASC 250-10-50-1(b)(2)); however, entities would still be required to disclose the effects on preadoption periods that were retrospectively adjusted.

Editor's Note: In July 2015, the IASB issued an exposure draft (ED) that proposes clarifications to IFRS 15,[5] the IASB's counterpart to the FASB's new revenue standard. Although the ED would amend some of the same topics as the FASB's proposed ASU, the two proposals are not identical. Comments on the ED are due by October 28, 2015.

Collectibility

Background

Step 1 of the new revenue standard requires entities to assess whether "it is probable that the entity will collect substantially all of[6] the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer." The collectibility threshold is assessed at contract inception (and will continue to be assessed if the threshold was not originally met). If collectibility is not probable, an entity would not be permitted to recognize revenue under ASC 606-10-25-7 unless either of the following conditions is met:

a. The entity has no remaining obligations to transfer goods or services to the customer, and all, or substantially all, of the consideration promised by the customer has been received by the entity and is nonrefundable.

b. The contract has been terminated, and the consideration received from the customer is nonrefundable.

Questions have arisen regarding situations in which (1) a contract does not meet the probability requirement and (2) the entity receives consideration from the customer for the entity's performance to date. Specifically, some stakeholders have asked the FASB to clarify whether revenue can be recognized when a portion of consideration is collected, the contract is legally valid, and the entity is able to reduce its credit risk exposure (e.g., the entity may cease to provide goods or services if the customer does not pay). Further, other stakeholders have found it difficult to determine whether, under certain circumstances, a contract has been terminated (i.e., whether the second condition above has been met).

Editor's Note: Entities will need to use significant judgment in interpreting the new phrase "substantially all of" in ASC 606-10-25-1(e). The FASB also added an example (ASC 606-10-55-98Q) to help entities apply such guidance.

[5] IFRS 15, *Revenue From Contracts With Customers*.

[6] The proposed ASU added the wording "substantially all of" to the text in ASC 606-10-25-1(e).

Key Provisions of the Proposed ASU

The proposed ASU adds a third criterion to ASC 606-10-25-7 (ASC 606-10-25-7 (c)) noting that if the criteria in ASC 606-10-25-7 are not met, revenue can be recognized if (1) the entity has transferred to the customer control of goods or services to which the consideration received is related, (2) the entity has stopped transferring additional goods and services and is not obligated to transfer any further goods or services, and (3) "consideration received from the customer is nonrefundable."

> **Editor's Note:** Stakeholders have raised concerns about the determination of whether a contract is terminated, including situations in which the entity stops delivering goods or services to the customer because the customer has not made payments under the contract. For example, some stakeholders noted that it was unclear whether the entity's process of pursuing delinquent payments from the customer would suggest that such a contact has not been terminated (and therefore would not meet the criterion for revenue recognition under ASC 606-10-25-7(b)).
>
> Rather than clarifying when a contract has been terminated (such clarification often is subject to legal interpretation), the proposed ASU would add the guidance in ASC 606-10-25-7(c). However, in assessing whether an obligation to deliver further goods or services exists, an entity must perform a careful analysis of the contractual terms and may need to obtain a legal interpretation in some instances.

In addition to amending and adding illustrative examples to the new standard, the proposed ASU includes implementation guidance that would help entities determine whether collectibility is probable under step 1 of the new revenue standard (i.e., under ASC 606-10-25-1(e)). The proposed implementation guidance notes that the objective of the collectibility assessment is to determine whether there is a substantive transaction between the entity and the customer. In addition, this guidance clarifies that the evaluation of collectibility:

- Is an assessment of whether the customer has the intent and ability to pay the consideration promised for the goods or services that the entity **will** transfer (and for which the entity will receive substantially all of this consideration) rather than an assessment of whether it will collect from the customer consideration for all goods and services in the contract (i.e., for the total transaction price).
- Is "not necessarily based on the customer's ability and intention to pay the entire amount of consideration to which it will be entitled for the entire duration of the contract if the entity expects to stop transferring additional promised goods or services in the contract in the event that the customer fails to pay consideration when it is due." Although ASC 606-10-25-3 requires entities to apply the provisions of the new revenue standard "to the duration of the contract," the proposed amendments would create a limited exception by permitting an entity that is evaluating collectibility to consider the goods or services that it expects to transfer rather than the total amount of goods and services to be transferred under the contract.
- Involves judgment because it is, in part, a "forward-looking assessment"; therefore, an entity should consider all facts and circumstances in performing this assessment, including its customary business practices and knowledge of its customer.

