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In This Issue

"Failed Sales" of Nonfinancial Assets Require Reassessment Upon Adoption of ASC 606 and ASC 610-20

The Bottom Line

- ASC 610-20[1] provides guidance on the recognition and measurement of transfers of nonfinancial assets. This newly established guidance, which has an effective date that is aligned with the requirements in the new revenue standard (ASC 606, as amended), conforms the derecognition guidance on nonfinancial assets with the new control model in the new revenue standard. It amends or supersedes the guidance in ASC 350 and ASC 360 on determining the gain or loss recognized upon the derecognition of nonfinancial assets, including in-substance nonfinancial assets, that are not an output of an entity's ordinary activities.
- Entities must elect a transition method for the guidance in ASC 610-20 (i.e., full or modified retrospective adoption method), with the ability to elect to apply (1) different adoption approaches for ASC 610-20 and ASC 606 and (2) practical expedients for contracts within the scope of ASC 610-20 that are different from those for contracts within the scope of ASC 606. In addition, if applying the modified retrospective adoption method, entities may also elect to apply the guidance retrospectively either to all contracts at the date of initial application or only to contracts that are not completed contracts (as discussed in further detail herein).
- Depending on the transition method elected and whether a transaction meets the definition of a completed contract, transactions that may have occurred before the effective date of 610-20 may be required to be adjusted for the provisions of ASC 610-20, which could affect whether and how much of a gain or loss is recognized. As a result, entities may be required to reverse previous accounting and make adjustments to beginning retained earnings.

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

Background

ASU 2014-09[2] provides guidance on the recognition and measurement of transfers of nonfinancial assets, which is codified in ASC 610-20. The new revenue standard amends or supersedes the guidance in ASC 350 and ASC 360 on determining the gain or loss recognized upon the derecognition of nonfinancial assets, including in-substance nonfinancial assets, that are not an output of an entity's ordinary activities, such as sales of (1) property, plant, and equipment; (2) real estate; or (3) intangible assets. ASC 610-20 does not amend or supersede guidance that addresses how to determine the gain or loss on the derecognition of a subsidiary or group of assets that meets the definition of a business. Gains or losses associated with these transactions will continue to be determined in accordance with ASC 810-10-40.

In February 2017, the FASB issued ASU 2017-05,[3] which clarifies both the definition of the term "in-substance nonfinancial asset" and the scope of ASC 610-20, as well as the accounting for partial sales of nonfinancial assets. The newly established guidance in ASC 610-20 (which consists of guidance in ASU 2014-09, as amended by ASU 2017-05) conforms the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard (ASC 606, as amended).

For more information, see Chapter 17 of Deloitte's *A Roadmap to Applying the New Revenue Recognition Standard*.

Scope of the Guidance on Nonfinancial Asset Derecognition

ASC 610-20 (as amended by ASU 2017-05) applies to all nonfinancial assets, not only to those within the scope of ASC 350 and ASC 360, if there is no other applicable guidance. For each nonfinancial asset, an entity would first determine whether the transfer of the nonfinancial asset is within the scope of ASC 606, ASC 810, or other U.S. GAAP. For example, if the nonfinancial asset is an output of the entity's ordinary business activities (e.g., a home builder's sale of real estate), the arrangement would be accounted for under ASC 606. However, if the nonfinancial asset is not an output of the entity's ordinary business activities (e.g., a public utility's sale of its headquarters), ASC 610-20 would apply.

An entity would continue to apply the derecognition guidance in ASC 810-10-40 when transfers or sales are not in-substance nonfinancial assets and the nonfinancial assets are held within a subsidiary or are a group of assets that **meets** the definition of a business.[4] Various types of transactions are subject to the scope exception in ASC 610-20-15-4.[5] Among the most common of these transactions are sale-and-leaseback transactions (e.g., real estate sale-and-leaseback transactions), which should be accounted for under ASC 840-40 (or ASC 842-40, upon adoption of the new leases standard).[6] Further, ASC 610-20 does not apply to certain arrangements related to oil and gas mineral rights (i.e., those within the scope of ASC 932-360) or nonmonetary transactions (i.e., those within the scope of ASC 845-10).

[2] FASB Accounting Standards Update (ASU) No. 2014-09, *Revenue From Contracts With Customers*.

