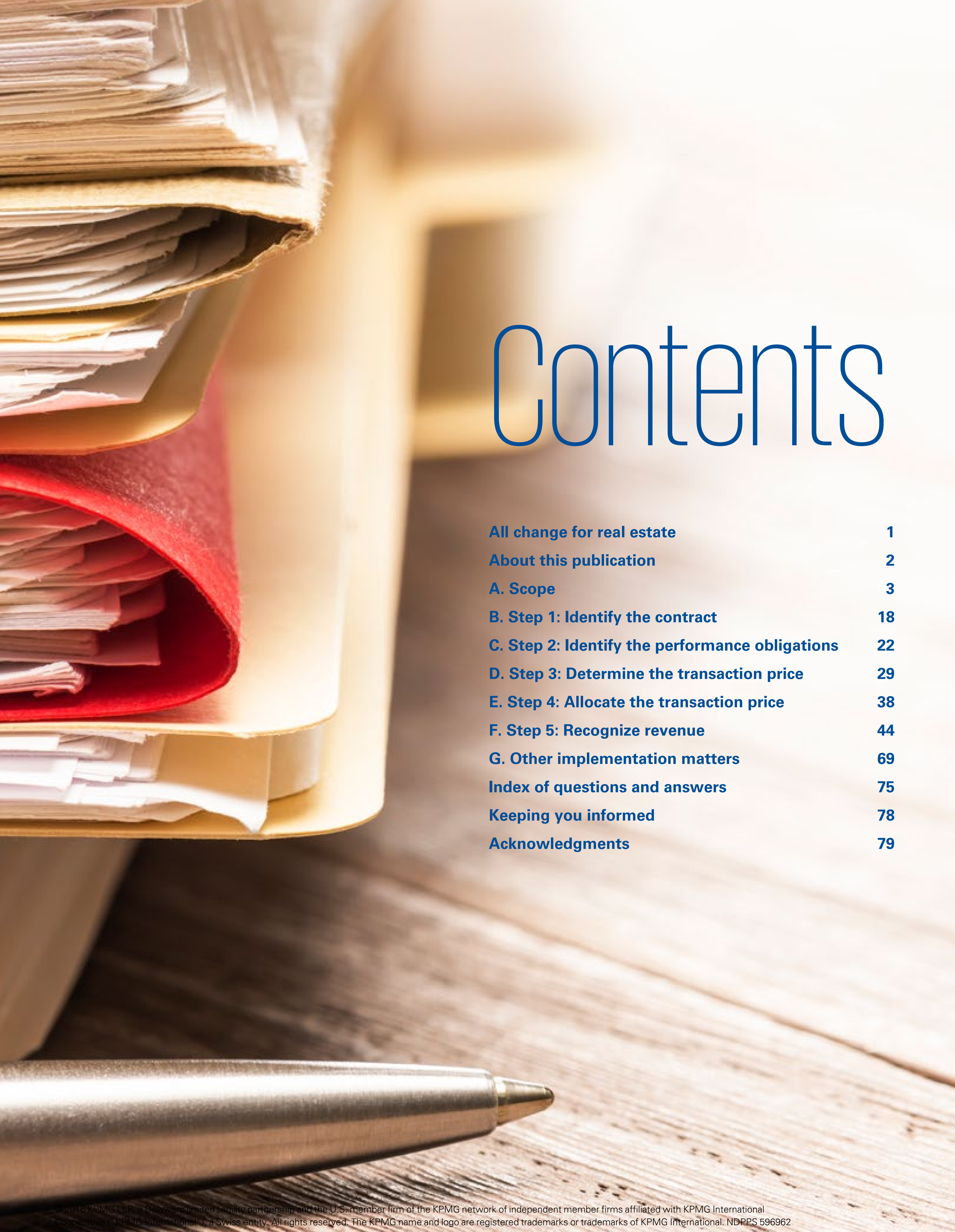
Revenue: Real estate

Questions and Answers

August 2016

US GAAP

kpmg.com/us/frn



Contents

All change for real estate	1
About this publication	2
A. Scope	3
B. Step 1: Identify the contract	18
C. Step 2: Identify the performance obligations	22
D. Step 3: Determine the transaction price	29
E. Step 4: Allocate the transaction price	38
F. Step 5: Recognize revenue	44
G. Other implementation matters	69
Index of questions and answers	75
Keeping you informed	78
Acknowledgments	79

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

All change for real estate

While it once seemed like a long way off, the 2018 effective date of the 2014 revenue recognition standard is fast approaching. The standard replaces most of the current US GAAP guidance on profit recognition for real estate sales.

The new standard requires real estate companies to determine its effect on their operations and accounting. As companies delve into the details, many are finding that the standard will affect them in some way. Those effects will vary widely depending on the nature of their businesses and their interactions with their customers and buyers.

In May 2016, we published the second edition of Revenue Issues In-Depth, which illustrates how the new standard applies to common transactions, provides examples about common scenarios, explains our emerging thinking on key interpretative issues, and compares the new requirements to current US GAAP.

This publication, now in its second edition, provides supplemental technical guidance on key issues when applying the new revenue model to sales of real estate, and focuses on the implications for US GAAP reporting entities. We address some of the common questions about the new standard's effects on sales of real estate, and we hope it will advance the dialogue on these and other issues.

Kimber Bascom and Angie Storm
Department of Professional Practice, KPMG LLP

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

About this publication

Purpose

The purpose of this publication is to assist you in understanding the requirements of FASB ASC Topic 606 *Revenue from Contracts with Customers* and Subtopic 610-20 *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets*, as they apply to real estate transactions.

