THE ARGON ADVISORS | BRINGING CLARITY TO COMPLEXITY

THE RUNDOWN

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The FASB, or Board, met on February 10, 2016 to discuss feedback on proposed Accounting Standards Update, *Revenue from Contracts with Customers Topic 606: Narrow-Scope Improvements and Practical Expedients*. The feedback came from various accounting organizations as well as preparers and users of financial statements. The Board largely upheld its proposed changes to the new revenue standard, with a few twists described below.

Collectability: Assessing "Substantially All," Mitigating Credit Risk and Next Steps When no Contract Exists

The Board re-affirmed its position that in determining whether a contract exists, it must be probable the entity will receive "substantially all" of the consideration to which it expects to be entitled. In approving the proposed language as currently drafted, the Boards underscored that the objective of collectability is to ensure the arrangement is "substantive", "valid" and "genuine."

The amended collectability guidance clarifies that an entity should only consider amounts subject to credit risk. That is, an entity may mitigate its credit risk through an advanced payment or by stopping to provide goods or services upon non-payment. In this case, one would evaluate collectability on the transaction price related to goods or services expected to be transferred and not otherwise covered by the advanced payment. This clarification could make it easier to pass collectability and conclude a contract exists for accounting purposes.

Interestingly, some respondents suggested that certain new collectability examples should be revised or removed. Some respondents were concerned that the examples imply bright lines to define "substantially all." Other respondents thought the examples raise more questions. For example, which GAAP should apply to transfers of control when an arrangement fails collectability and is thereby exempt from the control guidance under ASC 606?

Departing from current GAAP, the new revenue standard often disallows revenue recognition upon cash receipt if no contract exists for accounting purposes. The standard provides for two ways to release nonrefundable consideration into revenue, one of which requires terminating the contract. However, contract termination can often jeopardize one's ability to legally pursue payment from the customer.

To alleviate concerns, the Board re-affirmed a third way to release revenue where no contract exists. An entity may release revenue when non-refundable consideration is received, control has transferred on the goods or services to which the consideration relates, and the entity has stopped providing further goods or services (and is allowed to do so). This effectively allows an entity to recognize revenue without terminating the contract.

Noncash consideration: to Fair Value or Not to Fair Value...and When?

Entities may transfer goods or services to a customer in exchange for something other than cash... let's say equity/shares or bartered services (such as advertising). The Boards affirmed that noncash consideration should be measured at fair value at contract inception. This differs from current GAAP, which generally requires measurement of consideration when the equity instrument vests, rather than at contract inception. It is worth noting, however, evaluation at contract inception coincides with other measuring events throughout the standard, including estimating stand-alone selling price or evaluating the presence of a significant financing component.

The Boards further re-affirmed that changes in fair value attributable to the form of noncash consideration such as changes in the stock price of a traded security would not be subject to the constraint of variable consideration. As a result, fair value changes occurring between contract inception and final settlement would not be recorded as revenue, but rather presumably as gain or loss depending on other relevant GAAP. Additionally, the Board discussed whether the definition of fair value for noncash consideration should be linked to the fair value guidance under ASC 820 and whether the fair value of noncash consideration should be based on the spot price vs a forward price.

Transition Items: Clarification and Another Practical Expedient

The Board added a practical expedient for contract modifications upon adoption. Instead of tracing each contract modification over time to the initial contract and applying contract modification guidance to each and every step along the way, an entity may perform a single overall allocation at the earliest period presented in accordance with ASC 606 (e.g., 1/1/16 or 1/1/18 for calendar year entities). The entity would effectively allocate the total overall transaction price to the sum of satisfied and unsatisfied performance obligations (inclusive of all cumulative modifications) at that time. Although this single allocation may nevertheless be challenging, it represents something of a compromise and is available to an entity regardless of whether it elects to adopt retrospectively or prospectively using a cumulative catch adjustment.

Upon adoption an entity must apply the new standard to all contracts “open” at the date of initial application (e.g., for a calendar year company, at 1/1/16 under the retrospective model and 1/1/18 under the cumulative catch/prospective model). Contracts “completed” as of this date are exempt from evaluation under the new standard. The Boards clarified the definition of a completed contract, noting a contract is completed if “all or substantially all” of its revenue is recognized using previous GAAP by the date of initial application.

Additional Items of Possible Relief: Withholding Taxes and Remaining Performance Obligations

Current GAAP allows an entity to make a policy election to present certain taxes withheld from customers as gross revenue or net revenue. The Board acknowledged that without the policy election entities may find it difficult (and costly!) to make a gross vs net determination for each jurisdiction where revenue is earned. The Boards affirmed the proposed policy election allowing an entity to elect net presentation. The Board suggested that gross presentation is not elective and, rather, would require the entity to perform a full gross vs net analysis before it could report revenue gross of taxes withheld.

The Board is considering a practical expedient for disclosures of remaining performance obligations where an entity does not estimate variable consideration to measure and recognize revenue. Examples might include certain hosting or transactional arrangements where a series performance obligation exists. The Board will consider this matter at a future time.

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