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FASB Proposes to Clarify Scope of Derecognition of Nonfinancial Assets

The FASB's proposal would clarify the scope of its guidance about derecognizing nonfinancial assets and would address the accounting for partial sales of nonfinancial assets.[1]

Key Facts

- The proposal would clarify that the guidance in Subtopic 610-20 on accounting for gains and losses from the sale of a nonfinancial asset, including an *in-substance nonfinancial asset,* to a noncustomer applies only when the asset (or asset group) does not meet the definition of a *business* or is not a nonprofit activity.
- An in-substance nonfinancial asset would be defined as one that is included in a contract or consolidated subsidiary in which substantially all of the fair value (excluding cash and cash equivalents) is concentrated in nonfinancial assets.
- The proposal would apply to transfers and nonmonetary exchanges of an in-substance nonfinancial asset when the seller retains a noncontrolling equity interest. The seller would account for the noncontrolling interest as noncash consideration and measure it at fair value. Subtopic 610-20 would not apply to transfers of investments (e.g., equity method investments), even if the underlying assets would be considered in-substance nonfinancial assets.

Key Impacts

- This proposal would clarify the scope of the derecognition guidance in Topic 810 for businesses and the guidance for nonfinancial assets in Subtopic 610-20 when an asset, group, or subsidiary has characteristics of both a nonfinancial asset and a business.[2]
- The proposal would eliminate the partial profit recognition models in real estate and nonmonetary transactions guidance when a seller retains a noncontrolling interest in the transferred asset.[3] A seller would recognize its full gain in earnings when it loses its controlling financial interest, and would not recognize a gain in earnings when it retains a controlling financial interest.

Contents

[1] FASB Proposed Accounting Standards Update, Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets, June 6, 2016, available at www.fasb.org.

[2] FASB ASC Topic 810, Consolidation; and FASB ASC Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets, both available at www.fasb.org.

[3] FASB ASC Subtopic 360-20, Property, Plant, and Equipment – Real Estate Sales; and FASB ASC Topic 845, Nonmonetary Transactions, both available at www.fasb.org.

Comments on the FASB's proposal are due August 5, 2016.

Background

Because the Board believed that there was insufficient guidance about transferring a nonfinancial asset in a non-revenue transaction, it added guidance to the 2014 revenue standard about accounting for a gain or loss from the sale of a nonfinancial asset (Subtopic 610-20).[4]

The Board's current proposal would clarify when and how to apply Subtopic 610-20 because the current guidance does not define in-substance nonfinancial assets and does not include guidance on partial sales of in-substance nonfinancial assets.

Scope

The FASB's proposal specifies when a seller would apply the guidance in Subtopic 610-20 for derecognizing nonfinancial assets or in-substance nonfinancial assets. An asset would be an in-substance nonfinancial asset when the following conditions are met:

- It is included either in a group (by contract) or a subsidiary; and
- Substantially all of the fair value (excluding cash and cash equivalents) of that group or subsidiary is concentrated in nonfinancial assets.

When substantially all of the fair value of the group or the subsidiary is concentrated in nonfinancial assets, *all* the assets in the group or subsidiary are considered in-substance nonfinancial assets, even if individual assets would be considered financial assets if they were sold independently.

The scope of Subtopic 610-20 also would include situations in which a noncontrolling interest in a transferred in-substance nonfinancial asset is retained or received. Nonfinancial assets include land, buildings, use of facilities or utilities, materials and supplies, intangible assets, or services.

What Is Outside the Scope of Subtopic 610-20?

New Revenue Topic. If an entity transfers the asset, group, or subsidiary to a customer, it would account for the transaction under the new revenue topic.[5]

Investments. If the transferred asset is an investment (e.g., an equity method investment), an entity would account for the transaction under the guidance on transfers of financial assets.[6]

Business. If the group or subsidiary is a business and is sold to a noncustomer, an entity would account for the transaction under the derecognition guidance in Topic 810.

Subsidiary. If substantially all of the fair value of a transferred subsidiary is *not* concentrated in nonfinancial assets, an entity accounts for the transaction under the derecognition guidance in Topic 810.