Further, the proposed ASU indicates that on the basis of the contract's terms or an entity's customary business practices, the entity may conclude that its exposure to the customer's credit risk has been reduced to an amount lower than the total consideration promised under the contract. However, the proposed ASU notes that an entity should not consider repossession when evaluating its ability to mitigate its credit risk. Examples of factors that may mitigate credit risk include:

- Payment terms. The proposed ASU cites instances in which a customer is required to pay consideration before the entity transfers goods or services to the customer. The proposed ASU notes that such prepayments "would not be subject to credit risk."
- The right and ability to cease transfer of further goods or services under the contract for circumstances in which a customer fails to pay when payments are due. Collectibility would be assessed on the basis of the consideration for goods and services that would be transferred to the customer. The proposed ASU indicates that, as a result, "if the customer fails to perform as promised and consequently, the entity would respond . . . by not transferring further goods or services to the customer, the entity would not consider the likelihood of payment for the promised goods or services that will not be transferred under the contract."

Editor's Note: At the FASB's August 31, 2015, meeting, two Board members indicated that they disagreed with the issuance of the proposed ASU, primarily because of the Board's decision to reject moving the collectibility assessment from step 1 to step 5 of the new revenue model (i.e., change it from a criterion for evaluating whether a contract with a customer exists to one used to determine when to recognize revenue). These Board members believe that, unlike current U.S. GAAP, the proposed changes would not permit entities to recognize revenue on a cash basis. As a result, the proposed amendments could continue to lead to situations in which an entity would record a liability for which no obligation exists (i.e., the related obligation was satisfied because goods and services were transferred). One dissenting Board member referred to the example in ASC 606-10-55-98H to 55-98M (which would be added by the proposed ASU) as illustrating such situations.

The assessment of collectibility under the new revenue standard, compared with that under current GAAP, will most likely (1) require entities to use significantly more judgment and (2) create complexities (particularly for entities that use the cash basis under current GAAP because collectibility for some contracts is not reasonably assured). Accordingly, affected entities should consider the proposed amendments and provide feedback to the FASB.

Presentation of Sales Taxes and Similar Taxes Collected From Customers

Background

Under step 3 of the new revenue standard, the transaction price is 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." Stakeholders have questioned whether sales taxes and similar taxes ("sales taxes") should be excluded from the transaction price when such taxes are collected on behalf of tax authorities.

The new revenue standard provides guidance on assessing whether an entity is a principal or an agent[7] in a transaction and, therefore, whether sales taxes should be presented gross or net within revenue. The analysis is further complicated by the sales tax in each tax jurisdiction (which would include all taxation levels in both domestic and foreign governmental jurisdictions), especially for entities that operate in a significant number of jurisdictions.

[7] The FASB has issued a proposed ASU that would amend the principal-versus-agent guidance in the new revenue standard. For more information, see Deloitte's September 1, 2015, *Heads Up*.

Key Provisions of the Proposed ASU

The proposed ASU would permit entities to exclude from the transaction price sales taxes that are assessed by a governmental authority and that are "imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer (for example, sales, use, value added, and some excise taxes)." However, such an election would not apply to taxes assessed on "an entity's total gross receipts or imposed during the inventory procurement process." An entity that elects to exclude sales taxes would be required to provide the accounting policy disclosures in ASC 235-10-50-1 through 50-6.

Editor's Note: The proposed guidance would align the scope of sales taxes in the new revenue standard with that in ASC 605-45-15-2(e). Further, an entity that does not elect to present sales taxes on a net basis would be required to assess, for every tax jurisdiction, whether it is a principal or an agent in the sales tax transaction and would present sales taxes on a gross basis if it is a principal in the jurisdiction and on a net basis if it is an agent.

