What you need to know

- The FASB issued final guidance that clarifies the scope and application of ASC 610-20 on the sale, transfer and derecognition of nonfinancial assets and in substance nonfinancial assets to noncustomers, including partial sales.

- The ASU applies to the derecognition of nonfinancial assets, including real estate (e.g., buildings, land, windmills, solar farms), and intellectual property. It clarifies that the derecognition of businesses is in the scope of ASC 810 and defines an in substance nonfinancial asset.

- These amendments will likely result in larger gains for entities that sell real estate and today apply ASC 360-20.

- The amendments are effective at the same time as the new revenue standard. For public entities, that means annual periods beginning after 15 December 2017 and interim periods therein. Early adoption is permitted but only as of fiscal years beginning after 15 December 2016, including interim periods therein.

Overview

The Financial Accounting Standards Board (FASB or Board) amended the guidance in Accounting Standards Codification (ASC) 610-20 regarding the derecognition of a nonfinancial asset or an in substance nonfinancial asset if the transaction is not with a customer.
The Accounting Standards Update (ASU)\(^2\) addresses questions about ASC 610-20, which was issued with the new revenue recognition standard (ASC 606).\(^3\) ASC 610-20 requires entities to apply certain recognition and measurement principles in ASC 606 when they derecognize nonfinancial assets and in substance nonfinancial assets, and the counterparty is not a customer.

In this publication, the term “sale” also refers to a transfer of a nonfinancial asset or an in substance nonfinancial asset or any other transaction in which an entity loses control of a nonfinancial asset or in substance nonfinancial asset (e.g., expiration of a contractual agreement, dilution event, default on debt).

Examples of transactions in the scope of this ASU include:

- Sales of property, plant and equipment or intangible assets to noncustomers
- Transfers to noncustomers of nonfinancial assets held in a subsidiary that is not a business or nonprofit activity
- Transactions currently accounted for under the real estate derecognition guidance
- Contributions of nonfinancial assets that are not a business or a nonprofit activity to a joint venture or other noncontrolled investee in exchange for equity of that entity or other consideration

**Background**

After the issuance of ASC 610-20, stakeholders said its scope wasn't clear because it did not define an in substance nonfinancial asset. As a result, questions arose about what quantitative threshold or qualitative considerations should be used to determine whether an asset should be deemed an in substance nonfinancial asset and which assets should be included in the analysis (e.g., only those previously recognized by the seller or both recognized and unrecognized assets).

Stakeholders also said the guidance for partial sales of nonfinancial assets was unclear. Further, they said it wasn't clear why a transfer of a nonfinancial asset to another entity in exchange for a noncontrolling interest in that entity would be accounted for under ASC 845.\(^4\)

This ASU is part of a multiphase project. In the first phase, the FASB clarified the definition of a business. In the last phase of the project, the Board plans to discuss whether it can further align the guidance on acquiring and derecognizing assets and businesses.

**Scope**

The amendments clarify that ASC 610-20 applies to the derecognition of all nonfinancial assets, not just those in the scope of ASC 350 and ASC 360.

The amendments clarify that ASC 610-20 applies to the derecognition of all nonfinancial assets, not just those in the scope of ASC 350\(^5\) and ASC 360\(^6\), when no other guidance applies. This includes the sale of intangible asset and property and equipment, including real estate, as well as materials and supplies. However, it does not apply if the sale is to a customer, as defined in ASC 606. The ASU includes a flowchart to help entities determine when to apply ASC 606, ASC 810,\(^7\) ASC 610-20 or other guidance. The flowchart is summarized in the appendix to this publication.

The ASU also clarifies that businesses are generally\(^8\) derecognized using the deconsolidation guidance in ASC 810, which is consistent with current US GAAP before the adoption of ASU 2014-09.\(^9\) The FASB clarified this point because sales of businesses that only hold in substance nonfinancial assets would otherwise have been in the scope of ASC 610-20.

When determining whether a transaction involves a business, entities will apply the new definition of a business in ASU 2017-01,\(^10\) which likely will result in fewer transactions being accounted for as sales of businesses. Refer to our Technical Line, *A closer look at the FASB’s new guidance on the definition of a business*, for details.
**Scope exceptions**
In addition to transactions with customers and sales of businesses, several other types of transactions are excluded from the scope of ASC 610-20, including:

- A real estate sale-leaseback transaction or a non-real estate sale-leaseback transaction within the scope of ASC 360-20, ASC 840-40 or ASC 842 when entities adopt the new leases guidance
- A lease within the scope of ASC 840 or ASC 842
- A conveyance of oil and gas mineral rights within the scope of ASC 932-360
- A transaction entirely within the scope of ASC 860 (e.g., a transfer of loans or debt securities, equity investments, derivative contracts or other financial assets)
- A transfer of nonfinancial assets as consideration in a business combination
- A nonmonetary transaction within the scope of ASC 845 (e.g., a nonreciprocal transaction, spin-off, exchange of inventory for inventory)
- An exchange of takeoff and landing slots within the scope of ASC 908-350
- A contribution of cash and other assets or a promise to make such a contribution within the scope of ASC 720-25 or ASC 958-605
- A transfer of a nonfinancial asset to a venture that is accounted for using proportionate consolidation
- A transfer of nonfinancial assets between entities under common control, such as a parent and its subsidiary or two subsidiaries of the same parent

**How we see it**
We believe most transactions that are in the scope of ASC 845 today that do not involve customers will likely be in the scope of ASC 610-20. However, exchanges of inventory for inventory will continue to be in the scope of ASC 845. If an entity transfers its inventory in exchange for noncash consideration other than inventory, that transaction will generally be in the scope of ASC 606, because inventory is typically an output of the entity's ordinary activities.

