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FASB — final guidance

Applying the new revenue recognition standard to sales of real estate

In this issue:

What you need to know

- Entities will apply the new revenue recognition standard to revenues from sales of real estate to customers.
- When it issued the new standard, the FASB amended other parts of the ASC to address the accounting for the sale of certain nonfinancial assets, including real estate, to noncustomers.
- Entities will need to apply the recognition and measurement principles in the new standard (including estimating variable consideration) to account for gains or losses resulting from the sale of real estate to noncustomers.
- Entities that sell real estate will generally recognize a gain or loss when they transfer control of a property. They will no longer have to apply the prescriptive real estate sales criteria, including evaluation of the buyer's initial and continuing investments and the seller's continuing involvement with the property.

Overview

As part of Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, the Financial Accounting Standards Board (FASB) issued consequential amendments to other sections of the Accounting Standards Codification (ASC or Codification) that will require entities to change how they account for sales of real estate. These amendments include the elimination of existing guidance in ASC 360-20, *Real Estate Sales*, and the addition of ASC 610-20, *Other Income — Gains and Losses from the Derecognition of Nonfinancial Assets*.

Building a better working world

Revenues from sales of real estate to customers (i.e., sales that are part of the seller's ordinary activities) will be recognized using the guidance in ASC 606, *Revenue from Contracts with Customers*. However, entities that sell real estate assets to noncustomers[1] will generally account for these transactions using the guidance in ASC 610-20, which directs entities to apply certain control and measurement principles of ASC 606. These new standards will only be applied by sellers of real estate; purchasers will continue to use existing guidance (e.g., ASC 360-10, *Property, Plant, and Equipment* or ASC 805, *Business Combinations)*.

The elimination of today's guidance for sales of real estate in ASC 360-20 will be a major change for all real estate entities. ASC 360-20 is a complex, rules-based standard that requires entities to evaluate both the form and economic substance of a transaction. For some transactions, the application of ASC 360-20 results in the deferral of sale and/or profit recognition when certain criteria are not met.

The new guidance in ASC 606 and ASC 610-20 replaces the prescriptive literature in ASC 360-20 with a principles-based approach that will require entities to make a number of judgments and estimates. Under the new guidance, entities will generally recognize the sale, and any associated gain or loss, of a real estate property when control of the property transfers.

This publication discusses the implications of applying the recognition and measurement principles of ASC 606 and ASC 610-20 to sales of real estate. Throughout this publication, we compare the accounting for several common real estate sale transactions under the new guidance with the accounting under today's guidance in ASC 360-20.

In our discussion and in many of our examples, we use terminology from ASC 360-20 because the new standard does not describe specific real estate sales transactions. Our use of these terms is intended to help you compare the new guidance with today's guidance. By using these terms, we are not suggesting that entities should continue to use the guidance in ASC 360-20 or analogize to it to account for the sale of real estate once the new standard is effective.

In addition, any conclusions we reached in our examples are based on the facts we described and are subject to change. All arrangements will need to be carefully evaluated under the new guidance, based on the facts and circumstances.

This publication supplements our general Technical Line publication on the new standard and the other real estate industry Technical Line publications we have released. It should be read in conjunction with the following materials:

- *A closer look at the new revenue recognition standard* (SCORE No. BB2771)
- *The new revenue recognition standard — real estate* (SCORE No. BB2811)
- *Gains and losses from the derecognition of nonfinancial assets* (SCORE No. BB3021)

Summary of the new guidance

The new guidance in ASC 606 and ASC 610-20 outlines the principles an entity must apply to measure and recognize revenue and the related cash flows. The core principle is that an entity will recognize revenue at an amount that reflects the consideration it expects to be entitled to in exchange for transferring goods or services to a customer.

The prescriptive guidance in ASC 360-20 for evaluating a buyer's initial and continuing investment has been replaced with a collectibility assessment in ASC 606.

The new revenue standard (ASC 606) will be applied using the following five-step model:

Step 1: Identify the contract(s) with a customer

An entity must first identify the contract, or contracts, to provide goods and services to customers. These contracts may be written, oral or implied by the entity's customary business practice but must be legally enforceable and meet specified criteria. That is, the contract must be approved by all parties, and they must be committed to performing their respective obligations, the entity must be able to identify each party's rights regarding goods and services to be transferred and the associated payment terms, the contract must have commercial substance, and the entity needs to conclude it is probable that it will collect the consideration to which it will be entitled for transferring the goods or services to the customer.

Entities will need to consider the laws of their respective jurisdictions (e.g., United States Uniform Commercial Code, state and local real property laws) when determining whether a contract is legally enforceable. In the US, in nearly all real estate arrangements, a signed, written contract specifies the asset to be transferred or management services to be provided in exchange for a defined payment. This generally will result in a straightforward assessment of most of the contract criteria in the standard. The assessment may be different when evaluating transactions that occur in countries outside of the US.

However, the collectibility criterion may require careful consideration. When assessing collectibility, an entity must conclude that it is probable that it will collect the transaction price. The transaction price is the amount to which the entity expects to be entitled in exchange for the goods or services that will be transferred to the customer, which may be different from the stated contract price.

The transaction price may be less than the stated contract price if an entity concludes that it has offered or is willing to accept a price concession or other discount. Such concessions or discounts are forms of variable consideration (see Step 3: Determine the transaction price section below for further discussion) that an entity would estimate at contract inception and reduce from the contract price to derive the transaction price. The estimated transaction price would then be evaluated for collectibility. The following table illustrates these concepts:

Stated contract price	$ 2,000,000
Price concession - amount entity estimates it will offer (explicitly) or accept (implicitly) as a reduction to the contract price, unrelated to credit risk	($200,000)
Transaction price (assessed for collectibility)	$ 1,800,000

In assessing collectibility, the term "probable" is defined as when "the future event or events are likely to occur." This is consistent with the existing definition in US GAAP. An entity should consider the buyer's intent and ability to pay the amount of consideration when it is due in evaluating whether collectibility of the transaction price is probable.

In many circumstances, an entity may not be willing to accept less than the contract price (i.e., offer a price concession) but is willing to accept the risk of default by the customer of contractually agreed-upon consideration (i.e., credit risk). In these circumstances, the transaction price would not differ from the contract price, and this amount would be evaluated to determine if collection is probable.

How we see it

Entities that sell real estate and provide financing to the buyer may find that more judgment is required to evaluate the collectibility of the transaction price. These entities may be used to applying the strict quantitative criteria in ASC 360-20 for determining whether a buyer's initial and continuing investment is sufficient to allow for sale and profit recognition. This guidance will be eliminated, and there is little guidance in the new standard to help entities evaluate collectibility.[2] Therefore, this assessment may be difficult and necessitate that entities develop new processes and controls to evaluate some arrangements, including those in which the seller provides financing to the buyer.

When seller financing is provided, we believe that entities will need to consider a variety of factors when evaluating collectibility of the transaction price. Those factors may include analysis of commercially available lending terms for similar transactions, down payment sufficiency, projected cash flows of the property, borrower creditworthiness, experience and expertise of the buyer's management team and historical experience of the seller in similar transactions.

Step 2: Identify the performance obligations in the contract

The new revenue standard requires an entity to identify at contract inception all promised goods and services and determine which of these promised goods or services (or bundle of goods and services) represent performance obligations. Promised goods and services represent a performance obligation if (1) the goods or services are distinct (by themselves or as part of a bundle of goods and services) or (2) if the goods or services are part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. A promised good or service that is not distinct is combined with other goods or services until a distinct bundle is formed.

A good or service (or bundle of goods and services) is distinct when both of the following criteria are met:

- The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e., the good or service is capable of being distinct).
- The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e., the good or service is distinct within the context of the contract).

Goods or services that are part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer are required to be combined into one performance obligation. To meet the same pattern of transfer criterion, each distinct good or service in the series must be considered a performance obligation satisfied over time (discussed in Step 5), and an entity must use the same method to measure the progress of transferring each distinct good or service (e.g., time elapsed). Examples include repetitive services provided on an hourly or daily basis.

Step 3: Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to the customer and includes:

- An estimate of any variable consideration (e.g., amounts that vary due to discounts or bonuses) using either a probability-weighted expected value or the most likely amount, whichever better predicts the amount of consideration to which the entity will be entitled

- The effect of the time value of money, if there is a financing component that is significant to the contract
- The fair value of any noncash consideration
- The effect of any consideration payable to the customer, such as vouchers and coupons

The transaction price may be constrained because of variable consideration. That is, the standard limits the amount of variable consideration an entity can include in the transaction price to the amount for which it is probable that a significant revenue reversal will not occur when the related uncertainties are resolved. A significant reversal occurs when a change in the estimate results in a significant downward adjustment in the amount of cumulative revenue recognized from the contract with the customer. The transaction price is not adjusted for credit risk.

Step 4: Allocate the transaction price to performance obligations in a contract

An entity must allocate the transaction price to each performance obligation on a relative standalone selling price basis, with limited exceptions. One exception in the standard requires an entity to allocate a variable amount of consideration, together with any subsequent changes in that variable consideration, to one or more performance obligations or one or more (but not all) distinct goods or services promised in a series of goods or services that forms part of a single performance obligation, if specified criteria are met (i.e., terms of the variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service and the allocation of variable consideration is consistent with the objective of allocating the transaction price in an amount the entity expects to be entitled in exchange for transferring the promised goods or services to the customer).

When determining standalone selling prices, an entity must use observable information, if it is available. If standalone selling prices are not directly observable, an entity will need to use estimates based on reasonably available information. Example estimation approaches include an adjusted market assessment approach or an expected cost plus a margin approach.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

Under the new revenue standard, an entity has to determine at contract inception whether it will transfer control of a promised good or service over time. An entity transfers control of a good or service over time (rather than at a point in time) when any of the following criteria are met:

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- The entity's performance creates or enhances an asset (e.g., work in process) that the customer controls as the asset is created or enhanced.
- The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.