This publication is intended for use by preparers and other interested parties with a working knowledge of the existing real estate sales guidance and an understanding of the new revenue recognition model.

Organization of the text

The publication is in a Q&A format, and is organized into chapters that largely reflect the steps in the revenue model. Our commentary is referenced to the FASB ASC (or Codification), when excerpts are not included, where applicable. For example, 606-10-25-1 is paragraph 25-1 of ASC Subtopic 606-10.

Terminology

Unless otherwise indicated explicitly or by comparison, we use the terms 'customer' and 'buyer' interchangeably to refer to the purchaser in a transaction involving the sale of real estate. This is because the guidance in this publication addresses both the requirements of Topic 606 on revenue recognition from sales to customers, and the requirements of Subtopic 610-20 on recognition of gains and losses from the derecognition of nonfinancial assets in transactions with parties other than customers.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

A Scope

A10. How do you determine whether real estate sales, including sales of financial assets that are in-substance real estate, fall within the scope of Topic 606 or Subtopic 610-20?

Determining which guidance applies depends on whether the buyer is a customer. If so, the seller accounts for the sale under Topic 606 and recognizes revenue and cost of sales. The Master Glossary 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." [Master Glossary, 360-10-40-3A]

A real estate developer predominantly in the business of selling retail land or residential units would be an example of an entity that likely is selling real estate as an output of its ordinary activities.

In contrast, a real estate investment trust (REIT) that primarily leases real estate generally would not sell real estate as an output of its ordinary activities. While some REITs often sell properties as part of their overall investment strategy, they identify the output of their normal activities as the service they provide to their tenants. This conclusion is consistent with how a REIT's operations are characterized for US federal income tax purposes.

While a REIT's income generally is tax-free (assuming it meets qualification criteria), US tax law prohibits, and taxes, sales of property held primarily for sale to customers in the ordinary course of business. To preserve the maximum tax advantage to the REIT and its investors, a REIT generally does not sell property to customers in its ordinary course of business.

Accounting for sales to customers – Topic 606

A seller accounts for customer sales under Topic 606 and recognizes revenue and cost of sales in its income statement. The seller follows this accounting regardless of whether the sale takes the form of a:

a. direct sale of real estate, including when real estate is the predominant component and has non-real estate components such as a ski resort;

b. sale of a financial asset (e.g. an ownership interest in an entity) that is in-substance real estate (e.g. an entity that holds only land); or

c. sale of a financial asset comprising an interest in an entity that holds an operating real estate asset that is a business (as defined under Topic 805). [360-20-15-2]

When a contract exists and the performance obligation is satisfied by transferring control of the property, Topic 606 requires the seller to derecognize the real estate (or in-substance real estate) and recognize the transaction price as revenue.

If a contract does not exist, the seller recognizes the cash received as a deposit liability, continues to report the real estate in its financial statements, depreciates it (if not held-for-sale), and tests it for impairment. [360-10-35, 360-10-40-3C, 45-9 – 45-10]

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

This reporting continues until a contract does exist and control of the property has transferred, or until the seller meets one of these conditions:

a. the seller has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the promised consideration has been received and is nonrefundable;

b. the contract has been terminated and the consideration received is nonrefundable; or

c. the seller has transferred control of the goods or services to which the consideration that has been received relates, has stopped transferring goods and services to the customer (if applicable) and has no obligation under the contract to transfer additional goods or services, and the consideration received from the buyer is nonrefundable. [606-10-25-7]

Proposed scope changes for sales of noncontrolling interests that are in-substance real estate

The FASB has proposed changing the scope of Topic 860 (transfers and servicing) to include transfers of investments that are currently excluded from the financial assets' derecognition guidance because they are sales of in-substance of nonfinancial assets. Under the proposed guidance, the sale of that noncontrolling interest would be within Topic 860's scope regardless of whether the buyer is a customer or a noncustomer.

Topic 860 currently excludes an investor's sale of its noncontrolling interest in a real estate entity that is accounted for under the equity or cost methods if that investment is an in-substance nonfinancial asset. Those sales currently are within the scope of the revenue guidance if the buyer is a customer or the other income guidance if the buyer is a noncustomer. [860-10-15-4(e)]

Accounting sales to noncustomers – Subtopic 610-20

If the seller determines that the buyer is not a customer, it generally accounts for the sale under Subtopic 610-20 because real estate typically is a nonfinancial asset or an in-substance nonfinancial asset. The seller recognizes a gain or loss in the income statement for these noncustomer sales. If the real estate is not considered a nonfinancial asset (or an in-substance nonfinancial asset), other GAAP may apply. See Question A20. [360-10-40-3A]

To address real estate sales to noncustomers, Subtopic 610-20 incorporates many of Topic 606's principles that address sales to customers. Specifically, paragraphs 610-20-32-1 and 40-1 require a seller of a nonfinancial asset (or an in-substance nonfinancial asset) to a noncustomer to apply Topic 606's guidance to determine the:

a. existence of a contract; [606-10-25-1 – 25-8]

b. transaction price, including estimating variable consideration, constraining that consideration, and evaluating whether there is a significant financing component, noncash consideration and consideration payable to the customer; and [606-10-32-2 – 32-27, 32-42 – 32-45]

c. when an entity satisfies a performance obligation by transferring control of an asset. [606-10-25-30]

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Currently Subtopic 610-20 does not incorporate Topic 606's guidance on identifying performance obligations (Step 2) and allocating transaction price (Step 4). However, the proposed ASU, *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets,* clarifies that a seller would apply the revenue guidance on identifying distinct goods and services and allocating consideration to those distinct goods and services in noncustomer sales of nonfinancial assets or in-substance nonfinancial assets. The proposal also would require that the seller separately account for parts of a contract that are not assets of the entity to be derecognized, for example, guarantees or ongoing service contracts (see Question A20).