**In substance nonfinancial assets**
Defining the term “in substance nonfinancial assets” is important because ASC 610-20 says that all of the assets promised in a contract are in its scope if they are all nonfinancial assets or in substance nonfinancial assets.

An in substance nonfinancial asset is a financial asset that is promised to a counterparty in a contract in which substantially all of the fair value of the assets promised in the contract is concentrated in nonfinancial assets. The analysis requires consideration of the fair value of promised assets that have not been recognized by the seller, such as in process research and development, internally generated intangibles or off-market contracts.

However, the guidance excludes cash or cash equivalents from the analysis because the Board did not want an entity to be able to achieve a particular accounting outcome simply by giving cash to a counterparty and increasing the consideration it receives by the same amount. The guidance also excludes liabilities (both assumed and relieved; for example, a mortgage) from the evaluation because the FASB focused on the nature of the assets that were transferred.
How we see it

Entities will apply judgment to determine what to consider “substantially all” because the standard does not provide a bright line for making this assessment. They should apply the threshold consistently with how they apply the concept of “substantially all” in other areas of US GAAP (e.g., ASC 810).

Currently, some entities determine that a transferred set is in substance real estate even if the fair value of the real estate assets is less than substantially all the fair value of the total assets transferred. Applying the substantially all threshold may change practice for these entities.

The following example illustrates the analysis to determine whether a contract includes an in substance nonfinancial asset.

Illustration 1 – Definition of an in substance nonfinancial asset

Company A enters into a contract to sell an entity that contains nonfinancial assets (e.g., real estate and the related operating leases) and financial assets (e.g., lease receivables). The counterparty is not a customer, and the assets transferred do not meet the definition of a business under ASU 2017-01. Assume that substantially all of the fair value of the assets promised in the contract is concentrated in the real estate and the operating leases. Therefore, all of the assets promised in the contract, including the lease receivables, are in the scope of ASC 610-20. That is, the lease receivables meet the definition of in substance nonfinancial assets.

The conclusion would be the same even if the contract included cash or cash equivalents.

In many transactions, the transferred set of assets will clearly be a business in the scope of ASC 810. If the transferred set of assets comprises solely nonfinancial assets or just nonfinancial assets and in substance nonfinancial assets, the transaction generally will be in the scope of ASC 610-20. However, if the transferred set of assets is not a business or includes more than just nonfinancial assets and in substance nonfinancial assets, further analysis will be required.

In these cases, the accounting depends on whether the transaction involves the sale of an ownership interest in one or more subsidiaries. If the transaction does not involve such a sale, the contract may be partially in the scope of ASC 610-20 and partially in the scope of other guidance (e.g., ASC 860 for equity method investments). An entity will apply the guidance in ASC 606 to determine how to separate and measure one or more parts of a contract that are in the scope of other guidance.

If the transaction involves the sale of an ownership interest in one or more subsidiaries, each subsidiary must be evaluated individually to determine whether substantially all of the fair value of the promised assets held in each subsidiary is concentrated in nonfinancial assets. If substantially all of the fair value of the assets in an individual subsidiary is concentrated in nonfinancial assets, the financial assets in that subsidiary are in substance nonfinancial assets and are in the scope of ASC 610-20.

Subsidiaries that do not hold solely nonfinancial assets and in substance nonfinancial assets are in the scope of ASC 810 unless the substance of the transaction is addressed by other guidance (e.g., ASC 845, ASC 860, ASC 932).

In the rest of this publication, the term nonfinancial asset also refers to an in substance nonfinancial asset. The following examples illustrate the determination of whether a transaction is in the scope of ASC 610-20.
Illustration 2 – Transferring nonfinancial assets and financial assets

An entity enters into a contract to sell machinery and noncash financial assets with fair values of $3 million and $1 million, respectively. The counterparty is not a customer as defined in ASC 606, and the assets transferred do not meet the definition of a business under ASU 2017-01. Substantially all of the fair value of the assets promised in the contract is not concentrated in nonfinancial assets. Therefore, the financial assets in the contract are not in substance nonfinancial assets. The entity would apply the guidance in ASC 606 to determine how to separate and measure the machinery and the financial assets. The machinery would then be accounted for under ASC 610-20, and the financial assets would be accounted for under other US GAAP.

Illustration 3 – Evaluating assets held by multiple subsidiaries

Parent enters into a contract to sell two subsidiaries, Sub A and Sub B. The counterparty is not a customer as defined in ASC 606, and the assets sold do not meet the definition of a business under ASU 2017-01.