Customer simultaneously receives and consumes benefits as the entity performs

In developing their new revenue standards, the FASB and International Accounting Standards Board (IASB, together the Boards) intended for this criterion to address repetitive service contracts (e.g., cleaning services, transaction processing), therefore it is unlikely to be applied when a real estate asset is sold.

However, this criterion may be applicable to a management contract that is retained by the seller of a real estate property. Real estate entities that provide property management and other services will need to carefully evaluate their contracts to determine whether the services performed are simultaneously received and consumed by the customer (i.e., real estate owner). For further discussion of these and other topics affecting the real estate industry, refer to our Technical Line publication, *The new revenue recognition standard — real estate*.

Customer controls asset as it is created or enhanced

The Boards said[3] they believe the customer's control over the asset as it is being created or enhanced indicates that the entity's performance transfers goods or services to a customer over time. For example, in a construction contract in which an entity is building an asset on the customer's land, the customer generally controls any work in process resulting from the entity's performance.

For discussion of the application of this criterion to construction contracts, refer to our Technical Line publication, *The new revenue recognition standard — engineering and construction*.

Asset with no alternative use and right to payment

The Boards acknowledged[4] that the application of the first two criteria could be challenging in certain circumstances. For example, a developer may construct an asset but transfer title of the land and/or building to the customer only upon completion. As a result, a third criterion was added that, if both of the following requirements are met, will require entities to recognize revenue for a performance obligation over time:

- The entity's performance does not create an asset with alternative use to the entity.
- The entity has an enforceable right to payment for performance completed to date.

For further discussion of this criterion and its application to sales of real estate, refer to the section "Sales of real estate by real estate developers" below.

Control transferred at a point in time

Control is transferred at a point in time if none of the criteria for a good or service to be transferred over time is met. For sales of existing real estate properties, transfer of control will generally occur at a point in time.

The Boards included five indicators in ASC 606 for entities to consider when determining whether control of a promised asset has been transferred at a point in time. These indicators include consideration of whether the seller has a present right to payment for the property and whether title to, and physical possession of, the property has been transferred to the buyer.

Scope

ASC 606 applies to all contracts with customers (i.e., parties that have contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities), except for contracts that are specifically excluded from the scope, which include:

- Lease contracts within the scope of ASC 840, *Leases*
- Financial instruments and other contractual rights or obligations (e.g., receivables, debt and equity securities, derivatives)[5]
- Guarantees (other than product or service warranties) within the scope of ASC 460, *Guarantees*

- Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange within the scope of ASC 845, *Nonmonetary Transactions*

Entities may enter into transactions that are partially within the scope of the new revenue guidance and partially within the scope of other guidance. In these situations, the new guidance requires an entity to first apply any separation and/or measurement principles in the other guidance before applying the revenue standard.

For example, in certain transactions, the seller of a real estate property may agree to support the operations of the property for a period of time or provide a guarantee of the buyer's return on investment. Under today's guidance, because these guarantees either prevent the guarantor from being able to account for the transaction as a sale or recognize in earnings the profit from the sale, these "seller support" guarantees are excluded from the scope of ASC 460 and are instead accounted for using ASC 360-20.

Under the new standard, the presence of a guarantee does not, on its own, affect whether an entity can recognize a sale and the associated profit from the transfer of the property. Instead, the fair value of the guarantee will first be separated from the transaction price and recorded as a liability in accordance with ASC 460.[6] The remainder of the estimated arrangement consideration is allocated among the other elements in the arrangement (e.g., other performance obligations, including the transfer of the asset). The entity then evaluates whether the other performance obligations have been satisfied without considering the guarantee.

Sales of nonfinancial assets

The sale of real estate (i.e., a nonfinancial asset or in substance nonfinancial asset) could be within the scope of ASC 606, if the sale is to a customer, or ASC 610-20, if the sale is to a noncustomer. The new revenue guidance defines 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." The standard does not define the term "ordinary activities" because it was derived from existing guidance. CON 6[7] refers to ordinary activities as an entity's "ongoing major or central operations."

Nonfinancial assets, including real estate properties, are often sold in transactions that would not represent a contract with a customer because the sale of the asset is not an output of the entity's ordinary activities (e.g., the sale by an entity of its corporate headquarters building). If an entity sells a nonfinancial asset to a party that is a customer in other transactions (i.e., the party is purchasing goods or services from the entity that are the output of the entity's ordinary activities), the purchasing party will be considered a customer for the transactions involving the goods or services but not for the sale of the nonfinancial asset.

The FASB amended ASC 360-10 to help entities apply the appropriate guidance when derecognizing a nonfinancial asset (e.g., real estate) sold to a noncustomer. The amended guidance states that sales of nonfinancial assets, including in substance nonfinancial assets, should be accounted for using new guidance in ASC 610-20, unless the contract is with a customer. However, ASC 610-20 does not contain incremental guidance to ASC 606 but rather instructs entities to apply certain control and measurement guidance from ASC 606, including guidance related to:

- Evaluating the existence of a contract
- Measuring the consideration (i.e., determining the transaction price) in the contract
- Determining when control of the nonfinancial asset has transferred (i.e., when a performance obligation is satisfied)

Accounting for contracts that include the sale of a nonfinancial asset to a noncustomer or a customer generally will be consistent, except for financial statement presentation and disclosure. The Boards noted in the Basis for Conclusions[8] in the new standard that there is economically little difference between the sale of real estate that is, or is not, an output of the entity's ordinary activities and that the only difference in the accounting for these transactions should be the presentation in the statement of comprehensive income (i.e., revenue and expense when the sale is to a customer or gain or loss when the sale is to a noncustomer). Entities that sell nonfinancial assets to noncustomers will follow guidance in ASC 360-10 for presenting a gain or loss on the sale of a long-lived asset.

In certain circumstances, neither ASC 606 nor ASC 610-20 will be applied when derecognizing a nonfinancial asset. Instead, the sale of nonfinancial assets in a subsidiary or group of assets that meets all of the following requirements will be accounted for in accordance with the derecognition guidance in ASC 810, *Consolidation*:[9]

- The nonfinancial assets are not being sold to a customer (i.e., they are not outputs of the entity's ordinary activities).
- The nonfinancial assets in a subsidiary or group of assets meet the definition of a business.
- The nonfinancial assets in a subsidiary or group of assets are not in substance nonfinancial assets (e.g., because the group of assets or subsidiary also contains significant financial assets).
- No other scope exceptions in ASC 810-10 apply.

The following table summarizes the appropriate derecognition guidance to apply to common transactions involving real estate:

ASC topic	When applied?	Possible transactions
ASC 606, *Revenue from Contracts with Customers*	Sales to customers of real estate (i.e., nonfinancial assets or in substance nonfinancial assets, regardless of whether they also meet the definition of a "business")	Sales of residences by homebuilders and real estate developers
ASC 610-20, *Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets*	Sales to noncustomers of real estate (i.e., nonfinancial assets or in substance nonfinancial assets, regardless of whether they also meet the definition of a "business")	Sales of commercial properties (e.g., office buildings, hotels, manufacturing facilities) by REITs, real estate funds with historical cost reporting and non-real estate entities
ASC 810-10, *Consolidation - Overall*	Sale (deconsolidation) to noncustomers of real estate in a subsidiary or group of assets that constitutes a "business" that is not, in substance, a nonfinancial asset (e.g., group of assets comprised of both financial and nonfinancial assets)	Sales by any entity of an asset group including real estate that together are a "business" and are not considered in substance nonfinancial assets

How we see it

The FASB did not define an "in substance nonfinancial asset" in the consequential amendments. An entity that derecognizes a subsidiary or group of assets that meet the definition of a business will need to exercise significant judgment to determine whether the transaction also constitutes the transfer of an in substance nonfinancial asset that will be subject to the guidance in ASC 610-20 rather than ASC 810-10.

The FASB has a project[10] on its agenda to clarify the definition of a business. In subsequent phases of this project, the FASB also plans to clarify the accounting for the acquisition or disposal of in substance nonfinancial assets and provide guidance for partial sales. It's not clear whether or when the FASB will issue additional guidance.

Sale and leaseback transactions

While the FASB made it clear that ASC 360-20 should no longer be applied to sales and transfers of real estate, the guidance was retained on sale and leaseback transactions involving real estate that are within the scope of ASC 840-40, *Sale-Leaseback Transactions*. ASU 2014-09 included a number of consequential amendments that narrowed the scope of ASC 360-20, and the FASB stated[11] that entities should not analogize to the retained guidance when evaluating any transaction that is not a sale-leaseback.

Sales of real estate that qualify for full accrual profit recognition under ASC 360-20 will generally continue to meet the criteria for sale and associated profit recognition under the new guidance.

The FASB plans to issue new guidance on leases later this year, including new guidance for sale-leaseback transactions that will eventually replace the guidance in ASC 360-20 and ASC 840-40. Under the proposal, a seller-lessee would use the definition of a sale in ASC 606 to determine whether a sale has occurred in a sale and leaseback transaction (e.g., whether the buyer-lessor has gained control of the underlying asset). In addition, the new leases standard would eliminate existing guidance for sale and leaseback transactions specifically involving real estate. For further information about the forthcoming leases standard, refer to our Technical Line publication, *Final standard on leases is taking shape* (SCORE No. BB2952).

