MARCH 2017
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AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO **FLASH** REPORT

FASB

SUBJECT

FASB CLARIFIES THE SCOPE OF ASSET DERECOGNITION GUIDANCE AND ACCOUNTING FOR PARTIAL SALES OF NONFINANCIAL ASSETS

SUMMARY

The FASB recently issued ASU 2017-05[1] to clarify the scope of Subtopic 610-20[2] and to add guidance for partial sales of nonfinancial assets, including partial sales of real estate. Historically, U.S. GAAP contained several different accounting models to evaluate whether the transfer of certain assets qualified for sale treatment. Moving forward, the new standard reduces the number of potential accounting models that might apply and clarifies which model does apply in various circumstances. The ASU becomes effective in 2018 for public entities and is available here.

DETAILS

Background

ASC 610-20 was established in conjunction with the new revenue standard[3] and provides guidance for recognizing gains and losses from the transfer of nonfinancial assets[4] in contracts with noncustomers. For example, a one-time sale by a company of its building would fall within this guidance.

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[1] Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets

[2] Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets

[3] ASU 2014-09, Revenue from Contracts with Customers (Topic 606)

[4] Generally, a financial asset (in contrast to a nonfinancial asset) includes cash, an ownership interest in an entity, or a contract to receive cash or financial instruments from another party. The ASC Master Glossary contains a more detailed definition of "financial asset."

ASC 610-20 also includes transfers of “in substance” nonfinancial assets. Stakeholders requested additional clarity on the definition of *in substance nonfinancial assets*, as well as the accounting for partial sales of nonfinancial assets.

Main Provisions

The amendments in ASU 2017-05 affect three basic aspects of Subtopic 610-20: 1) scope, 2) distinct nonfinancial assets, and 3) partial sales.

Scope

The amendments define the term *in substance nonfinancial asset*, and clarify that the inclusion of a financial asset as part of a larger arrangement does not preclude the group from meeting this definition. If substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets, a financial asset in the same arrangement would still be considered part of an in substance nonfinancial asset. For example, if an entity sells commercial real estate, including the related lease receivables, the arrangement would generally represent the sale of an in substance nonfinancial asset.

In addition, nonfinancial assets may include nonfinancial assets contained within a legal entity that is transferred to a counterparty. This includes transferring control of nonfinancial assets by transferring an ownership interest, if substantially all of the fair value of the underlying assets in the entity is concentrated in nonfinancial assets. For example, if an entity transfers an ownership interest in an entity that holds commercial real estate and the related lease receivables, this would still represent the transfer of an in substance nonfinancial asset.

The amendments also state that the derecognition of all businesses as defined under ASU 2017-01[5] and nonprofit activities are excluded from the scope of ASC 610-20. Those transactions continue to be evaluated under the consolidation literature,[6] with limited exceptions related to conveyances of oil and gas mineral rights or contracts with customers. The amendments also indicate that entities will apply Topic 860[7] to the transfer of an equity method investment that is not part of a larger arrangement, as opposed to “looking through” the equity method investment to the underlying business or assets in certain circumstances.

The ASU includes a decision tree to assist entities with applying the scope guidance of Subtopic 610-20. We have reproduced this decision tree in the appendix to this publication.

Distinct Nonfinancial Assets

The ASU clarifies that an entity should identify each distinct nonfinancial asset (e.g., real estate and inventory) or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of it. An entity should allocate consideration to each distinct asset by applying the guidance in Topic 606 on allocating the transaction price to performance obligations. In addition, if an entity transfers a nonfinancial asset along with a financial asset with substantial value, the entity should allocate consideration to each asset in the same manner, and account for the transfer of the nonfinancial asset in accordance with the guidance in the ASU. The transfer of the financial asset is accounted for using other applicable guidance.

Partial Sales

Partial sales can occur in a variety of ways. One basic example is a parent selling 50% of its wholly owned subsidiary that does not meet the definition of a business to a third party and thereby losing control of the subsidiary. The ASU requires an entity to derecognize a distinct nonfinancial asset or distinct in substance nonfinancial asset in a partial sale transaction when two criteria are met:

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[5] Business Combinations (Topic 805): Clarifying the Definition of A Business

[6] ASC 810-10 Consolidation-Overall

[7] Transfers and Servicing

(1) the entity does not have (or ceases to have) a controlling financial interest in the legal entity that holds the asset in accordance with Topic 810, and

(2) the entity transfers control of the asset in accordance with Topic 606.

Once an entity transfers control of a distinct nonfinancial asset or distinct in substance nonfinancial asset, it is required to measure any noncontrolling interest it receives (or retains) at fair value.

If an entity transfers ownership interests in a consolidated subsidiary but retains a controlling financial interest in that subsidiary, it does not derecognize the assets and liabilities of the subsidiary, but rather accounts for the transfer as an equity transaction e.g., debit cash and credit equity. Therefore, no gain or loss is recognized.

The amendments supersede the guidance in the Exchanges of a Nonfinancial Asset for a Noncontrolling Ownership Interest Subsection within Topic 845[8] because that guidance is similar to the guidance for partial sales of nonfinancial assets within the scope of Subtopic 610-20. The amendments also clarify that partial sales transactions within the scope of Subtopic 610-20 include contributions of nonfinancial assets to a joint venture or other noncontrolled investee, an area for which limited guidance existed previously. Lastly, the amendments require an entity to recognize a full gain or loss on transfers of nonfinancial assets within the scope of Subtopic 610-20 to equity method investees.