Business Combinations. An entity would account for a nonfinancial asset transferred as consideration in a business combination under Topic 805.[7]

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[4] FASB Accounting Standards Update 2014-09, Revenue from Contracts with Customers, available at www.fasb.org.

[5] FASB ASC Topic 606, Revenue from Contracts with Customers, available at www.fasb.org.

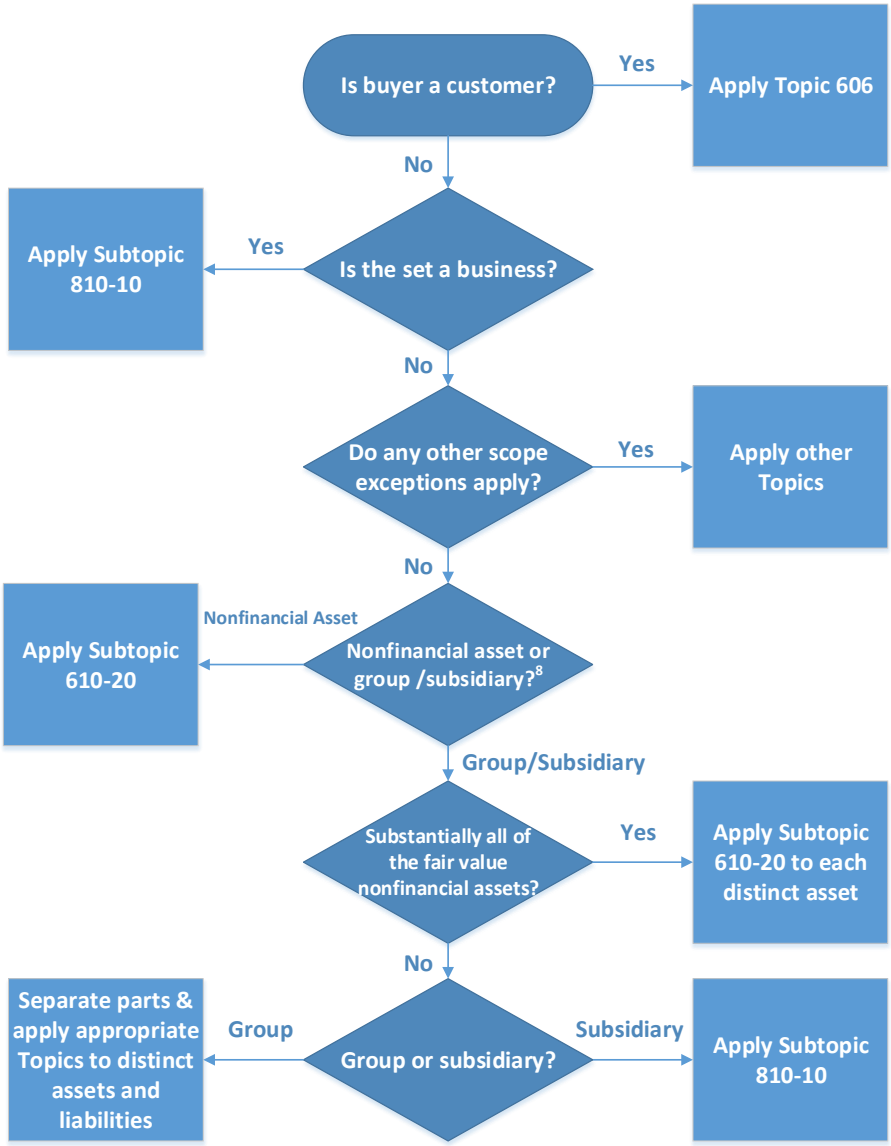
[6] FASB ASC Topic 860, Transfers and Servicing, available at www.fasb.org.

[7] FASB ASC Topic 805, Business Combinations, available at www.fasb.org.

Nonmonetary Exchanges. The guidance in Subtopic 610-20 would not apply to nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers and nonreciprocal transfers. An entity should account for these transactions under the nonmonetary exchange guidance.

