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Heads Up

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FASB Proposes Clarifications to Guidance on Derecognition and Partial Sales of Nonfinancial Assets

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Introduction

Last week, the FASB issued a proposed ASU[1] that would clarify the scope of the Board's recently established guidance on nonfinancial asset derecognition (ASC 610-20[2]) as well as the accounting for partial sales of nonfinancial assets. The proposed ASU would conform the derecognition guidance on nonfinancial assets with the model for revenue transactions in ASC 606.

The proposed guidance is in response to stakeholder feedback indicating that (1) the meaning of the term "in-substance nonfinancial asset" is unclear because the Board's new revenue standard[3] does not define it and (2) the scope of the guidance on nonfinancial assets is complex and does not specify how a partial sales transaction should be accounted for or which model entities should apply.

Comments on the proposed ASU are due by August 5, 2016.

This *Heads Up* summarizes the ASU's key provisions. The appendix of the *Heads Up* contains the proposal's questions for respondents, which have been reproduced for ease of reference.

Key Provisions of the Proposed ASU

Scope of the Guidance on Nonfinancial Asset Derecognition

The proposed ASU would clarify the scope of ASC 610-20 and require entities to apply that guidance to the derecognition of all nonfinancial assets and in-substance nonfinancial assets. While the concept of in-substance assets resided in ASC 360-20,[4] this guidance would not have applied to transactions outside of real estate. The FASB is therefore proposing to add to the Codification Master Glossary the following definition of an in-substance nonfinancial asset:

> An asset of a reporting entity that is included in either of the following:
>
> a. A contract in which substantially all the fair value of the assets (recognized and unrecognized) promised to a counterparty is concentrated in nonfinancial assets
>
> b. A consolidated subsidiary in which substantially all the fair value of the assets (recognized and unrecognized) in the subsidiary is concentrated in nonfinancial assets.

[1] FASB Proposed Accounting Standard Update, *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*.

[2] For titles of *FASB Accounting Standards Codification* (ASC or "Codification") references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

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

[4] ASC 360-20, which provides guidance on real estate sale transactions, was superseded by ASC 606 and ASC 610-20.

An in substance nonfinancial asset does not include:

a. A group of assets or a subsidiary that is a business or nonprofit activity

b. An investment of a reporting entity that is being accounted for within the scope of Topic 320 on investments—debt securities, Topic 321 on investments—equity securities, Topic 323 on investments—equity method and joint ventures, or Topic 325 on other investments regardless of whether the assets underlying the investment would be considered in substance nonfinancial assets.

Accordingly, since business or nonprofit activities are not in-substance nonfinancial assets, they would be excluded from the scope of ASC 610-20 and accounted for under the consolidation guidance in ASC 810-10. Further, all investments would be accounted for under the guidance in ASC 860 on transfers and servicing transactions, regardless of whether the investment was a business or nonprofit activity or an in-substance nonfinancial asset.

Editor's Note: The clarification that a business activity would not be considered an in-substance nonfinancial asset is based on another proposed ASU[5] that would clarify and narrow the definition of a business and most likely reduce the number of real estate transactions that would be considered businesses. The comment period on that proposal ended in January 2016, and on the basis of feedback, the FASB may need to reconsider whether ASC 610-20 should be applied to certain types of businesses. Question 3 of the proposed ASU's questions for respondents (see the appendix) asks for feedback from stakeholders on the appropriateness or operability of clarifying the definition of a business in accordance with the proposed amendments to ASC 610-20.

The proposed ASU would also clarify that if a transaction that does not involve a subsidiary is partially within the scope of ASC 610-20 and partially within the scope of other guidance, an entity would apply the separation and allocation guidance in ASC 606 to determine how to separate and measure certain parts of the transaction. A transaction involving a subsidiary that does not have in-substance nonfinancial assets would be excluded from the scope of ASC 610-20 in its entirety.

Distinct Nonfinancial Assets

For derecognition purposes, the proposed ASU would clarify the unit of account, which is defined as a distinct nonfinancial asset. The entity would, at the inception of the contract, identify the nonfinancial and in-substance nonfinancial assets and would, in accordance with the guidance on identifying distinct performance obligations in ASC 606, identify the *distinct* nonfinancial assets. The entity would then allocate the consideration to each distinct nonfinancial asset, consistent with the approach outlined in ASC 606.

Partial Sales

"Partial sales" are sales or transfers of a nonfinancial asset to another entity in exchange for a noncontrolling ownership interest in that entity. Such sales are common in the real estate industry (e.g., a seller transfers an asset to a buyer but retains either an interest in the asset or has an interest in the buyer). Entities account for partial sales before adoption of the new revenue standard principally under the transaction-specific guidance in ASC 360-20 on real estate sales and partly under ASC 845-10-30. Since ASC 606 and ASC 610-20 supersede that guidance, the proposed ASU would clarify that any transfer of a nonfinancial asset in exchange for the noncontrolling ownership interest in another entity (including a noncontrolling ownership interest in a joint venture or other equity method investment) would be accounted for in accordance with ASC 610-20.