Sub A holds land and receivables with fair values of $49 million and $1 million, respectively. Sub B consists entirely of financial assets with a fair value of $60 million. Parent evaluates all the assets promised in the contract and concludes that substantially all of the fair value of the assets promised in the contract (i.e., $110 million) is not concentrated in nonfinancial assets. As a result, Parent evaluates each subsidiary individually. When evaluating Sub A, Parent determines that substantially all of the assets’ fair value (i.e., 98%) is concentrated in nonfinancial assets. As a result, the sale of Sub A (i.e., the land and the receivables held by Sub A) is in the scope of ASC 610-20. The sale of Sub B is in the scope of ASC 810, unless other guidance addresses the substance of the transaction. In this fact pattern, the sale of Sub B would be within the scope of ASC 860.

If all of the assets were in Sub A, Parent would likely determine that substantially all of the assets’ fair value is not concentrated in nonfinancial assets. Therefore, the sale of Sub A would be in the scope of ASC 810 unless other guidance addresses the substance of the transaction. That is, Parent would not separate the nonfinancial assets from the financial assets, but would instead account for the derecognition of the subsidiary as one unit of account.

Definition of a customer

ASC 610-20 and ASC 606 define a customer as “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.” Neither standard defines the term “ordinary activities” because it was derived from legacy guidance. Statement of Financial Accounting Concepts No. 621 refers to ordinary activities as an entity’s “ongoing major or central operations.”

For example, a heavy equipment manufacturer sells equipment that is an output of its ordinary activities. Likewise, a homebuilder’s sale of a home is an ordinary activity. For these entities, these sales would be within the scope of ASC 606. In contrast, an entity that sells equipment it previously used in its manufacturing operations to another entity likely would conclude that its sale of an operating asset is not an output of its ordinary activities and, therefore, the sale agreement is not a contract with a customer. In this case, the transaction would likely be within the scope of ASC 610-20.
If an entity sells a nonfinancial asset to a party to which it also sells goods or services that are the output of its ordinary activities, the buyer will be considered a customer for the transactions involving the goods or services but not for the sale of the nonfinancial asset. For example, a widget maker’s sales of widgets to Entity A would be in the scope of ASC 606. But if the widget maker sells its widget-making machine to Entity A, that transaction would be in the scope of ASC 610-20.

**How we see it**

The income statement presentation of sales in the scope of ASC 606 and ASC 610-20 differs. Consideration from sales in the scope of ASC 606 is presented as revenue, on a gross basis, but net gains or losses from sales in the scope of ASC 610-20 are presented in income from operations, if such a subtotal is presented.

**Real estate transactions**

Practice will change significantly for entities that derecognize real estate (or in substance real estate) pursuant to ASC 360-20. Upon adoption of the new revenue standard, ASC 360-20 will be eliminated (except for the guidance on sale-leaseback transactions), and entities will determine which guidance to apply based on whether the sale involves a business and whether the counterparty is a customer.

Entities with sale-leaseback transactions within the scope of ASC 840-40 (prior to the adoption of ASC 842) will continue to follow that guidance and will not apply ASC 610-20. For sales of real estate that are part of a sale-leaseback transaction within the scope of ASC 840-40, entities will continue to follow the guidance in ASC 360-20. The FASB stated that entities should not analogize to this guidance when evaluating any transaction that is not a sale-leaseback because the Board narrowed the scope of ASC 360-20 to apply only to these transactions.

ASC 842, which was created by ASU 2016-02, provides new guidance for sale-leaseback transactions that will replace the guidance in ASC 360-20 and ASC 840-40 when an entity adopts it. In many cases, applying ASC 842 will not result in a different outcome from applying ASC 610-20 because ASC 842 requires entities to apply certain guidance in ASC 606 (e.g., existence of a contract, determining when an entity satisfies a performance obligation by transferring control of an asset). However, ASC 842 provides additional guidance on whether a sale occurs, so some differences may result. The guidance in ASU 2016-02 is effective for public entities for annual periods beginning after December 15, 2018 but can be early adopted. Nonpublic entities will have an additional year to adopt ASU 2016-02. See our Financial reporting developments (FRD) publication, *Lease accounting – Accounting Standards Codification 842, Leases*, for further details.

**Partial sales**

Partial sales of nonfinancial assets are common in certain industries (e.g., real estate) and can be structured in different ways. The term “partial sale” usually refers to when an entity sells a controlling financial interest in a subsidiary but retains a noncontrolling interest. An entity also could transfer a nonfinancial asset to an entity that is owned or newly formed by a third party in exchange for a noncontrolling interest in that entity. Those transactions generally will be accounted for under ASC 610-20.

Under the new guidance, a partial sale of real estate will be in the scope of ASC 610-20 and will no longer be in the scope of ASC 360-20. The partial sale of other nonfinancial assets (e.g., an intangible asset) to an entity for a noncontrolling ownership interest in that entity also will be in the scope of ASC 610-20 and will no longer be in the scope of ASC 845.
Transfers of investments and residual profits

The ASU will significantly change practice for entities that sell equity method investments that are in substance real estate.

Under today’s guidance, transfers of equity method investments are accounted for under ASC 860, unless the investment is considered in substance real estate (and is therefore accounted for under ASC 360-20), the transaction does not meet the ASC 860’s definition of a transfer or another scope exception applies. To determine whether an equity method investment is in substance real estate, an entity “looks through” to the underlying assets and liabilities of that investment.