Other. Subtopic 610-20 would not apply to real estate sale-leaseback transactions, a conveyance of oil and gas mineral rights, or the exchange of airline take-off and landing slots.

How a Seller Determines What Guidance Would Apply When Transferring a Nonfinancial Asset



[8] If the transfer includes other contractual arrangements that are not the assets of the seller to be derecognized (e.g., guarantees), those contracts are separated and accounted for under the applicable literature.

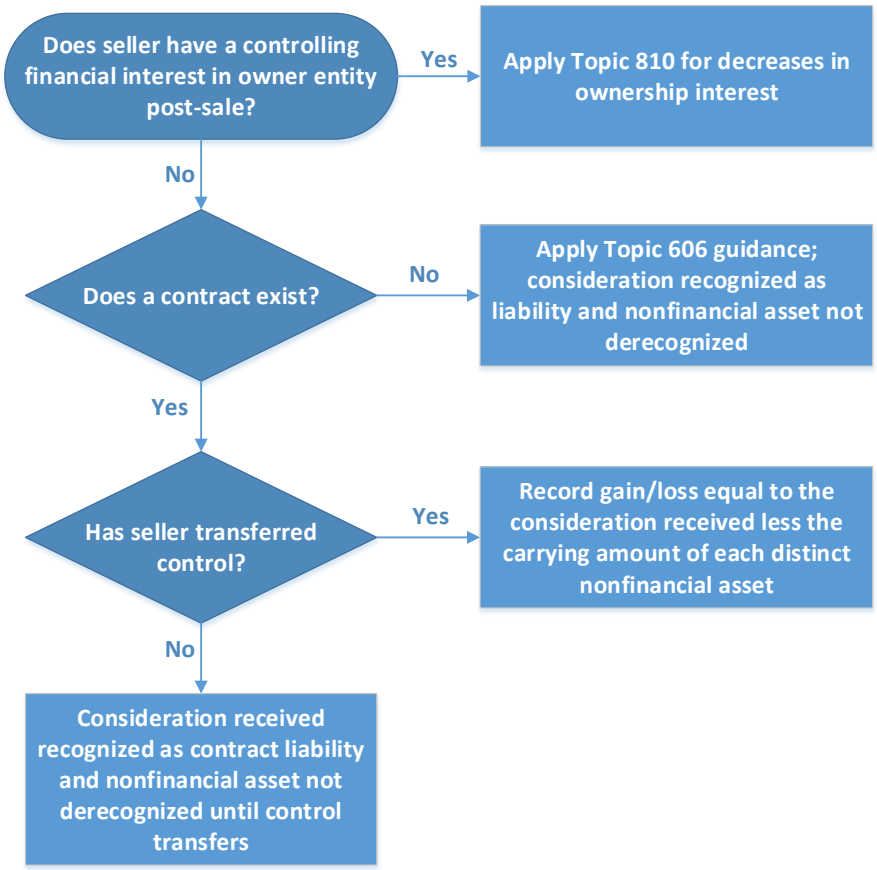
Derecognition

An entity would use the guidance in the new revenue recognition standard to determine whether it is transferring multiple, distinct nonfinancial assets, and would recognize a gain or loss for each distinct nonfinancial asset transferred.

To determine when to derecognize a distinct nonfinancial asset that is within the scope of Subtopic 610-20, an entity would apply the new revenue recognition guidance to decide whether a contract exists and when it has transferred control of the asset.

When an entity transfers nonfinancial assets included in a subsidiary and retains (or receives) an equity interest, it first would determine whether it has retained a controlling interest in the subsidiary's assets. If so, the entity would not derecognize the assets and would account for the sale of the noncontrolling interest under the consolidation guidance covering decreases in ownership. That guidance would result in recognizing the gain or loss in equity. If the entity did not retain a controlling interest, it would evaluate whether a contract exists and whether it has transferred control of the underlying assets to their owner (i.e., the subsidiary) using the new revenue recognition guidance.

How a Seller Would Evaluate Whether and When It Should Derecognize a Nonfinancial Asset



Consideration received would include the:

- Transaction price, and
- Carrying amount of liabilities assumed by the other party.