[3] FASB Accounting Standards Update No. 2017-05, *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*.

[4] In January 2017, the FASB issued ASU 2017-01, *Clarifying the Definition of a Business*, which clarifies and narrows the definition of a business. An entity should apply that definition when adopting the guidance in ASU 2017-05 since ASU 2017-01's guidance coincides with the effective date of ASUs 2014-09 and 2017-05. Under the revised definition, an entity is likely to consider fewer real estate transactions to be businesses than it has under legacy guidance, and therefore more transactions will be accounted for in accordance with ASC 610-20. For additional information about ASU 2017-01, see Deloitte's January 13, 2017, *Heads Up*.

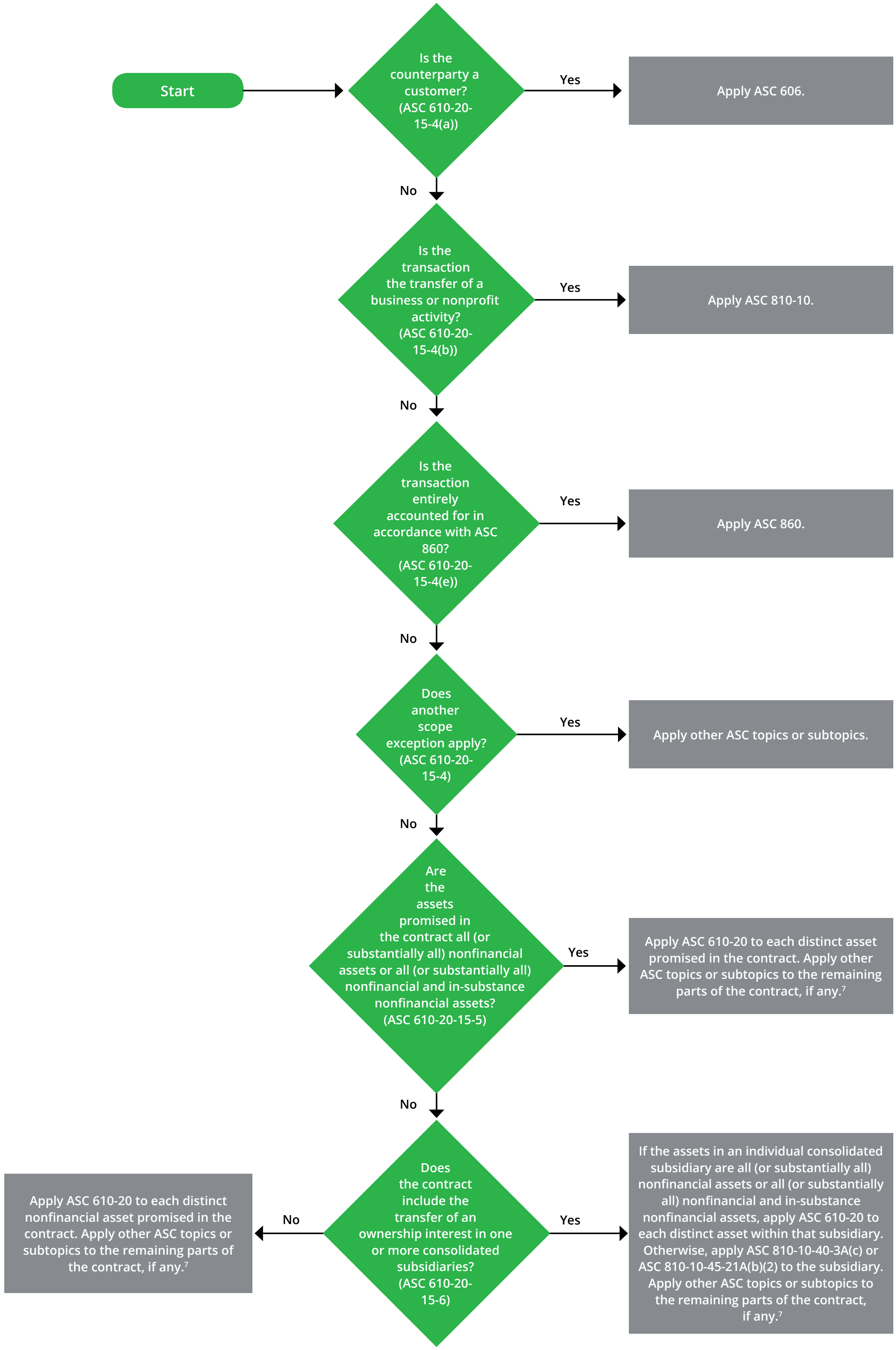
[5] See ASC 610-20-15-4(a)–(l) for a list of various scope exceptions.