Under Subtopic 610-20, when a contract exists and the performance obligation is satisfied by transferring control of the property, the seller derecognizes the real estate (or in-substance real estate) and recognizes as a gain or loss the difference between the transaction price and the carrying amount of the real estate. In the proposed amendment to Subtopic 610-20, the carrying amount of liabilities assumed by the buyer also would be included in the consideration (subject to the constraint on estimating variable consideration in paragraph 606-10-32-11) used to compute the gain or loss.

Similar to Topic 606, if a contract does not exist, the seller recognizes the cash received as a deposit liability, continues to report the real estate in its financial statements, depreciates it (if not held for sale), and tests it for impairment. [360-10-35, 360-10-40-3C, 45-9 – 45-10]

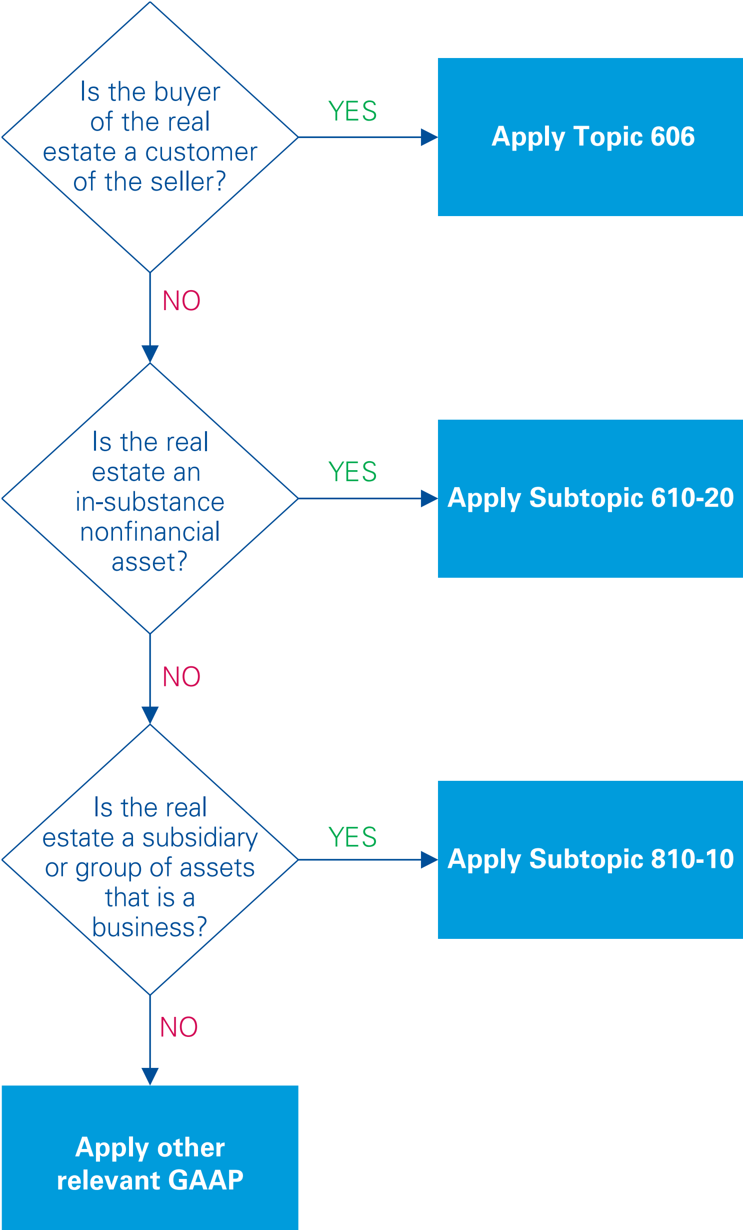
This reporting continues until a contract does exist and control of the property has transferred, or until the seller meets one of the conditions in paragraph 606-10-25-7.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

A20. When is a noncustomer real estate sale considered a sale of an in-substance nonfinancial asset that is accounted for under Subtopic 610-20, versus a sale of a business that is accounted for under Subtopic 810-10?

In some cases, a noncustomer sale involving real estate-related assets (or a group or subsidiary holding real estate assets) may seem to have the characteristics of both the sale of a business (generally subject to Subtopic 810-10) and the sale of an in-substance nonfinancial asset (generally subject to Subtopic 610-20). Determining which Subtopic applies is important because that determination may affect the amount and timing of profit recognition.

This flowchart depicts the decision sequence.



© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Profit recognition under Subtopics 360-10 and 610-20

Paragraphs 360-10-40-3A and 40-3B (applicable to property, plant and equipment) state that derecognition of an in-substance nonfinancial asset should be accounted for under Topic 606 (if the sale is to a customer) or Subtopic 610-20 (if the sale is to a noncustomer). Under Subtopic 610-20, when a contract exists and control of the property is transferred, the seller derecognizes the real estate (or in-substance real estate) and recognizes as a gain or loss the difference between the transaction price and the carrying amount of the real estate (otherwise, the entity generally continues to report the real estate in its financial statements as discussed in Question A10).

The proposed amendment to Subtopic 610-20 also would include in the consideration used to compute the gain or loss the carrying amount of liabilities assumed by the buyer. The carrying amount would be subject to the constraint on estimating variable consideration (see the section *Proposed Clarifications to the Scope of Asset Derecognition Guidance*). [606-10-32-11]

Profit recognition under Subtopic 810-10

When the seller/parent *no longer* has a controlling financial interest in a business, it deconsolidates/derecognizes the subsidiary or group of assets. It then recognizes as a gain or loss the difference between the fair value of the consideration received (including the fair value of any noncontrolling interest retained post-sale) and the carrying amount of the subsidiary's assets and liabilities (as well as the carrying amount of any noncontrolling interest existing just before the sale).