Noncash Consideration

Background

When providing goods or services, an entity may receive noncash consideration from its customers (e.g., goods, services, shares of stock). Step 3 of the new revenue standard requires entities to include the fair value of the noncash consideration in the transaction price. Further, the guidance states that changes in the fair value of noncash consideration for reasons other than its form would be subject to the variable consideration constraint in ASC 606-10-32-11 through 32-13.

Questions have arisen regarding the measurement date in the determination of the fair value of noncash consideration received in a contract with a customer. Further, stakeholders have questioned the applicability of the variable consideration constraint when changes in the fair value of the noncash consideration are due both to (1) its form (e.g., stock price changes attributable to market conditions) and (2) reasons other than its form (e.g., additional shares of stock that may become due on the basis of a contingent event).

Key Provisions of the Proposed ASU

The proposed ASU would define the measurement date as the "contract inception" date. In addition, the transaction price would not include any changes in the fair value of the noncash consideration after the contract inception date that are due to its form. Further, the proposed ASU would clarify that if changes in noncash consideration are due both to its form and to reasons other than its form, the variable consideration constraint would only apply to the variability resulting from changes in fair value that are due to reasons other than the consideration's form.

Example — Noncash Consideration in the Form of Publicly Traded Common Stock

As part of a revenue contract with a customer for the delivery of goods, an entity is entitled to receive 500 shares of its customer's common stock when all of the goods are provided to the customer. In addition, if the entity delivers all goods within 90 days, it will receive an additional 100 shares of the customer's common stock. The changes in the fair value of the noncash consideration may vary between the contract inception date and the delivery of goods as a result of (1) the form of the common stock (i.e., because of changes in the market value) and (2) reasons other than its form (i.e., the quantity of shares that the entity will receive may vary because delivery occurs in 90 days).

The proposed ASU would clarify that the variable consideration constraint would only apply when changes in fair value are due to reasons other than the consideration's form, which, in this example, is the quantity of shares to be received by the entity. Consequently, in this example, increases or decreases in the market value of the common stock would not be recorded as adjustments to the transaction price (i.e., revenue).

Editor's Note: The proposed guidance may represent a significant change in practice for entities whose contracts with customers commonly include noncash consideration. In addition, although the FASB intended to clarify the measurement date for noncash consideration under the proposal, entities may interpret the contract inception date as either (1) the legal form date (i.e., when the rights and obligations are assigned to each party) or (2) the date on which the contract meets all the requirements in ASC 606-10-25-1. We believe that the contract inception date is the date on which the contract meets the requirements in ASC 606-10-25-1.

Contract Modifications and Completed Contracts at Transition

Background

When initially adopting the new revenue standard, entities may apply either the full or the modified retrospective transition method. Either method requires entities to evaluate the impact of contract modifications before the date on which the new revenue standard is initially applied. Under the new revenue standard, the subsequent accounting for contract modifications may result in (1) a separate contract, (2) a termination of an old contract and the creation of a new contract, and (3) a cumulative catch-up adjustment.

Stakeholders have expressed concerns regarding situations in which an entity applies the transition guidance and has a high volume of customer contracts (especially long-duration contracts) that may be modified frequently. In particular, stakeholders have questioned whether the costs of assessing pre-adoption modifications may exceed the benefits because of the limited usefulness of applying the contract modification guidance to periods before the date of initial adoption. In addition, questions have arisen about when a contract is considered completed for transition purposes.

Key Provisions of the Proposed ASU

The proposed ASU would provide a practical expedient for situations in which an entity uses the retrospective transition method to evaluate contract modifications that occurred before the beginning of the earliest period presented. The practical expedient would not require entities to evaluate the impact of each contract modification before the beginning of the earliest period presented. The proposed ASU would add the following guidance to ASC 606-10-65-1(f):

> An entity need not separately evaluate the effects of contract modifications before the beginning of the earliest reporting period presented in accordance with the [new revenue standard]. An entity shall determine the transaction price of the contract considering all satisfied and unsatisfied performance obligations from contract inception to the beginning of the earliest reporting period presented in accordance with the [new revenue standard]. An entity shall perform a single allocation of the transaction price to each identified performance obligation on the basis of an estimate of the relative standalone selling price of each performance obligation. The transaction price allocated to an unsatisfied performance obligation shall be recognized as revenue when (or as) the performance obligation is subsequently satisfied (see paragraphs 606-10-25-23 through 25-37). An entity shall apply the guidance in paragraphs 606-10-25-10 through 25-13 to contract modifications after the beginning of the earliest reporting period presented in accordance with the [new revenue standard].