[6] As a result of the effective date of ASC 842 trailing the effective date of ASC 606 and ASC 610 by one year, sale-and-leaseback transactions remain within the scope of ASC 840-40 during that period (the "stub period"). Further, sale-and-leaseback transactions involving real estate will also continue to be subject to the guidance in ASC 360-20 for the stub period; however, as of the effective date of ASC 842, ASC 360-20 will be entirely superseded.

Connecting the Dots — Industry Prevalence

For entities in the power and utilities industry, there could be a significant number of sale transactions that include assets or ownership interests in assets that meet the definition of sales of nonfinancial assets or in-substance nonfinancial assets, particularly with the clarified definition of a business resulting from ASU 2017-01 (effective date mirrors that of ASC 606 and ASC 610). For example, assets such as renewable or fossil fuel power plants, natural gas or electricity transportation or distribution infrastructure, or ownership interests therein, would most likely meet the definition of a nonfinancial asset or in-substance nonfinancial asset.

The decision tree below, which is adapted from ASU 2017-05, can help an entity determine whether assets promised to a counterparty are within the scope of ASC 610-20.



[7] If the transfer includes other contractual arrangements that are not assets of the seller to be derecognized (e.g., guarantees), those contracts are separated and accounted for in accordance with other ASC topics or subtopics.

Unit of Account

ASU 2017-05 clarifies that the unit of account is defined as a distinct nonfinancial asset.[8] At the inception of a contract, an entity should therefore identify each distinct nonfinancial and in-substance nonfinancial asset in accordance with the guidance on identifying distinct performance obligations in ASC 606. The entity should then, in a manner consistent with the approach outlined in ASC 606, allocate consideration to each distinct asset and derecognize the asset when a counterparty obtains control of it.

Contribution of Real Estate Transactions

Before the adoption of ASC 610-20, investors followed the guidance in ASC 970-323 to account for contributions of real estate to a real estate joint venture. Under the legacy guidance in ASC 970-323, contributions of real estate to a real estate venture were generally recorded at the investor's cost (less related depreciation and valuation allowances). This is consistent regardless of whether the other investors contribute cash, property, or services. ASC 970-323-30-3 states that "[a]n investor shall not recognize profit on a transaction that in economic substance is a contribution to the capital of an entity, because a contribution to the capital of an entity is not the culmination of the earnings process." However, if the transaction is an in-substance sale, it would be accounted for in accordance with ASC 360-20.

In issuing ASU 2014-09, the FASB initially retained the guidance in ASC 970-323, which addressed partial sales of real estate assets that are contributed to a joint venture. However, the new guidance in ASU 2014-09 did not adequately address partial sales transactions other than those within the scope of ASC 970-323, and raised several scope-related questions. Consequently, the FASB amended its guidance in ASC 610-20 by issuing ASU 2017-05, which, in part, amends the guidance in ASC 970-323 to align it with the requirements in ASC 606 and ASC 610-20. Therefore, although ASC 606 initially carried over the concept that an investor should record its contribution of real estate at cost, ASU 2017-05 (i.e., ASC 610-20) amended the guidance in ASC 970-323-30-3 to state that as long as the investor does not consolidate the real estate venture, "[a]n investor that contributes real estate to the capital of a real estate venture generally should record its investment in the venture at **fair value** when the real estate is derecognized, regardless of whether the other investors contribute cash, property, or services" (emphasis added).

For investments resulting from contributions of real estate that were previously recognized at the investor's cost (i.e., no gain or loss was recognized), the investor may be required to reevaluate those transactions under ASC 970-323-30-3, as amended by ASC 610-20. See the Effective Date and Transition section below for additional information.