When the seller/parent's ownership decreases, but it *retains* a controlling financial interest, the seller/parent recognizes an adjustment to equity equal to the difference between the fair value of the consideration received and the amount by which the noncontrolling interest is adjusted (i.e. there is no gain or loss recognized in consolidated net income or comprehensive income).

Interaction between Subtopics 810-10 and 610-20

Paragraphs 810-10-40-3A and 810-10-45-21A exclude the transfer of in-substance nonfinancial assets from Subtopic 810-10's deconsolidation and decreases in ownership guidance. Similarly, paragraphs 360-10-40-3A and 40-3B (applicable to property, plant and equipment) state that derecognition of an in-substance nonfinancial asset should be accounted for under Topic 606 (if the sale is to a customer) or Subtopic 610-20 (if the sale is to a noncustomer).

That guidance also says that derecognition of a subsidiary or group of assets is accounted for under Subtopic 810-10 only if that subsidiary is (a) not an in-substance nonfinancial asset, and (b) not sold to a customer. Therefore, the guidance on sales of an in-substance nonfinancial asset currently takes precedence over the deconsolidation/derecognition guidance for sales of a business (see the section *Proposed Clarifications to the Scope of Asset Derecognition Guidance).*

What is an 'in-substance nonfinancial asset'?

An in-substance nonfinancial asset is not currently defined (the FASB recently proposed a definition; see the section *Proposed Clarifications of the Scope of Asset Derecognition Guidance*). However, the FASB retained the legacy guidance in 360-20-15-2 on identifying in-substance real estate, including the requirement to consider the nature of the entire real estate component that the entity is selling. [978-10-15-7 – 15-12]

The FASB retained this guidance to identify the scope of sale-leaseback transactions that remain subject to the guidance in Subtopic 360-20[1] and timeshare transactions within the scope of Topic 978. However, we believe this discussion about what constitutes in-substance

[1] Sale-leaseback transactions remain subject to Subtopic 360-20 only until a company adopts ASU 2016-02, *Leases* (Topic 842). Topic 842 supersedes Subtopic 360-20 and provides a single accounting model for sale-leaseback transactions that applies regardless of the nature of the asset transferred.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

real estate remains relevant for concluding whether a sale of an asset with a real estate component to a noncustomer is within the scope of Subtopic 610-20 (in-substance nonfinancial assets) or Subtopic 810-10 (businesses).

Under paragraph 360-20-15-2, land plus property improvements and integral equipment are collectively considered in-substance real estate, so sales of those assets to noncustomers are accounted for under Subtopic 610-20. This guidance applies even if all (or part) of the operations of the property otherwise meet the definition of a business. Conclusions about whether an operating real estate property or an ownership interest in an entity with significant real estate assets is in-substance real estate (sales to noncustomers accounted for under Subtopic 610-20) is a matter of judgment, and all facts and circumstances should be considered.

We believe the sale of a single real estate property generally should be accounted for as the sale of a nonfinancial asset under Subtopic 610-20. Further, we believe if an entity has an ownership interest in an entity that holds a single real estate property, or substantially all of a multi-asset entity's value comprises real estate assets, selling the ownership interest likely would be a sale of an in-substance nonfinancial asset that would be accounted for under Subtopic 610-20. [610-20-15-2(b)]

Proposed clarifications to the scope of asset derecognition guidance

The FASB is reconsidering its guidance in its project on *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets* (previously referred to as *Clarifying the Definition of a Business Phase 2*).[2] In its *Clarifying the Definition of a Business (Phase 1)* project, the FASB proposed to change the definition of a business[3], which would result in most real estate being considered a nonfinancial asset rather than a business. In Phase 2, the FASB has proposed that Subtopic 610-20 would apply only when the property (in the form of a single nonfinancial asset or multiple, distinct in-substance nonfinancial assets) does not meet the definition of a business. When the property does meet the definition of a business, the seller would apply the deconsolidation and derecognition guidance in Subtopic 810-10.

There are also scope exceptions to the proposed guidance in Subtopic 610-20 for:

— nonprofit activities;

— sales to customers;

— transfers of investments (e.g. those accounted for under the equity method, see Question A10);

— transfers of subsidiaries in which substantially all of the fair value is not concentrated in nonfinancial assets;

— exchanges of nonfinancial assets for a controlling financial interest in a business (business combinations);

— exchanges between entities in the same line of business to facilitate sales to customers;

— nonreciprocal transfers;

— real estate sale-leaseback transactions;

— conveyances of oil and gas mineral rights; and

— exchanges of airline take-off and landing slots.

[2] For more information on this project, see KPMG's Defining Issues No. 16-21, FASB Proposes to Clarify Scope of Derecognition of Nonfinancial Assets.

[3] For more information on this project, see KPMG's Defining Issues No. 15-56, FASB Proposes to Clarify the Definition of a Business.