When it issued the new revenue standard, the FASB eliminated the scope exception for in substance real estate but added one for in substance nonfinancial assets. However, with the latest ASU, the FASB clarified that entities will not look through to the underlying assets and liabilities of an equity method investment to determine if it is an in substance nonfinancial asset. As a result, sellers will generally account for the sale of real estate that they controlled under ASC 610-20, but they will account for the sale of an equity method investment or investment in a joint venture in real estate under ASC 860.

In certain circumstances, the transfer of an equity method investment that is an in substance nonfinancial asset will be accounted for under ASC 610-20. This would be the case if the equity method investment is promised to a counterparty in a contract in conjunction with a nonfinancial asset, and the fair value of the nonfinancial asset is substantially all of the fair value of the assets transferred.

The FASB also amended ASC 310 to clarify that when an acquisition, development or construction arrangement is accounted for as an investment in real estate or a joint venture, and the expected residual profit is sold, the guidance in ASC 860 should be applied. However, the ASU does not change the accounting for the sale of future revenues under ASC 470.

How we see it

Transfers of equity method investments generally will be in the scope of ASC 860, unless the equity method investment meets the definition of an in substance nonfinancial asset (i.e., when the equity method investment is transferred as part of a group of assets in which substantially all the fair value is concentrated in nonfinancial assets). However, entities will need to consider the scope exceptions in ASC 860. See our FRD, Transfers and servicing of financial assets, for more information.

Derecognition

An entity that sells a nonfinancial asset in the scope of the ASU follows the steps below to determine whether (and when) to derecognize the asset.

Step 1
The seller evaluates the guidance in ASC 810 to determine whether it has a controlling financial interest in the entity that holds the nonfinancial asset after the transaction. The entity could be a new or existing entity in which the seller receives or retains an interest. See our FRD, Consolidation – Determination of a controlling financial interest and accounting for changes in ownership interests, for details on determining whether an entity has a controlling financial interest.
If the seller determines that it has a controlling financial interest, it does not derecognize the nonfinancial asset, and it accounts for the transaction in accordance with ASC 810. Under ASC 810, the transaction generally will be accounted for as a change in a parent’s ownership interest in a subsidiary in which it retains control (i.e., as an equity transaction). See our FRD, Consolidation – Determination of a controlling financial interest and accounting for changes in ownership interests, for further details. If the seller determines that it doesn’t have a controlling financial interest, it performs Step 2.

**Step 2**

The seller evaluates whether a contract exists under ASC 606. If it does, the seller follows the guidance in ASC 606, identifies each distinct nonfinancial asset promised to the counterparty and evaluates whether the counterparty (or counterparties, collectively) obtained control of each nonfinancial asset that is sold. If a contract exists and the counterparty obtained control of each nonfinancial asset, the seller derecognizes the asset. If control of the underlying asset has not transferred to the counterparty (e.g., because the seller retains a repurchase option), the seller does not derecognize the asset, and it records any consideration received as required by ASC 606. The entity also would continue to depreciate or amortize the asset, if applicable, and test for impairment as needed (e.g., under ASC 350 or ASC 360).

See Section 7 of our FRD, Revenue from contracts with customers (ASC 606), for details on assessing when control is transferred.

When ownership interests are sold to more than one counterparty (e.g., two buyers acquire a 50% equity interest each in an entity), the seller must evaluate whether the counterparties collectively obtained control of the nonfinancial assets.

**Partial sales**

When an entity retains a noncontrolling interest in the subsidiary that holds a nonfinancial asset (i.e., a partial sale), the ASU states that the seller will evaluate whether the entity that holds the nonfinancial asset (e.g., the former subsidiary) obtains or has control of the asset in accordance with ASC 606. That is, the seller must evaluate whether it transfers control of the underlying asset (e.g., the building) instead of whether control of the ownership interest transfers (i.e., the unit of account is the underlying asset and not the ownership interest in the former subsidiary).

**Illustrations**

The following illustrations show how transfers of control should be evaluated.

**Illustration 4 – Transfer of control under ASC 810 and ASC 606**

Parent holds a 100% equity interest in Entity A and enters into a contract to sell a 60% controlling equity interest in Entity A to Entity B. Entity B is not a customer as defined in ASC 606. Entity A is not a business under ASU 2017-01, and its only asset is land. As a result, Parent concludes that the transaction is in the scope of ASC 610-20. On the transaction closing date, Parent determines it has lost its controlling financial interest in Entity A under ASC 810 and does not have a controlling financial interest in Entity B. Further, Parent determines that Entity A has control of the nonfinancial asset under ASC 606. As a result, Parent derecognizes the land and recognizes a 40% noncontrolling interest in Entity A.
Illustration 5 – Transfer of control under ASC 810 but not under ASC 606

Assume the same facts as in Illustration 4, except that Parent holds a substantive call option to repurchase the 60% equity interest in Entity A in two years at a fixed price. On the transaction closing date, Parent determines it has lost its controlling financial interest in Entity A under ASC 810 and does not have a controlling financial interest in Entity B. However, because of the call option, control of the land does not transfer in accordance with ASC 606. As a result, Parent does not derecognize the land. Parent also cannot recognize an equity method investment for its retained 40% interest until it derecognizes the land.