Effective Date and Transition

The effective date of the new guidance in ASC 610-20 (i.e., both ASU 2014-09 and ASU 2017-05) governing sales of nonfinancial assets (including in-substance nonfinancial assets) is aligned with the requirements in the new revenue standard. Specifically, for public companies[9] the effective date is annual reporting periods beginning after December 15, 2017, including interim periods therein, and nonpublic companies have an additional year (annual reporting periods beginning after December 15, 2018). If an entity decides to early adopt the guidance in ASU 2017-05, it must also early adopt ASC 606 (and vice versa).

[8] In paragraph BC53 of ASU 2017-05, the FASB clarified that for a partial sales transaction structured as the sale of an ownership interest in a consolidated subsidiary, "an entity should evaluate whether it transfers control of the distinct underlying asset and not the ownership interest" in the former subsidiary.

[9] ASU 2017-05 specifically defines public companies as (1) a public business entity, (2) a conduit bond obligor, or (3) an "employee benefit plan that files or furnishes financial statements with [the SEC]." See Chapter 15 of Deloitte's *A Roadmap to Applying the New Revenue Recognition Standard* for further details and discussion on effective dates.

Like the new revenue standard, ASU 2017-05 allows an entity to use a full or modified retrospective adoption method. The entity can also elect to apply (1) different adoption approaches for ASC 610-20 and ASC 606 (e.g., modified retrospective for ASC 610-20 and full retrospective for ASC 606) and (2) practical expedients for contracts within the scope of ASC 610-20 that are different from those for contracts within the scope of ASC 606.

Definition of a Completed Contract

When an entity elects to transition to the new guidance using the modified retrospective method, it may also "elect to apply [the] guidance retrospectively either to all contracts at the date of initial application [effective date] or only to contracts that are not completed contracts at the date of initial application."[10] The transition guidance defines a completed contract as "a contract for which all (or substantially all) of the revenue was recognized" in accordance with legacy U.S. GAAP. However, this definition of a completed contract does not translate perfectly into transactions within the scope of ASC 610-20 since derecognition of nonfinancial (or in-substance nonfinancial) assets results in loss or gain recognition rather than in recognition of revenue. Nonetheless, the principle of what is deemed a completed contract in accordance with the transition provisions of ASC 606 can be applied to transactions within the scope of ASC 610-20.

As a result, transactions for which any gain or loss was deferred as of the legal sale date, and which had both of the following characteristics, would meet the definition of contract that is not completed:

- The transaction did not meet the requirements to apply sale accounting (i.e., a "failed sale" under legacy guidance (e.g., ASC 360-20)).
- The transaction date occurred before the effective date of ASC 610-20.

Note that many failed-sale transactions (excluding those within the scope of ASC 840-40) that occurred in periods before the effective date of ASC 610-20 possess the above characteristics and would therefore be considered contracts that are not complete.

Connecting the Dots — Reassessment in General

Questions often arise regarding whether entities are required to reassess all previous transactions in transition to the new standards, and the answer depends upon which method an entity elects for transition. For entities that elect either the full retrospective approach or the modified retrospective approach with an election to apply it to all contracts, all past transactions would be reevaluated to determine what the accounting would have been as if the entity had always applied the provision of ASC 610-20 and ASC 606.[11]

[10] Quoted from ASC 606-10-65-1(h).

[11] Note that if a transaction is within the scope of ASC 610-20, any reference to ASC 606 would be because ASC 610-20 refers to the control guidance in ASC 606. In other words, when describing the application of guidance in ASC 610-20 **and** ASC 606, we are not inferring that a certain transaction is or was within the scope of ASC 606, but that the control provisions in ASC 606 are required to be referenced in applying the guidance in ASC 610-20.

However, for an entity that elects the modified retrospective approach and elects to apply it only to contracts that are not complete as of the date of adoption, only a subset of transactions would be required to be reevaluated — specifically, those past transactions that failed the prior sale accounting guidance and prevented the entity from recognizing substantially all of any related gain or loss. These transactions are typically referred to as "failed-sale transactions." Therefore, for an entity that elects this method of transition, any failed-sale transactions are required to be reevaluated during transition to determine whether the failed-sale transaction would achieve sale under ASC 610-20. In some instances, the prior reason the entity failed to be able to apply sale accounting (and derecognize the asset) was linked to the risks and rewards principles embedded in legacy revenue or real estate sales literature.