Entities are also permitted to apply the practical expedient if they elect the modified retrospective transition approach for contract modifications to either (1) all contracts as of the initial application date or (2) all contracts that have not been completed as of the initial application date. Whichever transition method is used, an entity that elects to apply the practical expedient must apply it consistently to all contracts.

Further, the proposed ASU would clarify that a completed contract is one in which all (or substantially all) of the revenue has been recognized under the applicable revenue guidance before the new revenue standard is initially applied.

Editor's Note: The text that the proposal would add is intended to provide entities with a practical expedient. However, the extent of relief that entities would receive may be unclear because although the first sentence in ASC 606-10-65-1(f) notes that an entity "need not separately evaluate the effects of contract modifications [in prior periods]," the second sentence indicates that an entity would need to determine the transaction price by considering "all satisfied and unsatisfied performance obligations from contract inception."

We believe that the proposed guidance is intended to permit an entity to evaluate a contract (and allocate the transaction price accordingly) on the basis of the performance obligations that exist as of the date of initial application. In addition, entities would not need to consider the effects that contract modifications would have had on the revenue recognized before the date of the new standard's initial application. That is, entities can use hindsight to determine the performance obligations and transaction price associated with contracts in place as of the date of initial application of the new standard. Further, the amount of the transaction price allocated to satisfied or partially satisfied performance obligations would be accounted for as transition adjustments (according to the entity's method of transition), and unsatisfied performance obligations would be recognized as revenue when control is transferred in accordance with the new revenue standard.

Entities that may be affected by the proposed guidance (i.e., because they have many contracts that undergo modifications) may believe that further clarifications to the guidance would be helpful.

Appendix — Questions for Respondents

The proposed ASU's questions for respondents are listed below for reference.

Question 1: Does the proposed addition of paragraphs 606-10-55-3A through 55-3C, as well as the addition of new examples, clarify the objective of the collectibility threshold? If not, why?

Question 2: Paragraph 606-10-25-7(c) was proposed to provide clarity about when revenue should be recognized for a contract that does not meet the criteria in paragraph 606-10-25-1. Does this proposed amendment improve the clarity of applying the guidance? If not, why?

Question 3: The collectibility criterion in paragraph 606-10-25-1(e) refers to collectibility being probable, which is defined in Topic 606 as "likely to occur." If the Board were, instead, to refer to collectibility being "more likely than not," which would result in a converged collectibility criterion with IFRS, would the amendment improve the collectibility guidance in Topic 606? Explain your response.

Question 4: Paragraph 606-10-32-2A provides a policy election that would permit an entity to elect to exclude all sales (and other similar) taxes collected from customers from the transaction price. Does this proposed amendment reduce the cost and complexity of applying Topic 606? If not, why?

Question 5: Revisions to paragraph 606-10-32-21 and the related example specify that noncash consideration should be measured at contract inception. Does this proposed amendment improve the clarity of applying the guidance? If not, why?

Question 6: Revisions to paragraph 606-10-32-23 clarify that the guidance on variable consideration applies only to variability in noncash consideration resulting from reasons other than the form of the consideration. Would the proposed amendments improve the clarity of applying the guidance? If not, why?

Question 7: Paragraph 606-10-65-1(f)(4) provides a practical expedient for contract modifications at transition. Would the proposed amendment reduce the cost and complexity of applying Topic 606? If not, why?

Question 8: Revisions to paragraph 606-10-65-1(c)(2) clarify that a completed contract is a contract for which all (or substantially all) of the revenue was recognized under revenue guidance in effect before the date of initial application. Does this proposed amendment clarify the transition guidance? If not, why and what alternative would you suggest?

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