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No. US2017-06
February 24, 2017

FASB changes how to derecognize nonfinancial assets

At a glance

New guidance clarifies what constitutes an "in substance nonfinancial asset" and changes the accounting for partial sales of nonfinancial assets to be more consistent with the accounting for a sale of a business.

What happened?

ASC 610-20 was issued as part of the new revenue standard. While the revenue standard primarily focuses on contracts with customers, ASC 610-20 was added to provide guidance for recognizing gains and losses from the transfer of nonfinancial assets in contracts with non-customers. The guidance issued by the FASB on February 22, 2017[1] clarifies when and how to apply ASC 610-20, in certain situations. The new guidance:

- Defines "in substance nonfinancial asset"
- Unifies guidance related to partial sales of nonfinancial assets
- Eliminates rules specifically addressing sales of real estate
- Removes exceptions to the financial asset derecognition model
- Clarifies the accounting for contributions of nonfinancial assets to joint ventures

Clarified scope

The new guidance clarifies that ASC 610-20 applies to the derecognition of nonfinancial assets and in substance nonfinancial assets unless other specific guidance applies. As a result, it will not apply to the derecognition of businesses, nonprofit activities, or financial assets (including equity method investments), or to revenue transactions (contracts with customers). The new guidance also clarifies that an in substance nonfinancial asset is an asset or group of assets for which substantially all of the fair value consists of nonfinancial assets and the group or subsidiary is not a business.

In addition, transfers of nonfinancial assets to another entity in exchange for a noncontrolling ownership interest in that entity will be accounted for under ASC 610-20, removing specific guidance on such partial exchanges from ASC 845, *Nonmonetary Transactions*.

As a result of the new guidance, the guidance specific to real estate sales in ASC 360-20 will be eliminated. As such, sales and partial sales of real estate assets will now be subject to the same derecognition model as all other nonfinancial assets.

Changes to accounting for partial sales

The new guidance will also impact the accounting for partial sales of nonfinancial assets (including in substance real estate). When an entity transfers its controlling interest in a nonfinancial asset, but retains a noncontrolling ownership interest, the entity will measure the retained interest at fair value. This is similar to the guidance on the sale of

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[1] Accounting Standards Update 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*

controlling interests in businesses. This will result in full gain/loss recognition upon the sale of a controlling interest in a nonfinancial asset. Current guidance generally prohibits gain recognition on the retained interest.

Transition

The amendments to the nonfinancial asset guidance are effective at the same time an entity adopts the new revenue guidance. Therefore, for public business entities (PBEs) with calendar year ends, the standard is effective on January 1, 2018. All other entities have an additional year to adopt the guidance. Early adoption is permitted beginning January 1, 2017 for calendar year end companies. While the timing of adoption needs to coincide with the adoption of the revenue standard, the transition method does not have to be the same. Transition can use either the full retrospective approach (i.e., applied to prior periods currently being presented) or the modified retrospective approach.

Why is this important?

The new guidance clarifies the application of the guidance in the revenue standard for the derecognition of nonfinancial assets, which will improve consistency. The new guidance is expected to impact all industries, but may particularly impact the real estate sector due to the elimination of the specific sales model for real estate and the requirement to recognize a full gain upon partial sales of real estate. While the accounting by joint ventures has not changed, entities contributing assets to joint ventures may also be impacted by the new guidance. In addition, given the FASB's recently revised definition of a business, more transactions will likely be treated as dispositions of nonfinancial assets (rather than dispositions of a business), which will increase the number of transactions subject to the new guidance.

What's next?

The new guidance is the second phase of a broader project. The first phase was completed in January 2017 with the release of ASU 2017-01, *Clarifying the Definition of a Business*. In the third phase, the FASB may revisit some of the remaining accounting differences between asset and business acquisitions and disposals.

Questions?

PwC clients who have questions about this *In brief* should contact their engagement team. Engagement teams who have questions should contact the National Professional Services Group.

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