Those same transactions may, under the new guidance in ASC 610-20 (i.e., ASC 606[12]), be recognizable as sales. As such, careful consideration of the contract terms and a comparison of the original reasons for the failed sale to the new guidance (including, potentially, repurchase rights in ASC 606) is critical. When control is determined to have transferred to the buyer using the guidance in ASC 610-20 (i.e., ASC 606), previously failed sale accounting shall be reversed, and any adjustments to profit and loss would be recorded to beginning retained earnings as of ASC 610-20's effective date (or in the comparative periods presented on a recasted basis when using the full retrospective method of transition).

Connecting the Dots — Reassessment for Contributions of Real Estate Transactions

For contributions of real estate previously recorded at the investor's cost under ASC 970-323, the accounting upon transition will similarly depend on whether the investor elects the full retrospective or modified retrospective transition method, and, if the investor elects the modified retrospective transition method, whether the investor elects to apply the guidance to all contracts or only those contracts that are not yet "complete" as of the date of initial application (i.e., January 1, 2018, for calendar-year-end public companies). Although no gain or loss would have been recorded by the investor under legacy guidance in ASC 970-323, such contracts would be considered complete if the contribution occurred before the effective date of ASC 610-20, assuming that the contract did not include any additional performance obligations that are not yet fully satisfied by the investor (e.g., post-contribution support services). Therefore, in these circumstances, if the investor adopts ASC 610-20 using the modified retrospective transition method and elects the practical expedient to only apply the new guidance to contracts that are not yet completed, such contracts would not need to be reevaluated by the investor. However, if the investor does not elect the practical expedient or adopts using the full retrospective transition method, then reevaluation of such contracts would be required under ASC 610-20.

[12] See footnote 11. This applies to all references to "(i.e., ASC 606)" herein.

See the table below for the application of the discussion in Definition of a Completed Contract above. Note that this table assumes that the entity has applied the guidance in the above decision tree (adapted from ASU 2017-05), and thus determined that the transaction is now within the scope of ASC 610-20 upon its effective date (i.e., the transaction is not within the scope of ASC 606, ASC 810-10, ASC 860, or any other ASC topics or subtopics for the reasons noted in the decision tree).

Scenario	Full Retrospective Method	Modified Retrospective Method to All Contracts	Modified Retrospective Method Only to Contracts That Are Not Complete
Prior accounting = sale — the risks and rewards of ownership transferred to the buyer	Reevaluate. If ASC 610-20 (i.e., ASC 606) indicates control does **not** transfer, prior sale is recast to depict a failed sale and adjustment to equity as of the earliest period presented (i.e., as of January 1, 2016, for entities that adopt ASC 610-20 on January 1, 2018) or later if the transaction occurred during the comparative periods presented. If ASC 610-20 (i.e., ASC 606) indicates control does transfer, no change.	Reevaluate. See the Full Retrospective Method explanation (the only difference is that the equity impact is recognized as of the effective date of ASC 610-20).	Generally, do not reevaluate. Prior sale accounting would most likely have resulted in recognizing all (or substantially all) of the gain or loss. In those cases, reevaluation is not necessary, because the contract meets the definition of a completed contract.[13]
Prior accounting = failed sale — substantially all the risks and rewards of ownership did **not** transfer to the buyer	Reevaluate. If ASC 610-20 (i.e., ASC 606) indicates control does **not** transfer, no change. If ASC 610-20 (i.e., ASC 606) indicates control does transfer, prior accounting is recast to recognize the gain/loss and derecognize the asset with an adjustment to equity as of the earliest period presented (i.e., as of January 1, 2016, for entities who adopt ASC 610-20 on January 1, 2018) or later if the transaction occurred during the comparative periods presented.	Reevaluate. See the Full Retrospective Method explanation (the only difference is that the equity impact is recognized as of the effective date of ASC 610-20).	Reevaluate, since the contract does not meet the definition of a completed contract. If ASC 610-20 (i.e., ASC 606) indicates control does not transfer, no change. If ASC 610-20 (i.e., ASC 606) indicates control does transfer, prior accounting is recast to recognize the gain/loss and derecognize the asset with an adjustment to equity as of the effective date of ASC 610-20.