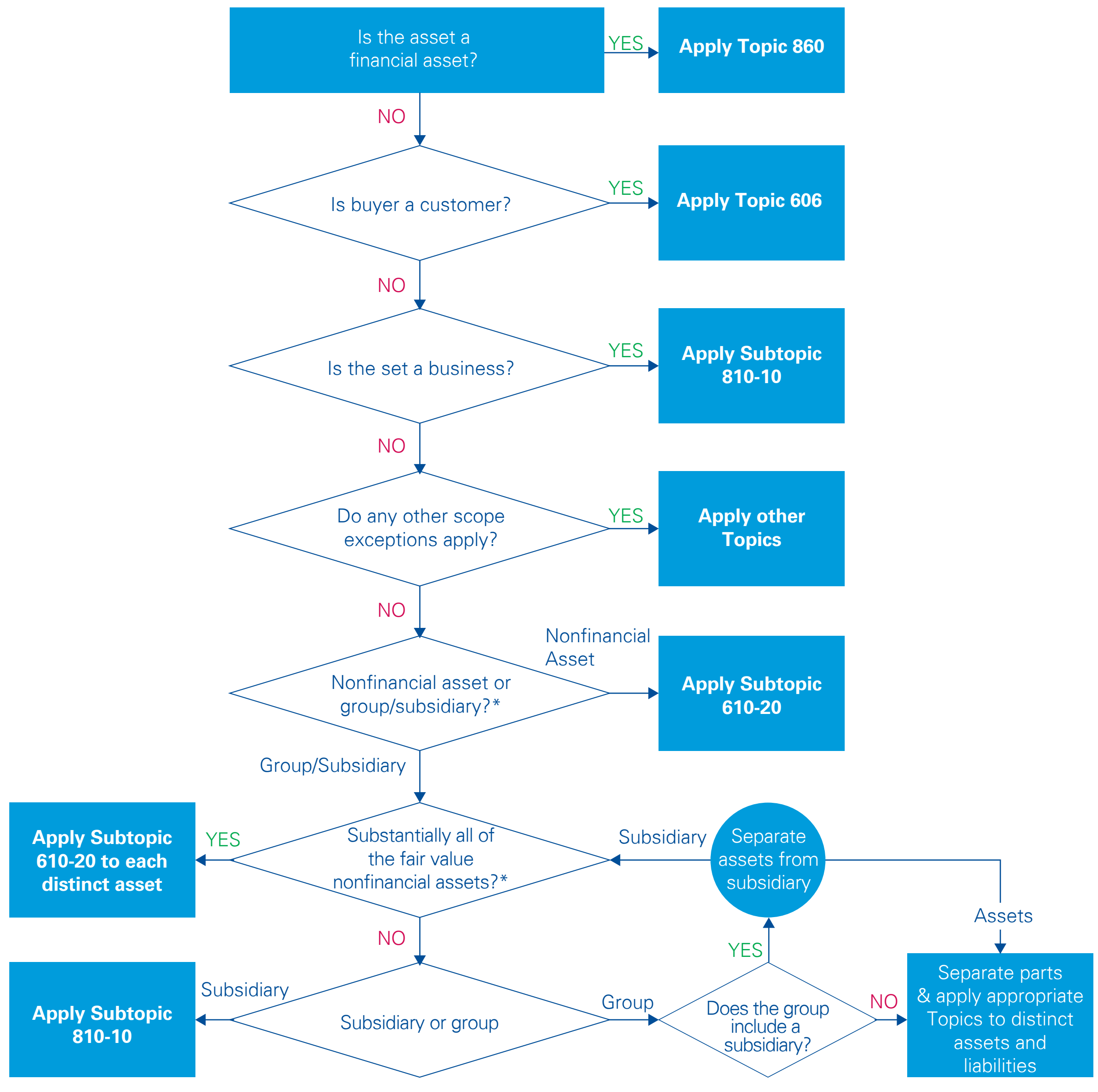
© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

An asset would be an *in-substance nonfinancial asset* when (a) it is included either in a group (by contract) or a subsidiary, and (b) substantially all of the fair value (recognized and unrecognized, but excluding cash and cash equivalents) of that group or subsidiary is concentrated in nonfinancial assets (e.g. real estate and intangibles).

When substantially all of the fair value of the group or subsidiary is concentrated in nonfinancial assets:	All the assets in the group or subsidiary are considered in-substance nonfinancial assets, even if individual assets would be considered financial assets if they were sold independently.
When substantially all of the fair value of a *group* of assets is *not* concentrated in nonfinancial assets and the group is not a business:	The seller would apply the revenue guidance on identifying distinct goods and services and allocating consideration to those distinct goods and services. Then, the seller would account for each of the distinct goods and services under the applicable guidance (usually Subtopic 610-20) for the sale of distinct nonfinancial assets in the group.
When substantially all of the fair value of a *subsidiary* is *not* concentrated in nonfinancial assets and the subsidiary is not a business:	The seller would apply the guidance in Topic 810 on derecognition and decreases in ownership of businesses, which is required for subsidiaries when no other guidance applies. Topic 810 requires full gain or loss in earnings when a controlling financial interest is sold, and no gain or loss in earnings when a controlling financial interest is retained (i.e. the gain or loss is an adjustment to equity).

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

How a seller determines what guidance would apply when transferring a nonfinancial asset



* If the transfer includes other contractual arrangements that are not the assets of the seller to be derecognized (e.g. guarantees), those contracts are separated and accounted for under the applicable literature.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

A30. How is Topic 606 applied when an entity sells property improvements (or integral equipment) and leases the underlying land to a customer? Does the answer differ if the transaction is with a noncustomer?

