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SUBJECT

FASB ISSUES NARROW SCOPE IMPROVEMENTS AND PRACTICAL EXPEDIENTS FOR NEW REVENUE STANDARD

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SUMMARY

The FASB recently issued ASU 2016-12[1] amending the new revenue recognition standard that it issued jointly with the IASB in 2014. The amendments do not change the core principles of the standard, but clarify the guidance on assessing collectibility, presenting sales taxes, measuring noncash consideration, and certain transition matters. The ASU becomes effective concurrently with ASU 2014-09[2] and is available here.

DETAILS

Background

In May 2014, the FASB issued ASU 2014-09 ("the standard"), establishing a comprehensive revenue recognition standard for virtually all industries, including those that previously followed industry-specific guidance such as the real estate, construction and software industries.

The amendments in ASU 2016-12 resulted from implementation issues discussed by the joint FASB/IASB Transition Resource Group (TRG). After considering the issues, the FASB decided certain clarifications were needed to reduce potential diversity and to simplify the standard.

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[1] *Narrow-Scope Improvements and Practical Expedients*

[2] *Revenue from Contracts with Customers (Topic 606)* is substantially converged with IFRS 15, the IASB's companion standard.

Main Provisions

The amendments in ASU 2016-12 clarify the following key areas:

- Assessing collectibility
- Presenting sales taxes and other similar taxes collected from customers
- Noncash consideration
- Contract modifications at transition
- Completed contracts at transition
- Disclosing the accounting change in the period of adoption

Assessing collectibility

To determine if a contract with a customer is in the scope of the standard, an entity must assess whether certain criteria are met (step 1, identifying the contract). One of the criteria is that it is probable that the entity will collect consideration for its performance. The amendments add a "substantially all" threshold to this criterion, and also expand the implementation guidance to clarify that the objective of this assessment is to determine whether the contract is valid and represents a substantive transaction based on whether a customer has the ability and intent to pay for the goods or services that will be transferred to the customer, as opposed to all of the goods or services promised in the contract. An entity should consider its exposure to credit risk and its ability to mitigate that credit risk as part of this assessment. The amendments also add examples to illustrate the collectibility assessment.

In addition, when a contract does not meet the criteria required to apply the recognition guidance within the standard at inception, but an entity receives consideration from the customer, the ASU clarifies the circumstances under which the entity may later recognize the consideration received as revenue.

BDO Observation: The ASU clarifies that an expectation of collecting all of the consideration promised in the contract is not required, only the consideration related to goods or services that will be transferred to the customer. This distinction takes into consideration an entity's credit risk management strategies, which may result in ceasing transfer of additional goods and services upon nonpayment by the customer. For example, an entity might discontinue providing service in the third month of a 12 month contract. As a result, fewer contracts are expected to fail the collectibility criterion.

However, for those contracts which do fail the collectibility criterion, any partial consideration received must be accounted for as a liability until one or more of the criterion in paragraph 606-10-25-7 have been met. Cash basis accounting is no longer appropriate under the new standard.

Presenting sales taxes and other similar taxes collected from customers

The amendments provide an accounting policy election whereby an entity may exclude from the measurement of transaction price all taxes assessed by a taxing authority related to the specific transaction and which are collected from the customer. Examples include sales, use, value added, and some excise taxes. That is, such amounts would be presented "net" under this option. Otherwise, an entity must analyze each jurisdiction in which it operates to determine whether such amounts should be included or excluded from the transaction price under Topic 606.

Noncash consideration

The amendments clarify that the fair value of noncash consideration is measured at contract inception. Subsequent changes in the fair value of noncash consideration based on the form of the consideration (e.g., a change in the quoted market price of a share received as consideration) are not included in the transaction price. In contrast, subsequent changes in the fair value due to reasons other than the form of consideration (e.g., a change in the exercise price of a share option resulting from the entity's performance) are subject to the guidance on variable consideration within the standard.

BDO Observation: While the standard contemplated noncash consideration, it did not specify the date at which noncash consideration should be measured. The guidance in ASU 2016-12 clarifies that noncash consideration, including any equity instruments received, should be measured at contract inception.

However, other GAAP may result in subsequent stock price fluctuations being recorded in earnings, outside of revenue. In addition, ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, will require most equity instruments to be accounted for at fair value through earnings. Consequently, entities that accept noncash consideration in the form of equity shares are likely to be exposed to greater income statement volatility.

Contract modifications at transition

The amendments provide a new practical expedient whereby an entity electing either the full or modified retrospective method of transition is permitted to reflect the aggregate effect of all prior period modifications (using hindsight) when 1) identifying satisfied and unsatisfied performance obligations, 2) determining the transaction price, and 3) allocating the transaction price to satisfied and unsatisfied obligations. The aggregate approach would be in lieu of separately accounting for individual modifications in each prior period.

Completed contracts at transition

The standard provides certain practical expedients in transition related to completed contracts. The amendments also changed the definition of a completed contract to mean one in which all (or substantially all) revenue has been *recognized* under legacy GAAP, as opposed to assessing whether goods and services have been *transferred* under legacy GAAP.

Disclosing the accounting change in the period of adoption

Topic 250[3] requires an entity to disclose the effect on the current period of retrospectively adopting a new accounting standard. ASU 2016-12 provides an exception to this requirement related to the new standard. This was in response to stakeholder feedback indicating the requirement would significantly increase transition costs because an entity would have to account for contracts with customers under previous guidance and the new standard for one additional year. However, entities are still required to disclose the impact on prior years.

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[3] *Accounting Changes and Error Corrections*

EFFECTIVE DATE AND TRANSITION

The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements of Topic 606, 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.[4]

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.

Although the IASB recently issued amendments[5] to the standard, the guidance in ASU 2016-12 is not identical, and in some cases is incremental, to the IASB's amendments. The Boards do not expect significant divergence as a result of their respective amendments.

[4] 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.

[5] *Clarifications to IFRS 15*

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