Illustration 6 – Control does not transfer under ASC 810

Assume the same facts as in Illustration 4, except that Entity A is a variable interest entity for which Parent is the primary beneficiary. On the transaction closing date, Parent determines that it retains a controlling financial interest in Entity A under ASC 810. As a result, Parent does not derecognize the land, and the transaction is accounted for as an equity transaction under ASC 810.

Illustration 7 – Transfer of control under ASC 810 and ASC 606 to multiple entities

Assume the same facts as Illustration 4, except that Parent transfers 30%, 20% and 50% equity interests in Entity A to Entity X, Entity Y and Entity Z, respectively.

When determining whether to derecognize the land, Parent concludes that Entity X, Entity Y and Entity Z are not customers as defined in ASC 606. On the transaction closing date, Parent concludes that it does not have a controlling financial interest in Entity A, Entity X, Entity Y or Entity Z. Entity X, Entity Y and Entity Z collectively obtained control of the land under ASC 606. As a result, Parent derecognizes the land, even though neither Entity X, Entity Y nor Entity Z individually controls Entity A.

How we see it

In practice, it will often be clear when the derecognition criteria are met. Other transactions may be more complex and require judgment. That may be the case when a subsidiary is a variable interest entity and the parent has a controlling financial interest in that entity.

When determining whether control has transferred under ASC 810, the seller only considers the substantive terms of an arrangement. For example, a deeply out-of-the-money call option may not be considered substantive and therefore would not be factored into the analysis.

Liabilities assumed or relieved

When a nonfinancial asset is transferred, a seller applies other US GAAP (e.g., ASC 405) to determine when to derecognize a liability that is to be assumed or relieved by the counterparty.

If the seller meets the criteria in ASC 405 to derecognize a liability before transferring control of a nonfinancial asset, the liability is derecognized, but no gain or loss is recognized. Instead, the seller recognizes a contract liability that represents consideration received before transferring control of the asset. If the seller transfers control of a nonfinancial asset before meeting the criteria to derecognize a liability, the seller recognizes a contract asset when the liability is included in the calculation of the gain or loss.
Measurement

The ASU requires the seller to recognize a full gain or loss (i.e., the difference between the consideration received and the carrying amount of the asset sold) when the derecognition criteria are met. The consideration received is the transaction price determined in accordance with ASC 606, plus the carrying amount of any liabilities assumed by the counterparty (e.g., mortgage loan assumed by the buyer).

An entity will allocate the consideration to each distinct asset using the guidance in ASC 606. The FASB observed that control of each asset will often transfer at the same time (e.g., when all assets are held in one entity). Therefore, in practice, an entity often may not need to separate and allocate consideration to each distinct nonfinancial asset. However, when distinct nonfinancial assets are transferred at different points in time (e.g., because of a repurchase agreement), ASC 610-20 says the guidance in ASC 606 should be applied to determine the point in time at which control of the nonfinancial asset transfers.

Contingent (variable) consideration

Under ASC 610-20, contingent consideration is measured in accordance with ASC 606 using the guidance on variable consideration. The amount of variable consideration an entity can include in the transaction price is limited (i.e., constrained) to the amount for which it is probable that a significant reversal will not occur when the uncertainties related to the variability are resolved. In these cases, an entity might recognize a loss when it derecognizes a nonfinancial asset even though it expects to ultimately recognize a gain from the transaction when the uncertainty related to the transaction price is resolved. See Section 5.2.3 of our FRD, Revenue from contracts with customers (ASC 606), for a discussion of the constraint.

Today, there is diversity in practice regarding the measurement of contingent consideration under ASC 810. For example, some entities don’t estimate consideration that is contingent on future events (i.e., variable consideration) but instead recognize these amounts when they are received. Other entities recognize contingent consideration at its fair value or apply a loss recovery approach.

How we see it

Entities may see significant changes in how they account for sales of nonfinancial assets due to the requirement to estimate variable consideration using the model in ASC 606.

Illustration 8 – Sale of a nonfinancial asset for variable consideration

Through its 100% equity interest, Parent has a controlling financial interest in Subsidiary, whose only asset is a ship with a carrying amount of $85 million.

Parent sells Subsidiary to Entity A for $75 million up front and additional cash over the next five years based on a percentage of Subsidiary’s annual earnings above an agreed-upon target (the earn-out). Based on its assessment of the factors in ASC 606-10-32-12, Parent determines that the amount that it should include in the transaction price for the earn-out is $25 million. Parent determines that it is probable that recognizing such an amount would not result in a significant reversal of that consideration.
Parent determines that the transaction is not with a customer, is not the sale of a business under ASU 2017-01 and is therefore in the scope of ASC 610-20. Parent also determines that subsequent to the sale of the equity interest, it does not have a controlling financial interest in Subsidiary or Entity A under ASC 810. Further, Parent determines that Subsidiary has control of the ship under ASC 606. As a result, the gain on the sale of the Subsidiary is calculated as follows:

<table>
<thead>
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<th>Description</th>
<th>Amount</th>
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<td>Transaction price</td>
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<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Carrying amount of Subsidiary's net assets</td>
<td>$ 85</td>
</tr>
<tr>
<td>Gain</td>
<td>$ 15</td>
</tr>
</tbody>
</table>

**Liabilities assumed or relieved**

Any liabilities assumed or relieved by a counterparty (e.g., mortgage loan assumed by the buyer) are included in the consideration promised in the contract at their carrying amount. The Board noted that including the carrying amount of a liability assumed or relieved by a counterparty as consideration received reflects the substance of the transaction because if the counterparty did not assume the liability, the counterparty would have to provide additional consideration to acquire the asset.