When a contract contains elements covered by different accounting Topics, the entity applies the guidance in those other Topics about how to separate and/or initially measure those elements. However, if the other guidance does not specify how to separate and/or initially measure one or more parts of the contract, then the entity applies Topic 606's separation and/or measurement guidance. [606-10-15-4]

The guidance in the current lease standard requires the seller/lessor to separate lease and non-lease components based on the relative stand-alone selling price. This requirement is consistent with the guidance in paragraphs 606-10-32-28 to 32-41. For example, in a sale of improvements together with a lease of the land on which the improvements are located, the seller/lessor separates the transaction into the lease of the land and the sale of the improvements and accounts for each separately. Revenue is recognized on the sale of the property improvements (or integral equipment) when control transfers to the customer (based on Topic 606's requirements). The lease of the land is accounted for under Topic 840, which requires lessors to classify land leases as operating leases if there is no automatic transfer of title to the lessee by the end of the lease term. [840-10-15-17 – 15-19]

Because Topic 840 generally addresses separation and measurement in transactions with lease and non-lease components regardless of whether the lessee is a customer, we believe this guidance applies equally to similar transactions with noncustomers. However, the presentation of the sale transaction would be treated differently. Subtopic 610-20 requires gain/loss presentation for noncustomer transactions while Topic 606 requires revenue and cost of sales presentation for customer transactions.

The FASB recently issued ASU 2016-02, which created a new Topic 842, *Leases*,[4] which will supersede Topic 840.

	Public business entities[5]	**Other entities**
Effective date	Annual and interim periods in fiscal years beginning after December 15, 2018	— Annual periods beginning after December 15, 2019 — Interim periods in fiscal years beginning after December 15, 2020
Early adoption	All entities can adopt Topic 842 immediately	

Topic 842, like Topic 840, includes guidance on separating lease and non-lease components. A lessor must separate a single contract into each separate lease component and non-lease component and allocate the consideration using the revenue accounting guidance, which specifies that the transaction price usually is allocated on a relative stand-along selling price basis. [606-10-32-28 – 32-41, 842-10-15-28 – 15-32, 15-38 – 15-42]

[4] For more information on ASU 2016-02, see Defining Issues 16-6, FASB Balloons Balance Sheet with New Lease Accounting Standard, and Leases: Issues in Depth.

[5] This includes (1) not-for-profit entities that have issued, or are conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and (2) employee benefit plans that file or furnish financial statements with or to the SEC.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Topic 842 requires a lessor to classify a lease as an operating lease unless the lessee:

a. effectively obtains control of the underlying asset as a result of the lease; or

b. does not obtain effective control but:

   – the present value of the sum of the lease payments ***plus***

   – any residual value guaranteed by the lessee (or any other third party unrelated to the lessor) not already reflected in the lease payments

   – ***equals*** or ***exceeds*** substantially all of the fair value of the underlying asset *and* it is probable that the lessor will collect the lease payments plus the amount needed to satisfy a residual value guarantee. [842-10-25-2 – 25-3]

A lessee effectively obtains control of the underlying asset when the lease meets any of the following criteria at lease commencement:

a. the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;

b. the lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise;

c. the lease term is for the major part of the remaining economic life of the underlying asset;

d. the present value of the sum of the lease payments and any residual value guaranteed by the lessee that is not already reflected in the lease payments equals or exceeds substantially all of the fair value of the underlying asset; or

e. the underlying asset is so specialized that it is expected to have no alternative use to the lessor at the end of the lease term. [842-10-25-3]

Comparison to legacy US GAAP

The sale of property improvements with an accompanying lease of the underlying land must be accounted for on a combined basis as a lease of the land and the improvements if the terms of the land lease either:

a. does not cover substantially all of the economic life of the improvements; or

b. is not for a substantial period (e.g. 20 years). [360-20-40-56 – 40-59, 55-33 – 55-43]

Under Topic 606 and the related amendments to Topic 840 (and Topic 842 when it becomes effective), the seller accounts for the sale of the improvements and the lease of the land separately.

Even when the sale of the improvements and the land lease are accounted for separately currently under Subtopic 360-20, the profit recognized on the sale of the improvements is a function of the:

— present value of the rental payments;
— term of the primary indebtedness on the improvements (if any);
— sale value of the improvements; and
— carrying amount of the improvements and the land.

Under Topic 606 and the related amendments to Topic 840 (and Topic 842 when it is effective), profit on the sale of the improvements is a function of the consideration allocated to the sale (usually based on the relative stand-alone selling prices of the two components) and the carrying amount of the improvements. In addition, the classification of the land lease under Topics 840 and 842 may differ because Topic 842 does not retain Topic 840's requirement to classify land leases as operating leases if there is no automatic transfer of title to the lessee by the end of the lease term.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

A40. How does a seller apply Topic 606 when it guarantees the return of a customer's investment (or a return on that investment) for a limited or extended period in connection with the sale of real estate? Is the answer different if the transaction is with a noncustomer?

When a contract with a customer contains elements addressed by different Topics, if the other Topics specify how to separate and/or initially measure one or more parts of the contract, then an entity first applies those separation and/or initial measurement requirements. [606-10-15-2, 15-4]

The seller first determines whether Topic 460, *Guarantees*, Topic 815, *Derivatives and Hedging,* or another Topic, applies to the guarantee. If the guarantee is within the scope of Topic 460 or Topic 815, the seller/guarantor initially recognizes and measures it at fair value using the initial measurement guidance in the applicable Topic. The seller then allocates the remainder of the consideration to the sale of the property. [606-10-15-2]

The following guarantee contracts are within the scope of Topic 460:

a. Contracts that contingently require a guarantor to make payments to a guaranteed party based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party.

b. Contracts that contingently require a guarantor to make payments to a guaranteed party based on another entity's failure to perform under an obligating agreement (performance guarantees).

c. Indemnification agreements (contracts) that contingently require a guarantor to make payments to an indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability, or an equity security of the indemnified party.

d. Indirect guarantees of the indebtedness of others, even though the payment to the guaranteed party may not be based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party. [460-10-15-4]

Paragraph 460-10-55-2(b) states that a market value guarantee on a nonfinancial asset owned by the guaranteed party is an example of the type of contract described in paragraph 460-10-15-4(a). We believe seller guarantees, similar to market value guarantees, generally fall within the scope of Topic 460 and are separated from the sale transaction and initially measured at fair value. The seller allocates the remainder of the contract consideration to the sale of the real estate, which is subject to Topic 606's guidance on determining the transaction price.