Nonmonetary transactions

The new revenue standard provides guidance for contracts with customers involving the exchange of nonmonetary consideration. As a result, the FASB excluded contracts that fall within the guidance of ASC 606 and ASC 610-20 from the scope of ASC 845. However, the FASB clarified that the exchange of a nonfinancial asset (including an in substance nonfinancial asset) for a noncontrolling ownership interest in the receiving entity will remain within the scope of ASC 845. In addition, the specific guidance in ASC 845 for exchanges of real estate involving monetary consideration will be eliminated.

Sales previously recognized using the full accrual method

ASC 360-20 provides the general principles that full profit on a real estate sale can be recognized if the profit is determinable and the earnings process is virtually complete. ASC 360-20 includes a number of criteria that describe how to determine whether these general principles are satisfied and the appropriate accounting to apply in circumstances in which the criteria are not met. These criteria in ASC 360-20 generally require an assessment of whether:

- The sale has been consummated.
- The buyer's initial and continuing investments demonstrate a commitment to pay for the property.
- The seller's receivable is not subject to future subordination.

- The seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property sold.

Recognition of the full profit when these criteria are satisfied is referred to as the "full accrual method." Many sales of real estate meet the criteria for full accrual profit recognition at the date of sale. For example, the criteria for full accrual recognition are generally satisfied if, upon the closing of a transaction, the buyer pays the full purchase price in cash, obtains title and possession of the property (including the risks and rewards of ownership), and the seller has no further involvement or obligation associated with the property. Even if the full purchase price is not paid in cash (e.g., the sale includes some form of non-subordinated seller financing) or the seller retains a non-prohibited form of continuing involvement, the full accrual criteria could be met if the sale has been consummated and the buyer's initial and continuing investments are sufficient.

It is likely that the timing of sale (and associated profit) recognition for transactions that qualify for full accrual profit recognition under ASC 360-20 will be consistent with the timing of sale (and associated profit) recognition for the same transactions under the new guidance. The new guidance provides that sales of nonfinancial assets (e.g., real estate) will be recognized when control of the asset transfers to the buyer, which will occur when the buyer has the ability to direct the use of, or obtain substantially all of the remaining benefits from, the asset. This will generally occur at the closing of the transaction. The following illustration compares full accrual profit recognition under ASC 360-20 to revenue/gain recognition under ASC 606/610-20.

Illustration 1: Sale recognized using full accrual method in ASC 360-20

An office building is sold for $1 million, and Seller A receives $1 million in cash ($150,000 directly from the buyer and $850,000 of proceeds from a secured first mortgage the buyer entered into with a third-party lender). Seller A is not contingently liable for the mortgage nor does it have any other risks related to the buyer's financing. Seller A transferred title and physical possession of the property to the buyer on the closing date of the transaction and has no continuing involvement with the property.

Future GAAP analysis (ASC 606/610-20):

Seller A determines that control of the building transfers at a point in time (rather than over time) and considers the indicators of control transfer, as well as any other relevant information. Seller A determines that the criteria to recognize revenue (i.e., gain on sale) have been met at closing because title and physical possession of the property were transferred to the buyer, and the contract specifies Seller A's right to payment (which has already been received in this transaction).

Current GAAP analysis (ASC 360-20):

Seller A received the full sales value of the property in cash, without any contingent liability on the debt incurred by the buyer or any other risk related to the buyer's financing. Therefore, the initial and continuing investment requirements are not applicable, and full profit recognition is appropriate assuming all other criteria for recognizing profit under the full accrual method (e.g., Seller A has no prohibited forms of continuing involvement) were satisfied.

Recognition when control of the property has not transferred

If an entity evaluates the indicators described above and concludes that control of the property has not transferred under ASC 606 or ASC 610-20, as applicable, a sale has not occurred and the asset is not derecognized. The entity records any consideration received as a contract liability (e.g., deposit liability), not as revenue/gain, until it concludes that the buyer has obtained control of the property. This accounting will be similar to the "deposit method" in today's guidance, which is applied when there is no consummation of a sale.

Sales for which initial or continuing investment criteria in ASC 360-20 are not met

Under ASC 360-20, collectibility of the sales price is demonstrated by the buyer's commitment to pay for the property. ASC 360-20 includes detailed guidance on evaluating whether the composition and size of the buyer's initial and continuing investments are adequate to demonstrate the buyer's commitment to pay for the property. When the initial or continuing investment tests are not met, the seller is required to defer profit at the sale date and recognize it in later periods using one of the alternative methods provided in ASC 360-20. In certain cases, a seller may determine that the buyer's investment is insufficient to recognize a sale and may instead apply the deposit method.

The new guidance eliminates all of the prescriptive requirements in ASC 360-20 for evaluating the buyer's initial and continuing investment and introduces new judgments that must be made regarding collectibility. The removal of the initial and continuing investment criteria may result in immediate recognition (i.e., gain on sale) for transactions for which gain deferral has been required under ASC 360-20.

Under the new guidance, however, a seller will still have to evaluate, at contract inception, whether it is probable that it will collect the consideration to which it expects to be entitled. The standard also says that entities should assess both the customer's intent and ability (i.e., capacity) to pay the amount to which the entity will be entitled. In some circumstances, the amount of consideration to which an entity will be entitled may be less than the price stated in the contract because the entity might provide a price concession to the customer. Such concessions or discounts are forms of variable consideration that an entity would estimate at contract inception and deduct from the contract price to determine the transaction price. Significant judgment will be required to determine whether an entity's expectation that it will receive less than the stated contract price indicates that the contract amount is not probable of collection or represents a price concession. Refer above to "Summary of the new guidance" section for further discussion of price concessions.

If it is not probable that the entity will collect the transaction price, the arrangement would not be considered a contract under the new guidance until the concerns about collectibility are resolved (i.e., becomes probable the transaction price will be collected). If the entity subsequently determines that the transaction price is probable of collection, the arrangement will then be recognized under the new guidance. Entities will apply similar judgments to those at contract inception (e.g., all parties have approved the contract, payment terms have been identified) when subsequently determining that the transaction price is probable of collection.

The new guidance addresses situations in which an arrangement does not meet the contract criteria (e.g., an entity determines that it is not probable that it will collect the transaction price). In certain circumstances, an entity may receive consideration from a customer (e.g., a down payment) before the contract criteria have been satisfied. When an arrangement doesn't meet the criteria to be accounted for as a contract, any consideration received from the customer is initially accounted for as a liability (not revenue/gain on sale), and assets transferred to the customer are not derecognized. This accounting is required even if the "deposit" exceeds the seller's carrying value of the property (unless one of the criteria noted below is met). The liability is measured at the amount of consideration received from the customer. This approach is similar to the deposit method prescribed in ASC 360-20.

An entity may only recognize consideration received as revenue/gain on sale when it subsequently determines that the agreement meets the criteria of a contract under the new guidance or when either of the following occurs:

- The entity has no remaining obligations to transfer goods or services to the customer, and all, or substantially all, of the consideration promised by the customer has been received by the entity and is nonrefundable.
- The contract has been terminated, and the consideration received from the customer is nonrefundable.

The following illustrates a transaction accounted for under the new standard for which the seller determines at sale closing that the transaction price is not collectible (Illustration 2). Based on changes in the borrower's ability to pay, the seller determines that collectibility is probable in a later period (Illustration 3). In addition, Illustration 2 reflects considerations for determining whether a contract is in the scope of ASC 606 or ASC 610-20.

Illustration 2: Seller financing with collectibility concerns at sale closing
Seller R owns and leases commercial real estate and, on occasion, will dispose of a property that no longer fits its operating or capital strategy. Seller R decides to sell an office building with a carrying value of $800,000 through the sale of its interest in a wholly owned subsidiary. The office building is the sole asset of the subsidiary. Seller R agrees to sell its 100% interest in the legal entity to another real estate operator, Buyer W, for $1,000,000, consisting of $50,000 of cash (paid up front and nonrefundable) and a 10-year nonrecourse first mortgage from Buyer W for $950,000. Substantially all of the office building is leased at acquisition. Because the seller provided nonrecourse financing, cash flows from operation of the property will be primarily relied upon to service the mortgage. The leases of the largest two tenants in the building expire within the next two years and there is significant uncertainty regarding Buyer W's ability to replace them with new tenants willing to pay comparable rents; therefore, there is uncertainty whether the property will continue to generate the cash flows necessary to service the mortgage. However, Seller R has attempted to dispose of this office building for several years and is willing to accept the risk of this contract since it has the ability to repossess the property, if necessary. The terms of the contract include required principal payments of $100,000 per year beginning in the second year of the contract, a $150,000 balloon payment at the end of the contract, and interest at a rate of 12% (which reflects the current market conditions and credit characteristics of Buyer W). For purposes of this example, we have ignored the accounting for the interest component. *Analysis:* Seller R determines that the transaction is not with a customer because the sale is not part of Seller R's normal business activities of operating and leasing commercial real estate. Therefore, the transaction is outside the scope of ASC 606. Seller R determines that it should apply ASC 610-20 because it has sold an in substance nonfinancial asset to a noncustomer (i.e., it transferred to Buyer W its 100% interest in a legal entity that held substantially only nonfinancial assets (i.e., an office building)). While the presence of in-place leases would likely have resulted in a conclusion by Seller R that the building was also a business, ASC 610-20 is applied to all sales of in substance nonfinancial assets, regardless of whether the asset sold also constitutes a business.

As a result of the uncertainty about whether the property will generate the cash flow necessary to service the mortgage, Seller R determines at contract inception that collection of the transaction price is not probable. Therefore, the remaining applicable aspects of ASC 606 (i.e., the measurement and derecognition principles) cannot be applied to the arrangement until Seller R is able to conclude that collectibility of the transaction price is probable. Seller R must account for the receipt of the $50,000 non-refundable down payment as a liability and does not derecognize the office building or record a mortgage receivable. Seller R also continues to recognize depreciation of the asset (assumed to be $25,000 per year for purposes of the example).