The FASB also decided that an entity should recognize the gain or loss on the asset at the same time and in the same line item as the gain or loss on the liability. Recognizing the gains or losses on the asset and liability separately would have required an entity to allocate the total gain or loss between the asset and liability derecognized.

**Partial sales**

The FASB determined the economic substance of a partial sale is akin to a transfer of a distinct underlying asset in exchange for a noncontrolling interest in an entity. Therefore, for transactions in the scope of ASC 610-20, a noncontrolling interest received or retained by the seller (e.g., in a partial sale) is noncash consideration and is measured at fair value under ASC 606. As a result, the accounting for a partial sale will result in the recognition of a full gain or loss.

This change generally aligns the measurement of a retained interest in a nonfinancial asset with that of a retained interest in a business. However, the measurement date for noncash consideration under ASC 610-20 and ASC 606, including a retained interest in a partial sale, is contract inception. In contrast, under ASC 810, fair value is measured at the date control is lost.

Under today's guidance, if the transaction is within the scope of ASC 845, an exchange of a nonfinancial asset (other than in substance real estate) for a noncontrolling ownership interest may be accounted for at either carrying amount (no gain) or fair value (partial or full gain). The ASU eliminated this guidance.

Today, under ASC 360-20, an entity that has conducted a partial sale of real estate generally recognizes a partial gain because any noncontrolling interest retained is measured on a carryover basis. Carryover basis also is used under today's guidance when the retained interest is in a joint venture.

The ASU generally does not change how the receiving entity accounts for the transaction. For example, a joint venture that receives an asset in exchange for issuing equity to one of its joint venturers would not apply ASC 610-20 but would instead apply other GAAP, which may result in the joint venture using carryover basis in its financial statements.
How we see it

ASC 610-20 will require entities to recognize full gains. It will eliminate the use of carryover basis for sales of real estate or contributions of assets to equity method investees or joint ventures, which today are accounted for under ASC 360-20 or ASC 845, respectively.

Because the ASU does not change how the receiving entity accounts for the transaction, the new guidance may result in more basis differences than under current US GAAP. For example, basis differences may arise when a joint venturer transfers an asset to a joint venture in exchange for an equity interest, and the venturer measures the equity at fair value, but the joint venture measures the asset received at carryover basis.

Illustration 9 – Transferring a nonfinancial asset and retaining a noncontrolling interest

Parent holds a 100% equity interest in Entity A and enters into a contract with Entity B to sell a 60% controlling equity interest in Entity A. Entity B is not a customer as defined in ASC 606. Entity A is not a business under ASU 2017-01, and its only asset is land. As a result, Parent concludes that the transaction is in the scope of ASC 610-20. On the transaction closing date, Parent determines it has lost its controlling financial interest in Entity A under ASC 810 and does not have a controlling financial interest in Entity B. Further, Parent determines that Entity A has control of the nonfinancial asset under ASC 606. As a result, Parent derecognizes the land under the new guidance.

The carrying value of Entity A’s land is $15 million. In exchange for the 60% equity interest in Entity A, Parent receives $18 million in cash. The fair value of the retained 40% investment is $12 million, which will become the initial measurement for that investment.

The gain on the sale is calculated as follows:

**Measurement under ASU 2017-05**

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<th>Description</th>
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</thead>
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</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Carrying amount of Entity A’s net assets</td>
<td>15</td>
</tr>
<tr>
<td>Gain</td>
<td>$15</td>
</tr>
</tbody>
</table>

**Measurement under current guidance – ASC 360-20**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash proceeds</td>
<td>$ 18</td>
</tr>
<tr>
<td>Carrying amount of retained interest*</td>
<td>6</td>
</tr>
<tr>
<td>Gain</td>
<td>24</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Carrying amount of Entity A’s net assets</td>
<td>15</td>
</tr>
<tr>
<td>Gain</td>
<td>$ 9</td>
</tr>
</tbody>
</table>

* $15 million carrying value x 40% retained interest

Other sales to equity method investees and joint ventures

In some transactions, an entity sells a nonfinancial asset to its joint venture or equity method investee for cash or other assets (i.e., a downstream transaction). To be consistent with its decisions on partial sales and with the accounting for a sale of a business to an entity method investee or joint venture, the FASB decided that all transactions in the scope of ASC 610-20 (including sales to equity method investees or joint ventures) will result in a full gain or loss. That is, the ASU amended ASC 323 \(^{30}\) and ASC 970-323 \(^{31}\) so that there will be no intra-entity profit elimination in a downstream transaction if the sale is in the scope of ASC 610-20.
That will be a change from today's guidance in ASC 323, which requires elimination of intra-entity profits and losses on most sales of nonfinancial assets to equity method investees or joint ventures until they are realized by the investor or investee in transactions with third parties.

The ASU does not affect intra-entity profits or losses for transactions with equity method investees or joint ventures that are in the scope of ASC 606. That is, if the asset being sold is an output of an entity's ordinary activities, an investor or investee will continue to eliminate profit from intra-entity transactions until that profit is realized in a transaction with third parties. Entities also will continue to eliminate profit from upstream transactions (i.e., when the investee sells an asset to the investor) until that profit is realized.