Because the seller accounts for it separately, the guarantee does not affect the seller's ability to recognize revenue under Topic 606 when it transfers control of the real estate to the buyer. Guarantee-like arrangements not within the scope of Topic 460 or other accounting guidance are combined with the sale transaction and accounted for under Topic 606. These guarantee-like provisions may affect the:

a. amount of revenue recognized on the sale (because it may result in the transaction price being variable), or

b. timing of profit recognition if the provision is significant enough to conclude that control of the property has not transferred.

See Question F10 for discussion about control transfer and Question F60 for discussion about put options, which is another situation when a seller may retain control despite relinquishing physical possession of the property.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

While Subtopic 610-20 currently does not address separating noncustomer multiple element transactions, we believe an entity selling to a noncustomer applies the same guidance as Topic 606. We hold this view because Subtopic 610-20 refers to Topic 606's transaction price and control transfer principles, which are most likely to be affected by a guarantee in connection with a sale. The FASB has confirmed this view in its proposed amendments to Subtopic 610-20. The FASB proposal would require that a seller separately account for parts of a contract that are not assets of the entity to be derecognized and cites as an example a guarantee accompanying the sale of real estate.

Comparison to legacy US GAAP

A guarantee of a buyer's return on or of investment in connection with a real estate sale, while generally meeting the definition of a guarantee in Topic 460, currently is accounted for in combination with the real estate sale under Subtopic 360-20 because it is scoped out of Topic 460. [460-10-15-17(g), 55-17(a)]

A seller that guarantees the return of the buyer's investment (or a return on that investment) for an extended period must account for the transaction as a financing, leasing or profit-sharing arrangement. If the guarantee of a return on the investment is for a limited period, the seller accounts for the transaction under the deposit method until the property's operating income covers all operating expenses, debt service and contractual payments. When all expenses are covered, profit is recognized based on the performance of the required services. [360-20-40-41]

Topic 606 changes this accounting because the guarantee by itself does not preclude the seller from recognizing a sale of the real estate; instead, the seller accounts for the guarantee separately under Topic 460 (if within its scope). The guarantee does, however, reduce profit on the sale of the real estate under Topic 606 because the fair value of the guarantee reduces the contract consideration allocated to the sale of the real estate. If the guarantee is not within the scope of Topic 460 or other Topics, it remains combined with the sale transaction and may affect the amount or timing of revenue (or profit) recognition.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

A50. How is Topic 606 applied when a seller is required to initiate or support the operations of a property that is sold to a customer? Is the answer different if the transaction is with a noncustomer?

If the seller's obligation to support the operations of the property is within the scope of Topic 460 because it has the characteristics of a guarantee listed in Section 460-10-15 (e.g. the seller agrees to support the operations up to a break-even level of cash flows for a period of time), the seller separates the support obligation and initially recognizes and measures it at fair value under Topic 460's initial measurement guidance. The seller allocates the remainder of the contract consideration to the sale of the real estate and follows Topic 606's guidance on determining the transaction price. [460-10-30-2]

In our experience, support obligations generally have the characteristics of a guarantee that is within the scope of Topic 460, because they are analogous to a guarantee of the collection of scheduled contractual cash flows from financial assets or business revenue. [460-10-15-4(a), 460-10-55-2(d) – 55-2(e)]

Therefore, we believe most support obligations will be separated from the sale transaction and initially measured at the fair value of the guarantee. When the seller accounts for support obligations separately, it does not affect the seller's ability to recognize revenue under Topic 606 when or as the seller transfers control of the real estate to the buyer.

Guarantee-like arrangements not within the scope of Topic 460 or other Topics remain combined with the sale transaction accounted for under Topic 606 and may affect the:

a. amount of revenue recognized on the sale (because it may result in the transaction price being variable), or

b. timing of profit recognition if the provision is significant enough to conclude that control of the property has not transferred.

See Question F10 for discussion about control transfer and Question F60 for discussion about put options, which is another situation when a seller may retain control despite relinquishing physical possession of the property.

While Subtopic 610-20 currently does not address separating noncustomer multiple element transactions, we believe an entity selling to a noncustomer applies the same guidance. We hold this view because Subtopic 610-20 refers to Topic 606's transaction price and control transfer principles, which are most likely to be affected by a guarantee in connection with a sale. The FASB has confirmed this view in its proposed amendments to Subtopic 610-20. The proposal would require that a seller separately account for parts of a contract that are not assets of the entity to be derecognized and cites as an example a guarantee of break-even cash flows accompanying the sale of real estate.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Comparison to legacy US GAAP

An agreement to initiate or support the operations of a property in connection with a sale of that property, while generally meeting the definition of a guarantee in Topic 460, currently is accounted for in combination with the real estate sale under Subtopic 360-20 and therefore is scoped out of Topic 460. [460-10-15-17(g), 55-17(b)]

A seller accounts for a sale transaction as a financing, leasing or profit-sharing arrangement if it is required to initiate or support operations or continue to operate the property at its own risk (or presumed to have such a risk) for an extended period of time and provides conditions that, if present, presume support for an extended period of time. If support is required (or presumed to be required) for a limited time, a seller must recognize profit on a proportional performance basis as the services are provided. [360-20-40-43 – 40-44]

Performance of those services is measured by the costs incurred and to be incurred over the period during which the services are performed (i.e. on a cost-to-cost basis). The seller begins to recognize profit when there is reasonable assurance that the future rent receipts will cover operating expenses and debt service, including payments due to the seller under the terms of the transaction.