Dr. Cash	$	50,000		
Cr. Deposit liability			$	50,000
Dr. Depreciation expense	$	25,000		
Cr. Accumulated depreciation			$	25,000

Illustration 3: Subsequent evaluation of collectibility

Following Illustration 2, Seller R continues to assess the contract to determine whether the transaction price is probable of collection. In the second year of the arrangement, Seller R receives a principal payment of $100,000 but continues to believe that collectibility of the remaining balance is not probable because Buyer W has yet to execute new leases for the space that will become available in the near term. As a result, Seller R records the $100,000 payment received as a deposit liability and continues to recognize depreciation of the asset. For purposes of this example, we have again ignored the accounting for the interest component.

In the third year of the arrangement, Seller R receives a $100,000 principal payment and Buyer W has recently entered into new long-term leases with the two largest tenants in the office building.

Analysis: Based on the change in Buyer W's circumstances, in Year 3, Seller R determines that Buyer W has the intent and ability to pay the full amount due and that it is now probable that it will collect the unpaid portion of the transaction price (i.e., the outstanding mortgage receivable). Seller R also determines that control transferred at a point in time (e.g., title to the asset previously transferred when the ownership of the entity owning the real estate was transferred and the buyer has physical possession). Seller R therefore derecognizes the property and recognizes gain on sale and a mortgage receivable for cash consideration that remains outstanding.

Dr. Cash	$	100,000		
Dr. Mortgage receivable	$	750,000		
Dr. Deposit liability	$	150,000		
Cr. Building, net			$	750,000
Cr. Gain on Sale			$	250,000

Note: The mortgage receivable of $750,000 is calculated by subtracting cash payments received from the total selling price ($1,000,000 less the down payment of $50,000 and two subsequent payments of $100,000 each). The gain on sale of $250,000 is calculated by subtracting the carrying value of the asset transferred from the total sales price ($1,000,000 less carrying amount of $750,000, which is comprised of the initial carrying value of $800,000 net of two years of depreciation of $25,000 each).

Accounting under current GAAP (ASC 360-20)

The transaction in these illustrations would not have initially met the initial investment criteria in ASC 360-20. Assuming the sale was consummated, the down payment was not in substance an option, recovery of the cost of the property was reasonably assured and the seller retained no form of prohibited continuing involvement, a sale would have been recognized on the closing date. However, profit would have been recognized using the installment or cost recovery method until the initial and continuing investment criteria were satisfied.

Sales with forms of continuing involvement

Under ASC 360-20, a seller generally cannot recognize profit on the sale of real estate under the full accrual method if it retains continuing involvement in the property without transferring substantially all of the risks and rewards of ownership. ASC 360-20 provides detailed guidance on how to consider the various forms of continuing involvement a seller may have with a property after it has been sold and requires the use of alternative accounting methods (e.g., financing, leasing, performance-of-services, profit-sharing methods) in certain circumstances, based on the nature and extent of the continuing involvement.

The concept of continuing involvement is not a specific consideration in the new guidance. Under the new guidance, a seller focuses on the transfer of control of the property to determine when the performance obligation is satisfied and associated revenue (i.e., gain on sale) or loss is recognized. In addition, an entity will assess whether any aspects of a contract (including those that result in continuing involvement under today's guidance) either represent a separate performance obligation or affect whether control of the real estate has transferred to the buyer. However, activities that were considered continuing involvement under ASC 360-20 may affect whether control transfers or whether an additional distinct promised good or service is present other than the sale of real estate.

Unlike today's guidance, future consideration from a real estate sale may be recognized when control of the property transfers.

The following sections describe a few of the common forms of continuing involvement under ASC 360-20 and compare today's accounting for these transactions to the accounting under the new model in ASC 606 and ASC 610-20.

Seller participates in future profit

In some real estate sales arrangements, the seller participates in future profits (e.g., from the property's operating profits or residual values) without further obligation or risk of loss, in addition to receiving fixed consideration from the sale of the property.

Under today's guidance, a seller may recognize profit from the fixed consideration if all other criteria for full accrual profit recognition in ASC 360-20 have been met. However, any future profit participation is recognized only when those amounts are realized.

Under the new guidance, amounts from future profit participation will represent variable consideration that a seller will need to estimate at contract inception and include in the transaction price when it is "probable" that a significant revenue reversal will not occur when the uncertainties related to the variability are resolved. An entity is required to estimate variable consideration using either the "expected value" approach (i.e., the sum of probability-weighted amounts) or the "most likely amount" approach (i.e., the single most likely outcome), whichever better predicts the amount of consideration to which it will be entitled. That is, the method selected is not meant to be a "free choice." The entity should apply the selected method consistently throughout the contract and update the estimated transaction price at each reporting date.

The Boards indicated[12] that the "most likely amount" approach may be the better predictor when the entity expects to be entitled to only one of two possible amounts (e.g., a contract in which an entity is entitled to receive all or none of a specified performance bonus but not a portion of that bonus). The following provides an illustration of how a real estate entity would estimate variable consideration resulting from future profit participation from a sale of real estate under the new standard.

Illustration 4: Estimating variable consideration

Developer D sells a newly constructed commercial property with a cost basis of $1.9 million for $2.0 million, plus a right to receive 5% of future operating profit from the property for the first year. Developer D has no additional ongoing performance obligations. Developer D determines there are a number of possible outcomes of consideration to be received based on the performance of the property (e.g., the buyer's ability to effectively secure tenants for the entire property at favorable rental rates). The buyer currently has executed leases or letters of intent from prospective tenants for 50% of the property.

Analysis: Developer D determines that the "expected value" approach is the better predictor of the variable consideration since multiple outcomes are possible.

Based on the buyer's current pre-leasing, Developer D estimates the following future profit participation:

Future profit	Probability
$ 50,000	10%
$ 25,000	70%
$ 0	20%

Assume for purposes of this illustration that the constraint, discussed further below, does not limit the amount that can be included in the transaction price at contract inception (i.e., assume it is probable that a significant revenue reversal will not occur). Using a probability-weighted estimate, Developer D would include $22,500 [($50,000 x 10%) + ($25,000 x 70%) + ($0 x 20%)] in the transaction price associated with this variable consideration. That is, the transaction price would be $2,022,500.

Developer D updates its estimate of the transaction price at the next reporting date, and after considering that the buyer now has letters of intent or executed leases for 75% of the property, determines it is now 75% likely to receive future profit participation of $50,000 and 25% likely to receive $25,000. As a result, Developer D's estimate of variable consideration is updated to $43,750 [($50,000 x 75%) + ($25,000 x 25%)] and additional revenue (i.e., gain on sale) of $21,250 ($2,043,750 — $2,022,500) is recognized.

To include variable consideration in the estimated transaction price, the entity has to first conclude that it is "probable" that a significant revenue reversal will not occur when the uncertainties related to the variability are resolved. For purposes of this analysis, "probable" is defined as "the future event or events are likely to occur," consistent with the existing definition in US GAAP. The Boards provided factors that may indicate that revenue is subject to a significant reversal:

- The amount of consideration is highly susceptible to factors outside the entity's influence (e.g., market volatility, judgment or actions of third parties, weather conditions).
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.

- The entity's experience (or other evidence) with similar types of contracts is limited or that experience (or other evidence) has limited predictive value.
- The entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- The contract has a large number and broad range of possible consideration amounts.

The indicators provided by the Boards are not meant to be an all-inclusive list, and entities may note additional factors that are relevant in their evaluations. In addition, the presence of any one of these indicators does not necessarily mean that it is probable that a change in the estimate of variable consideration will result in a significant revenue reversal.

When an entity is unable to conclude that it is probable that a change in the estimate of variable consideration that *would* result in a significant revenue reversal will not occur, the amount of variable consideration is limited. In addition, when an arrangement includes variable consideration, an entity should update both its estimate of the transaction price and its evaluation of the constraint throughout the term of the contract to depict conditions that exist at each reporting date.

The following provides an illustration of how an entity would apply the constraint in estimating variable consideration under the new standard:

Illustration 5: Evaluating the constraint
Assume the same facts as in Illustration 4 except that the buyer of the property has just begun negotiations with prospective tenants and has not signed lease agreements for a significant amount of space. *Analysis:* Developer D uses the "expected value" approach and estimates it is 25% likely to receive future profit participation of \$50,000, 50% likely to receive \$25,000 and 25% likely to receive none. Using a probability-weighted estimate (prior to considering the constraint), Developer D would include \$25,000 [(\$50,000 x 25%) + (\$25,000 x 50%) + (\$0 x 25%)] in the transaction price associated with this variable consideration. That is, the transaction price would be \$2,025,000. In this illustration, Developer D concludes that the constraint would be set at \$25,000 (i.e., the amount for which it's probable that a significant reversal will not occur), therefore the full \$25,000 would be included in the transaction price.

Seller provides management or development services to a buyer

A seller of real estate may agree to provide management services for the buyer for a period of time or commit to develop the property in the future (e.g., construct facilities on the land, provide improvements or amenities, such as roads, sewer lines or parks).

If the real estate property in the transaction is sold to a noncustomer, the sale is within the scope of ASC 610-20, which does not include guidance or refer to ASC 606, for identifying performance obligations and allocating consideration. If providing management or development services would generally be considered part of a real estate entity's ordinary activities, these services would be in the scope of ASC 606. Because the arrangement is partially in the scope of ASC 606 and partially outside, the guidance provided in ASC 606 for identifying performance obligations and allocating consideration will be applied to the entire arrangement since ASC 610-20 does not provide such direction.

