

To the Point

FASB – proposed guidance

Surprises lurk in the proposed revenue recognition model

Significant changes are proposed to current guidance that companies may not be expecting.

What you need to know

- ▶ The FASB issued its proposed amendments to the Accounting Standards Codification, which will help companies understand which ancillary guidance would change as a result of the joint revenue recognition proposal.
- ▶ Many of the proposed amendments are consistent with the revenue recognition proposal and the Boards' redeliberations, but there are some proposed changes that companies may not be expecting.
- ▶ Several of the proposed amendments would significantly change the way some companies recognize revenue and certain related costs.
- ▶ Comments are due by 13 March 2012.

Overview

In conjunction with its November 2011 re-exposure of the joint revenue recognition proposal that would converge guidance in US GAAP and IFRS, the Financial Accounting Standards Board (FASB) issued a draft of its proposed consequential amendments to the Accounting Standards Codification (the Codification).

The proposed amendments include not only the proposed changes to Topic 605, *Revenue Recognition*, but also changes to guidance that resides outside that Topic. While the proposed amendments to the Codification are generally consistent with the redeliberations by the FASB and the International Accounting Standards Board (collectively, the Boards) and, in many cases, current US GAAP, the proposed amendments include some changes to current practice that companies may not have expected.

Key considerations

Elimination of revenue guidance

Not surprisingly, the proposed consequential amendments would remove most of the current revenue recognition guidance included in the Codification under either Topic 605 or industry-specific guidance (for example, Subtopic 926-605 for films and Subtopic 985-605 for software).

Some small portions of the guidance within Topic 605 would be retained. These items generally don't provide revenue recognition guidance, but instead are *related* to revenue recognition (for example, the guidance in Subtopic 605-50 on a customer's accounting for consideration received from a vendor). While the FASB is not proposing to delete that type of guidance, the FASB plans to move it out of Topic 605 in the Codification.

Sale of nonfinancial assets

The FASB is also proposing to modify certain aspects of the Codification so that the measurement and recognition aspects of the proposed revenue model would apply to determining the amount and timing of any gain or loss associated with the sale of certain nonfinancial assets that are not an output of an entity's ordinary activities (i.e., are not revenue transactions). This would include the sale of intangible assets, property, plant and equipment and real estate.

Based on the proposed model, we believe that an entity would be required to derecognize an asset when a buyer obtains control and recognize a gain or loss from the transaction based on the difference between the transaction price and the asset's carrying amount. Consistent with the proposed guidance, an entity would take into consideration a number of factors to determine the transaction price, and any gain would be limited to amounts that are reasonably assured.

The proposal differs significantly from the current stringent requirements for gain or loss recognition on real estate sales. For example, the current guidance on real estate sales¹ says profit recognition is not appropriate if the seller finances the transaction and the buyer's initial investment (i.e., down payment) "does not demonstrate a commitment to pay for the property." Under the proposed model, a gain may be recognized for a transaction that does not meet the requirements of current real estate sales guidance if the expected transaction consideration is reasonably estimable and exceeds the carrying amount of the real estate sold.

How we see it

In their latest proposal, the Boards have asked constituents to comment on whether the proposed revenue recognition model is the appropriate model to account for such transactions. We encourage companies to comment on this issue.

Advertising costs, including 'direct-response' advertising

Under current guidance, advertising costs are expensed in the period the costs are incurred or the first time the advertisement is shown, except for certain "direct-response" advertising costs, which are reported as an asset and amortized over the future benefit period, if certain conditions are met.²

The proposed guidance for the sale of nonfinancial assets differs significantly from the stringent guidance that exists today.

However, the proposed amendments to the Codification indicate that current guidance on advertising costs would be superseded and all advertising costs, including “direct-response” advertising costs, would be expensed as incurred (except for “direct-response” advertising costs incurred by insurance entities). Companies would be required to follow the guidance in the proposed model to account for costs to obtain and/or fulfill a contract. This could result in a significant change in practice for some companies, including those in the retail and consumer products, media and entertainment and technology industries.

Advertising barter

Some companies enter into arrangements to exchange rights to place advertisements on one another’s websites. In many cases, no cash is exchanged between the parties or similar amounts of cash are exchanged. Under current guidance, revenue and expenses from an advertising barter transaction are recognized at fair value only if the fair value of the advertising surrendered in the transaction is determinable based on a company’s historical practice of receiving cash for similar advertising from buyers unrelated to the counterparty in the barter transaction. If the fair value of the advertising surrendered in the barter transaction is not determinable, the barter transaction is recorded based on the carrying amount of the advertising surrendered, which is typically zero. The specific guidance on advertising barter transactions³ was developed because of concerns that entities were essentially “round-tripping” online advertising transactions with one another and increasing their advertising revenues for transactions that lacked substance.

This guidance would be superseded, and similar guidance is not currently included in the proposed model. As a result, there could be an increased risk of companies overstating revenue by recognizing revenue and related costs on advertising barter transactions for which there is no ultimate realization of cash and no overall effect on net income.

Share-based payments

The proposed amendments may cause a vendor and a customer to calculate different fair value measurements for share-based payments made in exchange for goods and services. The guidance a vendor applies is currently aligned with the guidance the customer would apply, generally resulting in both parties valuing share-based payments on the same date and at the same amount. However, it appears the new proposal replaces the guidance a vendor applies in accounting for share-based payments received as payment from customers with general principles covering nonmonetary transactions that could result in a change in practice. The vendor’s accounting for share-based payments issued to customers (e.g., for volume discounts) would be unchanged because it is outside the scope of the proposal.

Recognition of sales to the dealer when financed

Many equipment manufacturers sell their products (including cars, boats and agricultural or construction equipment) to dealers or distributors and also provide financing to the end customer who purchases the equipment from the dealer or distributor. Currently, as long as certain criteria are met, the equipment manufacturer can recognize the sale upon transfer of risks and rewards to the dealer.⁴ This guidance would be superseded by the proposed model.

The proposed amendments would supersede guidance on advertising barter transactions, potentially permitting recognition of revenue for exchanges that lack substance.

Instead, entities would be required to determine whether the sale to the dealer results in the transfer of control, despite the fact that the entity may actually lease or finance the sale of that same equipment to the end customer. Without the current guidance in US GAAP, entities may reach different conclusions on these types of transactions.

Next steps

- ▶ Companies should carefully review the proposed amendments to ensure that they understand how current practice would be affected.
- ▶ Companies should communicate issues identified to the FASB by 13 March 2012.

Endnotes:

- ¹ Accounting Standards Codification (ASC) Subtopic 360-20, *Property, Plant, and Equipment – Real Estate Sales*
- ² ASC Subtopic 340-20, *Other Assets and Deferred Costs – Capitalized Advertising Costs* and Subtopic 720-35, *Other Expenses – Advertising Costs*
- ³ ASC Subtopic 605-20, *Revenue Recognition – Services* (formerly Emerging Issues Task Force (EITF) 99-17, *Accounting for Advertising Barter Transactions*)
- ⁴ ASC Subtopic 605-15, *Revenue Recognition – Products* (formerly EITF 95-4, *Revenue Recognition on Equipment Sold and Subsequently Repurchased Subject to an Operating Lease*)

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