Transaction price would include the:

- Estimated variable consideration under the new revenue recognition guidance;
- Effect of a significant financing component;
- Fair value of noncash consideration; and
- Consideration payable to the customer.

An entity would apply the new revenue recognition guidance for subsequent changes in the estimate of the transaction price.

Measurement

An entity would measure its gain or loss on the derecognition of each distinct nonfinancial asset as the difference between the amount of consideration received and the carrying amount of the distinct nonfinancial asset. The consideration received would include (a) the transaction price as determined using the new revenue recognition guidance, and (b) the carrying amount of liabilities assumed by the other party. If there is more than one distinct nonfinancial asset, the entity would allocate the total consideration received under the contract to each one using the allocation guidance in the new revenue recognition standard.

If the entity retains (or receives) a noncontrolling interest in the entity that owns the asset post-sale, that noncontrolling interest would be considered noncash consideration and would be included in the transaction price at its fair value. Including the retained noncontrolling interest in the transaction price at its fair value would result in the entity recognizing a 100 percent gain on the sale of the asset. This would contrast with accounting for a partial gain under current U.S. GAAP for partial sales of real estate.

Example: Applying the Proposed ASU

Company X owns 100% of Entity A, which is a consolidated subsidiary that holds land, a building subject to operating leases, and rent receivables. Entity A does not meet the definition of a business (under the FASB's November 2015 proposal), and the assets held by Entity A are not an output of Company X's ordinary activities.

Substantially all of Entity A's fair value is attributable to nonfinancial assets. Company X concludes that all of Entity A's assets are in-substance nonfinancial assets, including the rent receivables. The total carrying amount of Company X's investment in Entity A is $7 million.

Company X transfers a 60% ownership of Entity A to Company Z for $9 million. The fair value of Company X's 40% retained interest is $6 million. Company X concludes that it no longer has a controlling financial interest in Entity A.

The criteria for the existence of a contract are met, and Company X has transferred control of Entity A's assets to Company Z.

Company X derecognizes each of Entity A's assets and recognizes a total gain of $8 million (the fair value of the retained interest of $6 million plus cash of $9 million less the carrying amount of $7 million).

In this example, it was not necessary for Company X to determine whether each of Entity A's assets was distinct (and allocate the total consideration to each one) because control of all the individual assets transferred at the same point in time. However, the proposed ASU defines the unit of account to be each distinct asset included in the subsidiary when substantially all of the fair value of the subsidiary's assets is concentrated in nonfinancial assets.

Changes for Real Estate Entities

In its *Clarifying the Definition of a Business* project, the FASB proposed changing the definition of a business, which would result in more real estate properties being considered nonfinancial assets rather than businesses.[9]

Because Subtopic 610-20 would apply when real estate (or in-substance real estate) does not meet the definition of a business, we believe most noncustomer real estate sales would fall within its scope if these two proposed ASUs are finalized as proposed.

Additionally, sales of noncontrolling ownership interests accounted for under the equity method that are considered in-substance real estate under current U.S. GAAP would be accounted for under transfer and servicing guidance regardless of whether the buyer is a customer or a noncustomer.

Proposed Effective Date and Transition

The proposed amendments would be effective at the same time as ASU 2014-09, *Revenue from Contracts with Customers* (i.e., for annual periods beginning after December 15, 2017, for public business entities and certain not-for-profit entities and for annual periods beginning after December 15, 2018, for all other entities).

In a proposed change to the transition requirements of ASU 2014-09, an entity would be able to apply the guidance in the proposed ASU using a full retrospective or modified retrospective approach regardless of which approach it chooses to adopt Topic 606.[10]

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Earlier editions are available at: kpmg.com/us/frn

[9] FASB Proposed Accounting Standards Update, Clarifying the Definition of a Business, November 23, 2015, available at www.fasb.org.

[10] FASB Proposed Accounting Standards Update, Technical Corrections and Improvements to Update 2014-05, Revenue from Contracts with Customers, May 18, 2018, available at www.fasb.org.