To determine the performance obligations in the arrangement, a seller evaluates whether the management or development services are (1) capable of being distinct and (2) distinct within the context of the contract. If an entity concludes that more than one performance obligation is present in the contract, the transaction price is allocated to each based on their relative standalone selling prices. For further discussion, refer to Section 2 and 4 of our Technical Line publication, *The new revenue recognition standard — real estate.*

Development services

ASC 360-20 allows a seller that commits to develop the property sold to recognize profit using the percentage-of-completion method if (1) the seller can reliably estimate the future costs of development and the total profit that will be realized in the arrangement and (2) all other criteria for recognizing profit under the full accrual method have been satisfied.

Under ASC 360-20, if future costs of development can be reasonably estimated (i.e., the transaction would qualify to be accounted for using the percentage-of-completion method) but the transaction is otherwise required to be accounted for using the installment, cost recovery or reduced-profit method because the criteria for using the full accrual method have not been satisfied, both the percentage-of-completion method and the other applicable reduced profit method should be considered in determining the amount of profit to recognize. If a seller cannot reasonably estimate the future costs of development, no profit is recognized until costs can be reliably estimated or development is complete.

Under the new revenue standard, if an entity determines that the property and development services represent separate performance obligations in a contract with a customer, the transaction price is estimated (considering the constraint on any variable consideration) and allocated on a relative basis to each performance obligation based on their standalone selling prices. Revenue is then recognized when (or as) control is transferred. As discussed above, we anticipate that this guidance will also generally be applied when entities enter into these contracts with noncustomers because the transaction is partially in the scope of ASC 606 and partially in the scope of ASC 610-20. The guidance provided in ASC 606 for identifying performance obligations and allocating consideration will be applied to the entire arrangement since ASC 610-20 does not provide such direction.

Illustration 6: Sale of land with development contract

Developer D sells land with a carrying amount of $400,000 to Homebuilder V and agrees to build access roads and develop a recreation facility on the land for total consideration of $1,500,000. The estimated cost to complete the development (i.e., access roads and recreation facility) is $400,000, which is based on Developer D's experience and is considered reliable. Developer D incurs $160,000 in development costs in year 1 and $240,000 in costs in year 2. The standalone selling price of the land is $1,000,000, and the standalone selling price for the development services is $600,000.

Future GAAP analysis (ASC 606/610-20):

The sale of land and corresponding performance of development services are both part of Developer D's ordinary activities, so the entire transaction is within the scope of ASC 606. In contrast, if the sale of land was not part of Developer D's ordinary activities (e.g., if Developer D generally only performed development services and rarely sold raw, undeveloped land), the transaction would be partially in the scope of ASC 610-20 (i.e., sale of land to noncustomer) and partially in the scope of ASC 606 (i.e., performance of development services). In these circumstances where the transaction is partially in the scope of both standards, the guidance in ASC 606 for identifying performance obligations and allocating the transaction price will be applied to the overall arrangement since ASC 610-20 does not include such guidance. The measurement and recognition for the land would be the same under either ASC 606 or ASC 610-20 because ASC 610-20 relies on the concepts of ASC 606.

Developer D evaluates the arrangement and determines that the land and development services are each capable of being distinct and are distinct within the context of the contract, thus representing separate performance obligations under the new revenue standard.

Developer D must allocate the $1,500,000 transaction price based on the relative standalone selling prices of the land and development services. On a relative standalone selling price basis, the land represents 62.5% of the transaction price, or $937,500, and the management services represent 37.5% of the transaction price, or $562,500.

When control of the land transfers, Developer D recognizes revenue (and corresponding profit) based on the amount of the transaction price allocated to the land. The remaining transaction price allocated to the development services is recognized when (or as) control of the improvements is transferred to Homebuilder V.

For example, if Developer D determines that Homebuilder V controls the improvements as they are created, recognition of revenue over time, based on Developer D's selected measure of progress (e.g., cost incurred), may be appropriate. Profit from the total arrangement would be recognized as follows:

Profit recognized at sale closing: $537,500

$937,500 transaction price of land – $400,000 carrying value of land

Profit recognized in Year 1: $65,000

[$562,500 transaction price of development services x ($160,000 costs incurred/$400,000 total development costs)] – $160,000 costs incurred

Profit recognized in Year 2: $97,500

[$562,500 transaction price of development services x ($240,000 costs incurred/$400,000 total development costs)] – $240,000 costs incurred

Current GAAP analysis (ASC 360-20):

If all other criteria for recognizing revenue under the full accrual method in ASC 360-20 have been satisfied, Developer D should account for the arrangement using the percentage-of-completion method as follows:

Projected profit:

Sales value	$ 1,500,000
Costs	
Land	400,000
Development	400,000
	800,000
Total projected profit	$ 700,000

Profit recognized at sale closing: $350,000

($400,000 costs incurred/$800,000 total costs) x $700,000 projected profit

Profit recognized in Year 1: $140,000

($160,000 costs incurred/$800,000 total costs) x $700,000 projected profit

Profit recognized in Year 2: $210,000

($240,000 costs incurred/$800,000 total costs) x $700,000 projected profit

While the total profit recognized in this illustration is the same under either standard, $187,500 of additional profit is recognized at sale closing when the new revenue standard is applied to this transaction.

Management services

Under ASC 360-20, if a seller agrees to provide management services to the buyer of a property, the compensation for those services is excluded from the sales value of the property and recognized separately over the period of the management contract. If the services are provided "free of charge" or at a reduced rate, the seller must impute compensation for the management services (i.e., reduce the sales value of the property by the present value of the market rate of the services).

ASC 606 instead requires the seller to separately estimate the standalone selling prices of the real estate asset and the management services and allocate the transaction price (including any estimates of variable consideration that are not constrained) on a relative basis, assuming the entity determines the contract has two performance obligations. The following illustration compares the potential differences in the recognition of profit for these arrangements under ASC 360-20 and the new standard:

Illustration 7: Sale of land with management contract

Hotel Company M sells a hotel with a carrying value of $1,500,000 for $2,000,000 and agrees to manage the property for three years at no additional cost to Buyer R. The standalone selling price of the hotel is $1,800,000, and the standalone selling price for the management services is $100,000 per year. The current market rate of interest that reflects the credit characteristics of the buyer is 10%.

Future GAAP analysis (ASC 606/610-20):

The sale of a hotel is not part of Hotel Company M's ordinary activities (e.g., Hotel Company M ordinarily operates hotels under management agreements or provides licenses to franchisees and generally does not own and sell hotel properties), so the transaction is partially in the scope of ASC 610-20 (i.e., sale of the hotel to a noncustomer) and partially in the scope of ASC 606 (i.e., performance of management services). In these circumstances, the guidance in ASC 606 for identifying performance obligations and allocating the transaction price will be applied to the overall arrangement since ASC 610-20 does not include such guidance. The measurement and recognition for the hotel would be the same under either ASC 606 or ASC 610-20 because ASC 610-20 relies on the concepts of ASC 606.

Hotel Company M evaluates the arrangement and determines that the hotel and management services are each capable of being distinct and distinct within the context of the contract, thus representing separate performance obligations.

Hotel Company M must allocate the $2,000,000 transaction price based on the relative standalone selling prices of the hotel ($1,800,000) and management services ($100,000 x three years, or $300,000). On a relative basis, the transaction price is allocated as follows: the hotel property 85.7% ($1,800,000/$2,100,000), or $1,714,286, and the management services 14.3% ($300,000/$2,100,000), or $285,714.

Hotel Company M recognizes profit of $214,286 ($1,714,286 – $1,500,000) when control of the property transfers. The $285,714 of transaction price allocated to the management services is recognized over the remaining term of the contract based on Hotel Company M's selected measure of progress (e.g., time elapsed).

Current GAAP analysis (ASC 360-20):

Hotel Company M imputes compensation for the management services to be performed and recognizes that amount over the term of the management contract. The present value of $100,000 per year for three years, discounted at 10%, is $248,695.

If all other criteria for recognizing profit under the full accrual method are satisfied (including the initial and continuing investment tests after reducing the sales value by the consideration imputed for the management services), Hotel Company M recognizes profit of $251,305 ($2,000,000 sales price – $1,500,000 carrying amount – $248,695 discounted management fee) at the time of sale.

While the total profit recognized in this illustration is the same under either standard, $37,029 less is recognized at sale closing when the new standard is applied to this transaction.

Consideration of a significant financing component

Under the new standard, a significant financing component may be present in a contract if the timing of payments explicitly or implicitly provides the customer or the entity (i.e., the seller) with a significant benefit of financing the transfer of goods or services. The standard doesn't provide guidance on evaluating whether a financing component is significant, so entities will have to use judgment when making this determination.

For simplicity, illustrations 6 and 7 don't address the timing of payments in the arrangement (i.e., whether all consideration is paid at closing or a portion is paid as the services are provided). A significant financing component could be in the form of prepayment or a delayed payment. For example, if a contract contains "prepayments" for goods or services that will not be transferred for more than a year, an entity has to evaluate whether the timing of payments indicates that the arrangement contains a significant financing component.

If an entity concludes that the contract contains a significant financing component, the expected consideration is adjusted to reflect the cash selling price of the goods or services. When a contract has more than one performance obligation, such as those illustrated above, entities will need to use judgment when determining whether and how to allocate the financing to each performance obligation. The FASB-IASB Transition Resource Group for Revenue Recognition (TRG) recently discussed this issue and members of the TRG generally agreed that it may be reasonable for entities to apply other guidance in the standard that requires variable consideration and/or discounts to be allocated to one or more (but not all) performance obligations, if certain criteria for applying that guidance are met.[13]

How we see it

There likely will be significant judgment involved in determining whether a significant financing component exists when there is more than one year between the transfer of goods or services and the receipt of arrangement consideration. Entities will need to make sure that they have sufficiently documented their analyses to support their conclusions.