EFFECTIVE DATE AND TRANSITION

The effective date and transition requirements for ASU 2017-05 are the same as the effective date and transition requirements of Topic 606, and must be applied at the same date that Topic 606 is initially applied, specifically:

Public business entities will adopt the standard for annual reporting periods beginning after December 15, 2017, including interim periods within that year. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year.[9]

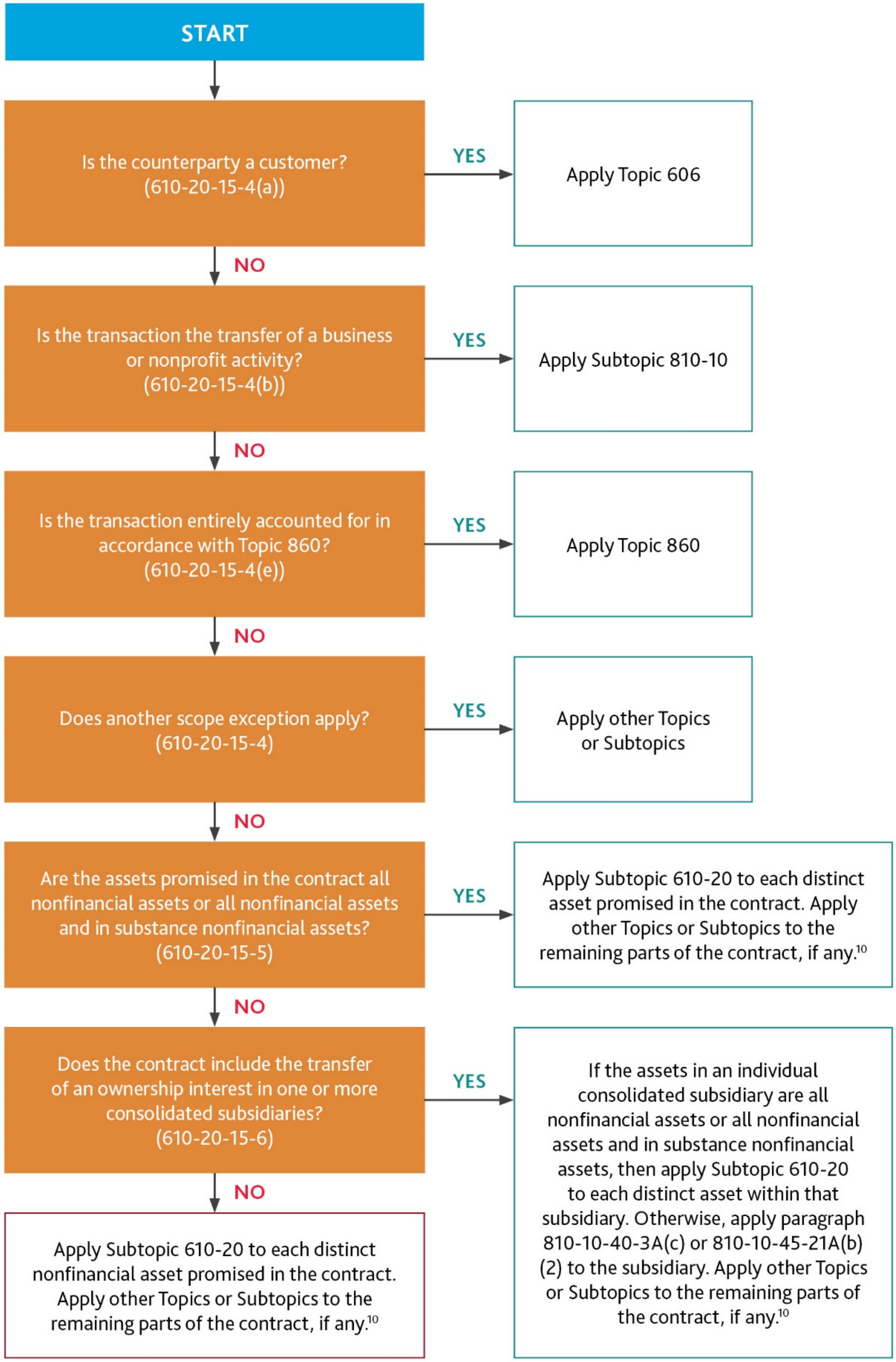
All other entities will adopt the standard for annual reporting periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. Early adoption is permitted as of either:

- An annual reporting period beginning after December 15, 2016, including interim periods within that year, or
- An annual reporting period beginning after December 15, 2016 and interim periods within annual reporting periods beginning one year after the annual period in which an entity first applies the new standard.

[8] Nonmonetary Transactions

[9] A not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and an employee benefit plan that files or furnishes financial statements with or to the SEC have the same effective date as public business entities.

APPENDIX



[10] If the transfer includes other contractual arrangements that are not assets of the seller to be derecognized (for example, guarantees), those contracts are separated and accounted for in accordance with other Topics or Subtopics.

Source: FASB ASU 2017-05, par. 610-20-15-10