**Illustration 10 – Intra-entity transaction (downstream)**

Investor A has a 30% equity method investment in Investee B. Investor A sells intellectual property to Investee B for $400 on 1 January 20X1 instead of licensing it. At the sale date, the intellectual property had a cost basis of $300. Investee B uses the intellectual property, which has a useful life of 10 years.

Investee B is not a customer as defined in ASC 606 because selling the intellectual property is not an output of Investor A’s ordinary activities, and the intellectual property is not a business under ASU 2017-01. As a result, Parent concludes that the transaction is in the scope of ASC 610-20. On the transaction closing date, Investor A determines it does not have a controlling financial interest in Investee B. Further, Investor A determines that Investee B has control of the nonfinancial asset under ASC 606. Therefore, Investor A derecognizes the intellectual property under the new guidance.

**Measurement under ASU 2017-05**

Since the transaction is in the scope of ASC 610-20, Investor A would recognize a gain of $100 ($400 - $300) on 1 January 20X1.

Subsequently, Investor A would recognize its proportionate share of the amortization over the 10-year useful life of the intellectual property. That is, Investor A would not adjust its equity method earnings for this intra-entity sale:

<table>
<thead>
<tr>
<th></th>
<th>Investee B's book value</th>
<th>Investor A's share (30%)</th>
<th>Intra-entity profit elimination</th>
<th>Investor A’s basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 January 20X1</td>
<td>400</td>
<td>120</td>
<td>-</td>
<td>120</td>
</tr>
<tr>
<td>Amortization (20X1)</td>
<td>(40)</td>
<td>(12)</td>
<td>-</td>
<td>(12)</td>
</tr>
<tr>
<td>31 December 201X1</td>
<td>360</td>
<td>108</td>
<td>-</td>
<td>108</td>
</tr>
</tbody>
</table>

**Measurement before adopting ASU 2017-05**

Since Investee B recognizes the intellectual property on its balance sheet, Investor A eliminates its intra-entity portion of the profit of $30 ($100 income x 30% interest in Investee B) with a corresponding decrease to its equity method investment. Thus, Investor A recognizes a gain of $70 on 1 January 20X1.

Investor A recognizes the $30 over the 10-year useful life of the intellectual property. Each year starting in 20X1, Investor A would recognize equity method earnings and increase its equity method investment by $3, which effectively adjusts Investor A’s share of the amortization recognized by Investee B. This concept is further illustrated below:

<table>
<thead>
<tr>
<th></th>
<th>Investee B's book value</th>
<th>Investor A’s share (30%)</th>
<th>Intra-entity profit elimination</th>
<th>Investor A’s basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 January 20X1</td>
<td>400</td>
<td>120</td>
<td>(30)</td>
<td>90</td>
</tr>
<tr>
<td>Amortization (20X1)</td>
<td>(40)</td>
<td>(12)</td>
<td>3</td>
<td>(9)</td>
</tr>
<tr>
<td>31 December 201X1</td>
<td>360</td>
<td>108</td>
<td>(27)</td>
<td>81</td>
</tr>
</tbody>
</table>
How we see it

The determination of whether an asset being sold to an equity method investee is an output of the entity's activities will be more significant than it is today for sales to equity method investees and joint ventures, because it will determine whether intra-entity profits are eliminated.

Recognizing profit from these transactions will result in higher carrying amounts of equity method investments than under current guidance. This might increase the potential for an equity method investment to be evaluated for other-than-temporary impairment more frequently.

Presentation and disclosure

The presentation and disclosure guidance in ASC 610-20 refers to certain requirements in ASC 360 and ASC 606.

Under ASC 360-10-45-5, a gain or loss recognized on the sale of a long-lived asset (disposal group) that does not qualify as a discontinued operation is included in income from continuing operations before income taxes in the income statement. If a subtotal such as income from operations is presented, it includes a gain or loss recognized upon the sale of a long-lived asset (disposal group) that does not qualify as a discontinued operation.

ASC 360-10-50-3 also requires disclosures for disposals of long-lived assets (disposal group), which include:

- The facts and circumstances leading to the disposal
- The gain or loss recognized
- If not separately presented on the face of the income statement, the caption that includes that gain or loss

ASC 360-10-50-3A requires disclosures for the disposal of individually significant components that do not qualify as discontinued operations.

ASC 610-20 refers to the guidance in ASC 606 on the presentation of a contract asset or a contract liability. That is, if the seller receives consideration before transferring control of the asset, it will recognize a contract liability. If the seller transfers control of a nonfinancial asset or in substance nonfinancial asset before the consideration is received, it will recognize a contract asset. See Section 10.1 of our FRD, Revenue from contracts with customers (ASC 606), for further discussion of contract assets and contract liabilities.

Effective date and transition

ASU 2017-05 has the same effective date as the new revenue standard. That is, it is effective for public entities (as defined) for annual reporting periods beginning after 15 December 2017 (2018 for calendar-year public entities) and interim periods therein. It is effective for nonpublic entities for annual reporting periods beginning after 15 December 2018, and interim periods within annual reporting periods beginning after 15 December 2019. All entities can early adopt the guidance as of fiscal years beginning after 15 December 2016, including interim periods therein. ASC 606 and ASC 610-20 must be adopted concurrently.