Under the new standard, guarantees included in a real estate sales arrangement are separated and accounted for using the guidance in ASC 460.

Guarantees of return on investment and seller support of operations

In certain real estate sales contracts, the seller may guarantee the return on, or of, the buyer's investment, while other arrangements may require that the seller initiate or support the property's operations. These two types of arrangements often may be confused, but the distinction is important under ASC 360-20.[14] An obligation to support the property's operations only guarantees that the buyer will recover funds from the seller related to the operating costs of the property for a period of time and does not guarantee that the buyer will receive a return on, or of, its investment.

Under ASC 360-20, if the seller guarantees a return of, or on, the buyer's investment, or agrees to support operations of the transferred real estate, sale accounting may be prohibited or profit may be reduced depending on several factors (e.g., duration and amount of the guarantees or support obligations). Depending on the terms, if the seller is not eligible for the full accrual method, the seller might account for the transaction under the deposit, financing, leasing or profit-sharing methods.

Unlike ASC 360-20, the new standard doesn't specify the accounting treatment for guarantees of return/investment or support obligations in contracts with customers. Instead, the seller determines whether these contract elements represent guarantees that are within the scope of ASC 460 (and not within the scope of ASC 606). If so, the seller recognizes a liability for the guarantee based on the estimated fair value and accounts for the guarantee as a separate element in the arrangement (i.e., the sale of real estate and sale of a guarantee). Although this is not explicit in ASC 610-20, entities that enter into these contracts with noncustomers will need to evaluate whether there are elements in the contract other than nonfinancial assets (or in substance nonfinancial assets) and account for those elements in accordance with the applicable literature (e.g., apply ASC 460 to guarantees provided in the contract).

Once the fair value of the guarantee has been determined, the remainder of the estimated arrangement consideration is allocated among the other elements in the arrangement (e.g., the sale of property, management arrangements, development services) in accordance with the revenue recognition standard. An entity recognizes a sale and associated profit when control of the property transfers, an assessment that is not affected by the presence of the guarantee.

The following illustration compares the accounting for an arrangement where the seller guarantees a return on the buyer's investment under ASC 360-20 and under the new revenue standard.

Illustration 8: Guarantee of return on buyer's investment

On 31 December 2018, Developer N sells a newly constructed apartment building with a cost of $1,200,000 to Buyer B for $2,000,000. Developer N guarantees that Buyer B will earn a minimum annual 10% profit in each of the next three years. Developer N's incremental borrowing rate is 5%.

Based on its experience with similar properties, Developer N forecasts that the property's operating results will be as follows:

	2019	2020	2021
Revenues	$ 300,000	$ 380,000	$ 400,000
Operating expenses	350,000	355,000	360,000
Profit (deficit)	(50,000)	25,000	40,000
10% profit	30,000	38,000	40,000
Guarantee requirement	80,000	13,000	N/A

Developer N transfers title to the building, and Buyer B takes possession of the property at the closing date. The sale also meets all of the other criteria for recognizing profit under the full accrual method in ASC 360-20, and Developer N has no other continuing involvement in the property.

Future GAAP analysis (ASC 606):

Developer N's ordinary activities include the construction and sale of real estate properties, thus the sale of the apartment building to Buyer B is a transaction with a customer within the scope of ASC 606.

Developer N concludes that it has provided a financial guarantee to Buyer B that is within the scope of ASC 460. ASC 606 states that Developer N must allocate a portion of the transaction price to the guarantee obligation in accordance with the measurement principles of ASC 460.

Assume that Developer N determines a guarantee obligation of $93,000 in accordance with ASC 460[15] and allocates that amount of consideration to the guarantee and records a liability. The remaining transaction price of $1,907,000 is allocated to the performance obligation representing the sale of the property. Developer N concludes that control of the property has transferred to Buyer B and records profit of $707,000 ($2,000,000 sale price — $93,000 guarantee liability — $1,200,000 cost basis) on the closing date.

Future GAAP analysis (ASC 610-20):

If the transaction illustrated above is with a noncustomer (e.g., the seller is a REIT that ordinarily owns and operates multifamily properties), ASC 610-20 would be applied to the sale of the building. ASC 610-20 does not include guidance similar to ASC 606 regarding the separation of units of accounting and allocation of transaction price to elements within a contract that are outside the scope of ASC 606 (e.g., guarantees). However, entities may have the same accounting result as a transaction with a customer under ASC 606 because the guidance in ASC 460 for guarantees would be applied.

Current GAAP analysis (ASC 360-20):

Because Developer N has guaranteed a return on Buyer B's investment, the deposit method should be applied to this transaction.

Repurchase agreements

Certain agreements for the sale of real estate may include provisions that require, or give an option to, the seller to repurchase the property. These provisions are generally structured in one of three ways:

- Forward option — An entity is obligated to repurchase the property
- Call option — An entity has the right to repurchase the property
- Put option — An entity is obligated to repurchase the property at the buyer's request

ASC 606 addresses the accounting for each of these repurchase provisions. ASC 610-20 does not explicitly refer to the repurchases guidance in ASC 606, but it does reference the transfer of control indicators in ASC 606-10-25-30, which incorporate the repurchases guidance. Therefore, repurchase agreements with customers and noncustomers should be evaluated using the repurchases guidance in ASC 606.

Forward or call option held by the entity

When an entity has the unconditional obligation or right to repurchase a property (i.e., a forward or call option), ASC 606 specifies that the buyer has not obtained control of the property even if the option is at fair value. Instead, the standard requires that an entity account for a transaction that includes a forward or a call option based on the relationship between the repurchase price and the original selling price.

If the entity has the right or obligation to repurchase the property at a price less than the original sales price (considering the effects of the time value of money), the entity would account for the transaction as a lease in accordance with ASC 840.

If the transaction is a sale-leaseback, the guidance in ASC 840-40 (including the guidance in ASC 360-20, which is retained only for sale-leaseback transactions until the Boards' project on lease accounting is finalized), would be applied.

In contrast, if the entity has the right or obligation to repurchase the property at a price equal to or greater than the original sales price (considering the effects of the time value of money), the entity would account for the arrangement as a financing arrangement. If a transaction is considered a financing arrangement, the selling entity would continue to recognize the property and record a financial liability for the consideration received from the customer. The difference between the consideration received from the customer and the consideration subsequently paid to the customer upon repurchase would represent the interest and holding costs, as applicable, that would be recognized over the term of the financing arrangement. If the option lapses unexercised, the entity derecognizes the property and financing liability and recognizes revenue at that time.

The concept of accounting for a forward or call option as a lease or financing arrangement is similar to existing guidance in ASC 360-20. However, under ASC 360-20, an entity can also apply the profit-sharing method if certain criteria are met. The new standard only allows a sale with a corresponding forward or call option to be treated as a lease or a financing arrangement and the likelihood of exercise is not contemplated in the accounting.

Illustration 9: Seller retains call option for amount greater than purchase price

Real Estate Fund E sells an office building to Buyer L on 1 January 2019 for $2.0 million. The contract includes a call option that gives Real Estate Fund E the right to repurchase the asset for $2.2 million on or before 31 December 2020. For simplicity, the time value of money is ignored in this example.

Future GAAP analysis (ASC 606/610-20):

Control of the asset does not transfer to Buyer L on 1 January 2019 because Real Estate Fund E has a right to repurchase the office building. Buyer L is therefore limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

As a result, Real Estate Fund E accounts for the transaction as a financing arrangement because the exercise price is more than the original selling price. Real Estate Fund E does not derecognize the office building and instead recognizes the cash received as a financial liability. Real Estate Fund E also accretes the liability and recognizes interest expense over the two-year period for the difference between the exercise price ($2.2 million) and the cash received ($2.0 million).

If the option subsequently lapses unexercised, the Real Estate Fund E derecognizes the office building and recognizes proceeds of $2.2 million.

Current GAAP analysis (ASC 360-20):

The repurchase option represents continuing involvement that prevents Real Estate Fund E from recognizing a sale or profit under the full accrual method at 1 January 2019. Real Estate Fund E evaluates the likelihood that it will exercise the option to determine whether to account for the transaction as a financing or profit-sharing arrangement.

Written put option held by the buyer

A real estate sales contract may give a buyer the ability to require the seller to repurchase the property at a previously agreed-upon price (i.e., a put option). Under ASC 606, a seller accounts for a contract that includes a put option using one of three methods (i.e., lease, sale with a right of return or financing arrangement) depending on the relationship of the exercise price to the original selling price of the property and whether the buyer has a significant economic incentive to exercise its right.

The determination of whether an entity has a significant economic incentive to exercise its right influences whether the buyer truly has control of the property. A seller has to consider many factors to determine whether a buyer has a significant economic incentive to exercise the put option, including the relationship of the repurchase price to the expected market value of the property at the date of repurchase and the amount of time until the option expires. The standard notes that if the repurchase price is expected to significantly exceed the market value of the property, the buyer has a significant economic incentive to exercise the put option.

How we see it

The new revenue standard does not provide guidance on determining whether the buyer has "a significant economic incentive" to exercise a put option. We believe entities that sell a property subject to a put option will need to estimate the future market price of the property and evaluate other facts and circumstances to determine whether the buyer has a significant economic incentive to exercise the option. This determination will require significant judgment.

A seller will account for a transaction that includes a buyer's put option as either a lease, a sale with a right of return or a financing arrangement.