[13] This accounting outcome assumes that (1) there are no other contractual obligations that have been allocated consideration that have yet to be fulfilled, and (2) there is no contingent consideration that has not yet been recognized (i.e., "substantially all" of the consideration has been recognized).

Example

Background Facts

On June 30, 2014, SEC-filer Entity C (the "seller") entered into a sale transaction (the "Transaction") with Entity F (the "buyer") in which C sold a natural gas–powered electric generating facility (the "power plant") to F. As of the sale date, it was determined that full accrual sale accounting could not be applied and the gain that would have resulted from the sale could not be recognized (in accordance with ASC 360-20) because of a prohibited form of continuing involvement. Specifically, the contract included a provision that obligated C to indemnify F for any preexisting environmental contamination at the power plant (regardless of whether this contamination was caused by the seller's prior use of the property). Further, because of the nature of the power plant, C's likelihood of loss resulting from this environmental indemnification has a greater than remote chance of occurring. (Note that all other "sale criteria" were met, with no other prohibited forms of continuing involvement existing, including the fact that there was no purchase option or purchase obligation held by C on the power plant.)

Previous Accounting

Before the adoption of ASC 610, the Transaction was prohibited from applying full accrual sale accounting and recognizing a gain on the legal sale because of the prohibited form of continuing involvement (i.e., C's specific indemnification of environmental contamination violated the criteria in ASC 360-20 to apply sale accounting). Thus, C retained the risks and rewards of ownership and was required to apply a failed sale accounting method, specifically the "financing method."

Additional Facts

- Upon its transition to ASC 610 on January 1, 2018, C plans to apply the modified retrospective method only to contracts that are not complete.
- The power plant meets ASC 610-20's definition of an in-substance nonfinancial asset.
- Upon reconsidering the transaction under the framework of ASC 610 (i.e., ASC 606), control of the power plant was determined to have transferred from C to F as of the initial sale date (June 30, 2014).

Transition to ASC 610 Analysis

At transition, because C previously applied a failed sale recognition method to the Transaction (i.e., the financing method) and thus the Transaction does not meet the definition of a completed contract, C is required to reevaluate the Transaction to determine whether:

- The Transaction is within the scope of ASC 610-20 or other U.S. GAAP (e.g., whether the power plant meets the clarified definition of a business as of January 1, 2018).
- The Transaction is within the scope of ASC 610-20.
  - If ASC 610-20 (i.e., ASC 606) indicates control of the power plant did not transfer to F, C makes no change to its previous accounting.
  - If ASC 610-20 (i.e., ASC 606) indicates control of the power plant did transfer to F, prior accounting is reversed and recast to recognize the gain/loss and derecognize the asset with an adjustment to equity as of the effective date of ASC 610-20 (i.e., January 1, 2018).

Entity C's Resulting Accounting

Upon reevaluation of the Transaction, C would be required to reverse its previous failed sale accounting because (as stated in Additional Facts above):

- The power plant (i.e., the in-substance nonfinancial asset) is within the scope of ASC 610-20.
- In accordance with ASC 610 (i.e., ASC 606), control of the power plant was determined to have transferred from C to F as of June 30, 2014.

Example (continued)

Entity C would then recast the Transaction using full accrual sale accounting as of the initial sale date of June 30, 2014. To do so, C would:

a. Derecognize the power plant and financing obligation (which resulted from the application of the financing method).
b. Determine any gain or loss that would have been recognized on the sale date had the Transaction not initially failed sale (including, if applicable, any liability that may require recognition for the environmental indemnification provisions, in accordance with ASC 410-30).
c. Consider recognition of a liability for the environmental indemnification in accordance with ASC 410-30.
d. Determine any income statement impact that had been recognized after the failed sale as a result of the asset remaining on its books (i.e., depreciation expense on the power plant and interest expense on the financing obligation, each of which was recognized after the failed sale).
e. Determine the income statement impact, if any, that would have been recognized in the comparative periods, if applicable, had the sale been recognized as of the initial sale date.
f. Recognize an adjustment to equity as of January 1, 2018,[14] for items (b), (c), (d), and (e) above.

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[14] Had Entity C elected the full retrospective method, it would have recognized an adjustment to equity as of January 1, 2016.

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