Entities may use either a full or modified retrospective approach to adopt the guidance in ASC 610-20, as they can in ASC 606. However, an entity will not have to apply the same transition method for transactions with customers (i.e., those in the scope of ASC 606) and
noncustomers (i.e., those in the scope of ASC 610-20). The FASB said\(^\text{32}\) that, because transactions in the scope of ASC 610-20 generally are nonrecurring, it may not be important to users of the financial statements that the reporting for these transactions be comparable with that of other transactions in all annual periods. As a result, an entity could use a full retrospective approach for transactions with customers in the scope of ASC 606 and a modified retrospective approach for transactions with noncustomers in the scope of ASC 610-20. An entity also may apply different practical expedients to each type of contract.

**How we see it**

Regardless of the transition method they select, many entities will have to apply the guidance to contracts they entered into in prior periods. The population of contracts will likely be larger under the full retrospective method; however, under the modified retrospective method, entities will at a minimum apply the guidance to all contracts that are not complete as of the initial application date. A contract may not be considered complete if it includes contingent consideration and all (or substantially all) of the consideration was not recognized before the date of initial application of this ASU. Refer to Section 1.3 of our FRD, *Revenue from contracts with customers (ASC 606)*, for further guidance on transition.

While the new guidance on the definition of a business requires prospective application for business combinations, entities will use it when applying ASC 610-20, even if it means applying ASU 2017-01 retrospectively to the sale of a nonfinancial asset. Therefore, an entity may use a different definition of a business to account for acquisitions than for disposals depending on the adoption date and method selected for each ASU.

To reduce cost and complexity of applying the ASU, the Board decided that if an entity concludes that a transaction previously recorded as the disposal of a business involved a set of assets that would not meet the new definition of a business, it should not reinstate amounts previously allocated to goodwill associated with that disposal. This will prevent entities from having to retrospectively test for goodwill impairment.

**Endnotes:**

1. ASC 610-20, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets*.
2. ASU 2017-05, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*.
3. ASC 606, *Revenue from Contracts with Customers*.
4. ASC 845, *Nonmonetary Transactions*.
5. ASC 350, *Intangibles – Goodwill and Other*.
6. ASC 360, *Property, Plant and Equipment*.
7. ASC 810, *Consolidation*.
8. The ASU does not change the existing scope exception in ASC 810 for conveyances of oil and gas mineral rights. These conveyances continue to be accounted for under ASC 932.
9. ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*.
13. ASC 842, *Leases*.
15. ASC 932-360, *Extractive Activities – Oil and Gas – Property, Plant and Equipment*.
16. ASC 860, *Transfers and Servicing*.
18. ASC 720-25, *Other Expenses – Contributions Made*. 
A closer look at the guidance on derecognition of nonfinancial assets and in substance nonfinancial assets 1 May 2017

19 ASC 958-605, Not-for-Profit Entities – Revenue Recognition.
20 ASC 932,Extractive Activities – Oil and Gas.
22 ASU 2016-02, Leases (Topic 842).
23 ASC 310, Receivables.
24 ASC 470, Debt.
25 ASC 405, Liabilities.
26 Paragraph BC41 of ASU 2017-05.
27 Paragraph BC34 of ASU 2017-05.
28 Paragraph BC35 of ASU 2017-05.
29 Paragraph BC63 of ASU 2017-05.
30 ASC 323, Investments – Equity Method and Joint Ventures.
31 ASC 970-323, Real Estate – General – Investments – Equity Method and Joint Ventures.
32 Paragraph BC73 of ASU 2017-05.
Appendix

Is the counterparty a customer? (ASC 610-20-15-4(a))
Yes → Apply ASC 606.

Is the transaction the transfer of a business or nonprofit activity? (ASC 610-20-15-4(b))
Yes → Apply ASC 810-10.1

Is the transaction in the scope of ASC 860? (ASC 610-20-15-4(e))
No → Apply ASC 810-10-40-3A to remaining subsidiaries. Separate remaining parts, if any, and apply relevant US GAAP to each asset (e.g., ASC 610-20) and liability.
Yes → Apply other US GAAP.

Are all the assets promised in the contract nonfinancial assets and in substance nonfinancial assets?
Yes → Apply ASC 610-20.

Is the transaction the transfer of an ownership interest in one or more subsidiaries?
Yes → Apply ASC 610-20 to subsidiaries that comprise nonfinancial assets or in substance nonfinancial assets.3 Apply ASC 810-10-40-3A to remaining subsidiaries. Separate remaining parts, if any, and apply relevant US GAAP to each asset (e.g., ASC 610-20) and liability.

1 Any conveyance of an oil and gas mineral right that is accounted for under ASC 932-360-40 is outside the scope of ASC 810’s derecognition provisions.
2 Sales of equity method investments, even if those investees only hold nonfinancial assets, such as real estate, are accounted for under ASC 860, unless a scope exception applies.
3 The evaluation of the presence of in substance nonfinancial assets will be performed at the subsidiary level (i.e., the entity will determine whether substantially all of the fair value of the assets of each subsidiary is concentrated in nonfinancial assets).