- *Lease* — If the repurchase price is less than the original selling price and the buyer has a significant economic incentive to exercise the put option, the seller should account for the agreement as a lease because the buyer is effectively paying for the right to use the property for a period of time.
- *Sale with a right of return* — If the repurchase price is less than the original selling price and the buyer does not have a significant economic incentive to exercise its right, the seller should account for the agreement in a manner similar to a sale with a right of return. A repurchase price that is equal to or greater than the original selling price, but less than or equal to its expected market value, should also be accounted for as a sale of a product with a right of return if the customer does not have a significant economic incentive to exercise its right. Refer to Section 5.2.2 of our Technical Line publication, *A closer look at the new revenue recognition standard*, for a discussion of the accounting for the sale of a product with a right of return.
- *Financing arrangement* — If the buyer has the ability to require the seller to repurchase the property at a price that is equal to or greater than the original selling price and greater than the expected market value of the property, the contract is in effect a financing.

Illustration 10: Buyer holds put option with exercise price less than market value
Real Estate Fund E sells an office building to Buyer L on 1 January 2019 for $2.0 million. The contract includes a put option that obligates Real Estate Fund E to repurchase the building at Buyer L's request for $1.9 million on or before 31 December 2020. The market value of the office building is expected to be $1.8 million on 31 December 2020. *Future GAAP analysis (ASC 606/610-20):* At contract inception, Real Estate Fund E assesses whether Buyer L has a significant economic incentive to exercise the put option to determine whether the arrangement should be accounted for as a lease in accordance with ASC 840 or a sale with a right of return. Real Estate Fund E considers all relevant factors and concludes that Buyer L has a significant economic incentive to exercise the put option because the $1.9 million repurchase price significantly exceeds the expected market value of $1.8 million at the date of repurchase. Real Estate Fund E concludes that control of the building does not transfer to Buyer L because the significant economic incentive to exercise the put option limits Buyer L's ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Consequently, Real Estate Fund E accounts for the arrangement as a lease in accordance with ASC 840[16] on leases. *Current GAAP analysis (ASC 360-20):* The put option represents continuing involvement that prevents Real Estate Fund E from recognizing a sale or profit under the full accrual method at 1 January 2019. Real Estate Fund E determined that the leasing method described in ASC 360-20 was appropriate for this transaction. Any cash received from Buyer L equal to the repurchase price should be recorded as a liability with the difference between the cash received and the repurchase price representing deferred rental income that should be recognized ratably over the rental period.

Sales of real estate by real estate developers

Under the new standard, there is no special condominium accounting guidance. Instead, any developer may be able to recognize revenue over time (i.e., similar to the percentage-of-completion method) if it can determine that the asset (e.g., building, land parcel, residential unit) under construction has no alternative use and the developer has an enforceable right (throughout the contract) to payment from the customer for performance completed to date.

Real estate developers generally own the land and/or asset until title is transferred at completion of construction. Therefore, they must evaluate whether the asset has no alternative use and a present right to payment from the customer exists. In contrast, a construction contractor builds an asset on the customer's land and the customer owns the work-in-process, generally allowing the contractor to conclude that the customer controls the asset as it is created or enhanced.

Alternative use

An asset created by an entity has no alternative use if the entity is either restricted contractually or practically from readily directing the asset for another use (e.g., selling to a different customer). An entity has to make this assessment at contract inception and does not update its assessment unless the parties to the contract approve a contract modification that substantively changes the performance obligation.

The Boards specified[17] that a contractual restriction on an entity's ability to direct an asset for another use must be substantive (i.e., a buyer could enforce its rights to the promised asset if the entity sought to sell the unit to a different buyer). In contrast, a contractual restriction may not be substantive if the entity could instead sell a different asset to the buyer without breaching the contract or incurring significant costs.

Further, the Boards believe a practical limitation exists if an entity would incur significant economic losses to direct the asset for another use. A significant economic loss may arise when significant costs are incurred to redesign or modify an asset, or when the asset is sold at a significantly reduced price.

A developer may be able to determine that an asset has no alternative use because its characteristics (e.g., location, design, technical specifications, materials) would generally result in a contractual and/or practical limitation to redirect its use to another buyer.

Enforceable right to payment for performance completed to date

An entity has an enforceable right to payment for performance completed to date if, at any time during the contract term, the entity would be entitled to an amount that at least compensates it for work already performed. This enforceable right to payment must exist, even if the buyer can terminate the contract for reasons other than the entity's failure to perform as promised.

The laws or legal precedent of a jurisdiction may affect an entity's conclusion of whether a right to payment is enforceable.

To satisfy this criterion, the amount to which an entity is entitled must approximate the selling price of the goods or services transferred to date, including a reasonable profit margin. Compensation for a reasonable profit margin doesn't have to equal the profit margin expected for complete fulfillment of the contract but must at least reflect either of the following:

- A proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party)
- A reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts

Entities are required to consider any laws, legislation or legal precedent that could supplement or override contractual terms. These may vary by country. In addition, the standard clarifies that including a payment schedule in a contract does not, by itself, indicate that the entity has the right to payment for performance completed to date. For example, progress billings collected from a customer may not reflect a reasonable profit margin on work completed to date. The entity has to examine information that may contradict the payment schedule and may represent the entity's actual enforceable right to payment for performance completed to date (e.g., an entity's legal right to continue to perform and enforce payment by the buyer if a contract is terminated without cause).

Measuring progress

When a performance obligation is satisfied over time, the standard allows the use of one of two methods for measuring progress under the contract: an input method or an output method. While the standard requires an entity to update its estimates related to the measure of progress selected, it does not allow a change in methods. A performance obligation is accounted for under the method the entity selects (i.e., either an input or output method) until it has been fully satisfied.

Under an input method, revenue is recognized "on the basis of the entity's efforts or inputs to satisfy the performance obligation … relative to the total expected inputs to the satisfaction of that performance obligation." The standard includes resources consumed, labor hours expended, costs incurred and time elapsed as possible input methods. The standard also notes it may be appropriate to recognize evenly expended inputs on a straight-line basis.

Under an output method, revenue is recognized "on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract." Measurements of output may include surveys of performance completed to date, appraisals of results achieved, milestones reached and time elapsed.

The standard does not say either type of method is preferable, but it says an entity should apply the method it selects to similar arrangements in similar circumstances. If an entity does not have a reasonable basis to measure its progress, the Boards decided that too much uncertainty would exist and, therefore, revenue should not be recognized until progress can be measured. However, if an entity cannot reasonably measure its progress, but expects it will not incur a loss, the new standard requires revenue to be recognized to the extent that costs are incurred until the entity is able to reasonably measure its progress.

The accounting for partial sales of real estate is not specifically addressed in the new standard.

How we see it

Many developers of residential condominium units currently recognize revenue using the percentage-of-completion method that is permitted in ASC 360-20 when certain criteria are met (e.g., construction is beyond a preliminary stage, buyer is unable to require a refund, sales price is collectible). This accounting treatment in ASC 360-20 is not available to other developers of real estate assets that are sold upon completion (e.g., build-to-suit commercial builders and land developers).

Under the new revenue standard, it may be difficult for developers of residential condominiums to conclude that their arrangements meet the criteria for revenue recognition over time. In many jurisdictions (e.g., the US) the developer receives an initial deposit from the buyer but is not entitled to further consideration until the sale of the unit closes. As a result, the developer may be unable to assert that it has an enforceable right to payment for performance completed to date at any point in the contract term.

Partial sales of real estate

Under ASC 360-20, a seller has made a partial sale of real estate if the seller has an equity interest in the buyer or retains an equity interest in the property. The nature of a partial sale of real estate indicates continuing involvement (i.e., retained ownership) in the property by the seller. However, ASC 360-20 allows a seller to recognize profit on the partial sale of real estate at the date of a sale if all other requirements for recognizing profit under the full accrual method have been satisfied. In addition, the seller must be independent of the buyer, and the seller cannot be required to support the operations of the property or its related obligations to an extent greater than its proportionate retained interest.

A partial sale of real estate may also occur if an entity contributes a property to a venture and withdraws cash from the venture that was contributed by another partner. For example, Investor X enters into a transaction with Investor Y in which Investor X contributes real estate with a fair value of $5,000 and Investor Y contributes $2,500 in cash, which Investor X immediately withdraws. The only asset in this venture is the real estate, and after the contributions and withdrawals, each investor has a 50% interest in the venture. Assuming Investor X is not committed to reinvest the $2,500 in the venture, the substance of this transaction is a sale of a one-half interest in the real estate by Investor X for $2,500 in cash.

The new guidance does not specifically address partial sales of real estate. It is unclear whether these transactions are in the scope of ASC 610-20, and thus generally follow the model in ASC 606, or whether existing guidance in another ASC topic (e.g., ASC 810, ASC 323, *Investments — Equity Method and Joint Ventures*) should be applied. If these transactions are within the scope of ASC 610-20, neither ASC 610-20 nor ASC 606 specifies how an entity would view a partial sale of real estate in the context of its evaluation of the indicators of control transfer. For example, absent a clarification by the FASB, some entities may evaluate whether they continue to control the *property* after the partial sale, while others may look to whether control of the *ownership interest* specified in the contract has transferred.

How we see it

The frequency of partial sales of real estate and the lack of clarity in the new guidance could lead to substantial diversity in practice when accounting for these transactions. The FASB has indicated that it may provide further guidance on this issue as part of its project on clarifying the definition of a business.

Contributions of real estate that are not in substance sales

Contributions of real estate by an investor to a real estate venture that are not in substance sales (as described above) will continue to be accounted for under existing guidance in ASC 970-323, *Real Estate — General*, *Investments — Equity Method and Joint Ventures*. This guidance states that an investor that contributes real estate to the capital of a real estate venture should generally record its investment at the book value of the real estate contributed and not recognize a profit on the transaction (i.e., the economic substance of the transaction is a contribution of capital and not a sale of real estate).