[5] FASB Proposed Accounting Standards Update, *Clarifying the Definition of a Business* (issued on November 23, 2015).

In addition, if the reporting entity no longer retained a controlling financial interest in the nonfinancial asset, it would derecognize the asset when it transferred control of that asset in a manner consistent with the principles in ASC 606. Further, any retained noncontrolling ownership interest (and resulting gain or loss to be recognized) would be measured at fair value in a manner consistent with the guidance on noncash consideration in ASC 606-20-32-21 through 32-24.

However, if the entity retained a controlling financial interest in a subsidiary (i.e., when the entity sold a noncontrolling ownership interest in a consolidated subsidiary), the entity would account for the transaction as an equity transaction in accordance with ASC 810 and would not recognize a gain or loss on the derecognition of nonfinancial assets. Only when the entity no longer had a controlling financial interest in a former subsidiary, and transferred control of the nonfinancial asset in accordance with ASC 606, would the entity apply the derecognition guidance in ASC 610-20.

The proposed ASU would thus eliminate the initial measurement guidance on nonmonetary transactions in ASC 845-10-30 (in a manner consistent with the FASB's deletion of the guidance in ASC 360-20) to simplify the accounting treatment for partial sales (i.e., entities would use the same guidance to account for similar transactions) and to remove inconsistencies between ASC 610-20 and the noncash consideration guidance in the new revenue standard.

Effective Date and Transition

The effective date of the new guidance and the transition methods would be aligned with the requirements in the new revenue standard as amended by ASU 2015-14,[6] which delays the effective date of the new revenue standard by one year[7] and permits early adoption on a limited basis. However, an entity would be permitted to use a transition approach to adopt ASC 610-20 that is different from the one it uses to adopt ASC 606 (e.g., the entity may use the modified retrospective approach to adopt ASC 610-20 and the full retrospective approach to adopt ASC 606). If different methods are used, an entity would need to provide the transition-method disclosures required by ASC 606 and indicate the method it used to adopt ASC 610-20.

[6] FASB Accounting Standards Update No. 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*.

[7] For public business entities, the standard is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. For nonpublic entities, the standard is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019.

Appendix — Questions for Respondents

The proposed ASU's questions for respondents are reproduced below for ease of reference.

Question 1: Is the list of transactions that are excluded from Subtopic 610-20 in paragraph 610-20-15-3 complete? If not, please describe what is missing.

Question 2: Do you agree that transfers of all businesses (including real estate businesses) or nonprofit activities should be excluded from the scope of Subtopic 610-20? If not, please describe the types of businesses that should be included in Subtopic 610-20 and how you would define them.

Question 3: Given that the amendments in this proposed Update would require all businesses to be excluded from Subtopic 610-20, do you have any further comments on the appropriateness or operability of the amendments in the proposed Accounting Standards Update, *Business Combinations (Topic 805): Clarifying the Definition of a Business*?

Question 4: The scope of Subtopic 610-20 includes in substance nonfinancial assets, which are defined in the Master Glossary and described in paragraphs 610-20-15-4 through 15-10 in this proposed Update. Is it appropriate to include those transactions within the scope of Subtopic 610-20, and would the guidance be operable? If not, why and what other alternatives would you suggest?

Question 5: Paragraph 610-20-15-3(k) in this proposed Update excludes subsidiaries that do not have in substance nonfinancial assets entirely from the scope of Subtopic 610-20. Alternatively, the Board could have decided to apply the guidance in paragraph 606-10-15-4 and separate each asset in a subsidiary that is not a business into different derecognition models. Would this alternative approach be operable for partial sales in which the seller retains an interest in the former subsidiary (see also paragraph BC34)? If yes, please provide examples of how this would be applied. If operable, do you support such an approach?

Question 6: When transferring an ownership interest in a subsidiary that is an in substance nonfinancial asset, do you agree that the unit of account should be each distinct nonfinancial asset in the subsidiary?

Question 7: Do you agree that an entity should measure a retained interest in a nonfinancial asset at fair value? If not, why?

Question 8: Paragraphs 610-20-40-3 through 40-10 provide guidance that would assist an entity in determining when it transfers control of distinct nonfinancial assets in a subsidiary. Would this guidance be operable? If not, why?

Question 9: Do you agree with providing an entity with the option to apply different transition methods to Subtopic 610-20 and Topic 606? If not, why?

Question 10: The proposed amendments on clarifying the definition of a business would require prospective adoption. If those proposed amendments are finalized before Subtopic 610-20 becomes effective, should an entity utilize either:

a. The definition of a business effective at the time of the transaction
b. The revised definition of a business when implementing Subtopic 610-20?

Question 11: Do you agree with the proposed amendments to eliminate the exception in Topic 860 for transfers of equity method investees that were formerly considered in substance nonfinancial assets or in substance real estate? If not, please describe the consequences of applying the guidance in Topic 860 instead of Subtopic 610-20.

Question 12: Overall, do you agree that the proposed amendments would reduce the cost and complexity of evaluating the derecognition of nonfinancial assets? Why or why not?

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