Surrender of real estate in satisfaction of an entity's obligation

ASU 2011-10, *Derecognition of in Substance Real Estate — a Scope Clarification,* clarified that the guidance in ASC 360-20 (rather than the derecognition provisions of ASC 810) should be applied to a parent that ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt.

The FASB's consequential amendments in ASU 2014-09 did not change the exclusion of these transactions from the derecognition provisions of ASC 810. However, entities will now apply the guidance in ASC 610-20 (and therefore the indicators of control transfer in ASC 606-10-25-30) when derecognizing all nonfinancial assets, including real estate, that are transferred in satisfaction of a subsidiary's default on nonrecourse debt.

Under ASC 360-20, derecognition of the in substance real estate by an entity is not appropriate before the date that the reporting entity's interest in the real estate is conveyed to the lender or a third-party purchaser and the subsidiary is released from its debt obligation. The indicators of transfer of control in the new standard include consideration of whether title to the property has transferred and the buyer or lender has obtained the significant risks and rewards of ownership. However, the standard does not specifically address whether the subsidiary must be legally released from its debt obligation in order to derecognize the property.

How we see it

The new revenue standard states that an entity's assessment of whether control of a property has transferred includes, but is not limited to, the five indicators in ASC 606-10-25-30. While we believe that the legal release of the debt obligation is an important factor in determining whether control of a property has transferred, diversity in practice could develop in this area because the standard does not specifically require that this condition be satisfied. Further, timing of transfer of control under ASC 606 may not coincide with the borrower's derecognition of the debt obligation in accordance with relevant debt extinguishment guidance.

Transition and effective date

The new standard is effective for public entities for fiscal years beginning after 15 December 2016 and for interim periods therein. It is effective for nonpublic entities for fiscal years beginning after 15 December 2017 and interim periods within fiscal years beginning after 15 December 2018, and they may elect to adopt the guidance as early as the public entity effective date. Under US GAAP, early adoption is prohibited for public entities.

The FASB voted to defer the effective date of the new standard for both public and nonpublic entities reporting under US GAAP for one year. As proposed, both public and nonpublic entities would be permitted to adopt the standard as early as the original public entity effective date. Early adoption prior to that date would not be permitted.

The IASB, which developed its new revenue standard jointly with the FASB, also voted to adopt a one-year deferral, which would keep the new standards' effective dates converged under IFRS and US GAAP.

All entities will be required to apply the standard retrospectively, either using a full retrospective or a modified retrospective approach. The Boards provided certain practical expedients to make it easier for entities to use a full retrospective approach.

Under the modified retrospective approach, financial statements will be prepared for the year of adoption using the new standard, but prior periods won't be adjusted. Instead, an entity will recognize a cumulative catch-up adjustment to the opening balance of retained earnings (or other appropriate component of equity or net assets) at the date of initial application for contracts that still require performance by the entity (i.e., contracts that are not completed). Entities will need to provide certain disclosures in the year of adoption, (e.g., entities using the modified retrospective approach must disclose the amount by which each financial statement line item is affected as a result of applying the new standard).

How we see it

Entities with deferred revenue balances or failed sales from real estate sales that predate their adoption of the new standard may experience "lost revenue." That's because the deferred amounts or previously unrecognized sales will be reflected in the recasted prior periods (under the full retrospective approach) or as part of the cumulative effect adjustment upon adoption (under the modified retrospective approach), but never reported as revenue in a current period within the financial statements.

The illustration below compares the application of the two transition approaches to a real estate sale for which profit was previously deferred under the installment method. Real estate entities that have previously deferred profit from a sale under another method in ASC 360-20 will need to consider specific transition issues that may arise from each respective method (e.g., interest expense and/or continued depreciation of the property under any of the financing, leasing, profit-sharing or deposit methods).

Illustration 11: Comparison of transition approaches

Developer A, a public entity with a 31 December fiscal year-end, sold a real estate property with a carrying value of $6 million for net proceeds of $11 million. The sale closed on 31 December 2015 but did not qualify for full accrual profit recognition because the terms of the four-year note receivable (i.e., seller financing) provided by Developer A did not meet the initial and continuing investment criteria in ASC 360-20. Under ASC 360-20, Developer A applied the installment method and determined that $1 million of profit should be recognized at the sale date, $1 million in 2016, $1 million in 2017 and $2 million in 2018 when the initial and continuing investment criteria were expected to be satisfied. Developer A will also recognize interest income from the note as it is received.

The illustration assumes that the new revenue standard is effective for Developer A for interim and annual periods beginning 1 January 2018. Management evaluates the new revenue standard and concludes that the terms of the seller financing would not have precluded the recognition of the $5 million of profit at the date of sale (i.e., the transaction price is probable of collection, control of the property has transferred).

Full retrospective approach

Developer A presents three years of comparative financial information in its 2018 annual filings with the Securities and Exchange Commission (SEC). In accordance with ASC 250,[18] the full $5 million of profit from the sale that occurred on 31 December 2015 would be recorded as a cumulative catch-up to retained earnings as of 1 January 2016 in the recasted financial information. Deferred profit of $1 million that was previously recognized in both 2016 and 2017 would no longer be included in the income statements of each respective period.

Quarterly SEC filings of Developer A will also reflect this presentation beginning 31 March 2018.

Modified retrospective approach

The sale of the property by Developer A constitutes a completed contract as defined in the new standard[19] because the property was transferred on 31 December 2015, before the date of initial application by the entity. Under the modified retrospective approach, the new standard is only applied to contracts that are in progress at the date of initial application (i.e., 1 January 2018). Therefore, Developer A would recognize the remaining $2 million of deferred revenue at 1 January 2018 as a cumulative catch-up to retained earnings at the beginning of the period. In contrast to the results under the full retrospective approach, the $1 million of deferred revenue recognized in both 2016 and 2017 continues to be reflected in each respective comparative period.

Developer A also must disclose the $2 million of profit that would have been recognized in 2018 had ASC 360-20 remained in effect.

The new standard defines a completed contract as one in which the entity has fully transferred all of the identified goods and services in accordance with today's revenue guidance before the date of initial application. However, some have questioned whether the Boards actually intended for a contract for which revenue is not yet fully recognized (e.g., a sale of real estate accounted for under one of the alternative methods in ASC 360-20) at the date of transition to be considered a completed contract. The TRG has discussed this issue and the Boards' staffs are working to summarize and clarify the Boards' intent. The answer to what constitutes a completed contract may change the accounting described in Illustration 11. Entities that are currently accounting for the sale of real estate using one of the alternative methods in ASC 360-20 should monitor the activities of the TRG and Boards.

Next steps

It is important for entities to continue to focus on their implementation plans. They should not postpone plans because the FASB has voted for a one-year deferral. Many entities are finding it more difficult to apply the new standard than they initially expected.

Entities should also continue to monitor the discussions of the Boards, SEC staff, the TRG, and hospitality and time-shares industry task forces formed by the AICPA to discuss interpretations and application of the new standard to common transactions. These groups may address issues that affect all real estate entities. In addition, the Board's project to clarify the definition of a business may also result in changes in the accounting for sales of real estate.

Endnotes:

1 The term customer is defined in ASC 606 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." Throughout this paper, the term "customer" may be used in reference to a transaction under ASC 610-20 in which the counterparty is a "buyer" and not a customer as contemplated in ASC 606. The use of "customer" in such instances is because ASC 610-20 refers to the guidance in ASC 606 and the discussion is focused on the requirements of ASC 606.

2 In March 2015, the FASB voted to propose amending its standard to refine the guidance in the Step 1 collectibility threshold and/or add or amend examples to clarify how the threshold should be applied. The FASB staff is in the process of drafting an Exposure Draft to reflect these tentative conclusions.

3 ASU 2014-09, *Basis for Conclusions,* paragraph 129.

4 ASU 2014-09, *Basis for Conclusions,* paragraph 132.

5 This exclusion includes contracts within the scope of the following Topics: ASC 310, *Receivables*; ASC 320, *Investments — Debt and Equity Securities*; ASC 405, *Liabilities*; ASC 470, *Debt*; ASC 815, *Derivatives and Hedging*; ASC 825, *Financial Instruments*; and ASC 860, *Transfers and Servicing*.

6 Neither ASC 606 nor ASC 460 provides guidance on recognizing revenue associated with a guarantee.

7 Statement of Financial Accounting Concepts No. 6, *Elements of financial statements*.

8 ASU 2014-09, *Basis for Conclusions,* paragraph 497.

9 ASC 810-10-40-3A and ASC 810-10-40-5.

10 For further information about the phases and status of the FASB's project, *Clarifying the Definition of a Business*, refer to the Board's technical agenda at www.fasb.org.

11 ASU 2014-09, *Consequential Amendments*, paragraph 63.

12 ASC 606-10-32-8.

13 For further discussion, refer to our publication, *Joint Transition Resource Group for Revenue Recognition (TRG) items of general agreement* (SCORE No. BB2927).

14 ASC 360-20-40-41 to ASC 360-20-40-44.

15 The $93,000 guarantee value is used in this scenario for illustrative purposes only and may not accurately consider the measurement guidance of ASC 460.

16 The FASB and IASB are jointly deliberating a new leases standard. A final standard is expected in 2015 but an effective date for the new guidance has not been determined.

17 ASU 2014-09, *Basis for Conclusions,* paragraphs 134–141.

18 ASC 250-10-45-5.

19 ASC 606-10-65-1(c)(2).