Topic 606 changes the accounting because the support obligation by itself does not preclude the seller from recognizing a sale of the real estate; instead, the seller accounts for the support obligation separately under Topic 460 (if within its scope). The guarantee does, however, reduce profit on the sale of the real estate under Topic 606 because the fair value of the support obligation reduces the contract consideration allocated to the sale of the real estate. If the support obligation is not within the scope of Topic 460 or other Topics, it remains combined with the sale transaction and may affect the amount or timing of revenue (or profit) recognition.

Example A50: Property sale with support obligation

Description of the arrangement

ABC Corp. sells a newly constructed property with a cost of $1,200,000 to DEF Corp. for $2,000,000 in cash. ABC guarantees the cash flows of the property will be sufficient to meet all the property's operating needs for the first three years after the sale date. The fair value of the guarantee at the sale date is $30,000 and there is no other variable consideration.

Evaluation

Because the support obligation is a guarantee within the scope of Topic 460, it is initially separated from the real estate sale and measured at fair value. ABC allocates $30,000 of the $2,000,000 contract consideration to the guarantee, and allocates $1,970,000 to the sale of the property, which is the transaction price.

ABC recognizes a profit of $770,000 ($1,970,000 less $1,200,000 cost) on transferring control of the property. The guarantee continues to be accounted for separately under Topic 460 and does not affect the profit recognized on the sale. ABC recognizes subsequent changes in the guarantee's carrying amount outside of revenue (or gain on sale if the buyer is not a customer).

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

A60. What is the unit of account under Topic 606 for sales of condominium units within a condominium project (or similar structure)?

Topic 606 generally specifies the unit of account is an individual contract with a customer. Further, paragraph 606-10-55-180 contemplates that individual contracts with customers to construct individual units in a multi-unit residential complex are accounted for separately. Paragraph 606-10-10-4, however, provides a practical expedient allowing an entity to apply the guidance to a portfolio of contracts (or performance obligations) with similar characteristics, but only if the entity reasonably expects the effect on the financial statements to not differ materially from applying the guidance to the individual contracts.

We believe it may be difficult for an entity to demonstrate a reasonable expectation that the effect of using a project approach is materially the same as using an individual contract approach because the:

a. control of the individual units likely will transfer at different points in time (see Question F40 about the pattern of control transfer in unit sales); and

b. transaction prices and the fulfillment costs of individual units within a project likely will be different.

Comparison to legacy US GAAP

If an entity separately sells individual units in a condominium project, it must recognize profit using the percentage-of-completion method on the sale of individual units, if the sale meets the following conditions:

— construction is beyond a preliminary stage;

— the buyer is committed to the extent of being unable to require a refund except for non-delivery of the unit;

— sufficient units have already been sold to assure that the entire property will not revert to rental property;

— sale prices are collectible; and

— aggregate sale proceeds and costs can be reasonably estimated. [360-20-40-50]

Sellers/developers may have historically applied the percentage-of-completion method by measuring progress on a cost-to-cost basis relative to the project as a whole, and applying that measure of progress to the estimated gross profit (revenue and expense) on an individual unit sale. The unit is considered sold if the above criteria are met, which typically occurs before closing.

Under Topic 606 sellers/developers generally are required to separately account for each contract with an individual customer unless they reasonably expect the effect on the financial statements of using a portfolio (or project) approach will not differ materially from applying the guidance to the individual contracts. As explained previously, we expect that the portfolio approach will not be appropriate for most condominium projects. See chapter F. Step 5: *Recognize Revenue* for discussion of the pattern of control transfer of real estate sales and Question F40 for discussion of unit sales.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

B Step 1: Identify the contract

B10. What consideration should an entity give to the buyer's initial and continuing investments when evaluating if a seller of real estate has a contract with a buyer?

Unlike current guidance for real estate sales, Topic 606 contains no explicit initial or continuing investment requirements for the buyer. The seller must evaluate whether the parties are "committed to perform their respective obligations" and whether it is "probable [the seller] will collect substantially all of the consideration to which it will be entitled" in exchange for property transferred to the buyer.

The objective of evaluating the customer's ability and intention to pay is to assess whether there is a substantive transaction between the seller and the buyer. This assessment is partially forward looking, which requires the seller to use judgment and consider all facts and circumstances, including the seller's customary business practices and its knowledge of the buyer. [606-10-25-1]

Seller's considerations when evaluating whether collectibility is probable	

Payment terms that suggest a significant uncertainty about the buyer's intention and ability to fulfill its obligations	Do the payment terms reflect inherent uncertainty about the buyer's intention to fulfill its obligations?
	— Small down payment relative to the overall contracted price
	— Nonrecourse, seller-provided financing
	— Customer-provided collateral or guarantees that are illiquid or have highly variable or unobservable fair value
	— Continuing periodic payments that extend beyond:
	  – a customary financing period for similar transactions
	  – the property's estimated useful life
	— No periodic payments required
	— Guarantees provided by lower-rated counterparties

Importance of the property to the buyer's operations	— Does the buyer's business model and reasons for entering into the transaction raise doubt about its intention to follow through with its obligations? — Does the buyer need the property to operate its business, which likely indicates that it would have a greater commitment to perform than if the purchase was made for speculative investment purposes?
Prior experience	— Does the seller have prior experience with the buyer (or a similar class of buyer) for the same or similar transaction that raises questions about the buyer's intent and ability to perform? — Has the seller previously chosen not to enforce its contractual rights in similar contracts with the buyer (or buyer class) under similar circumstances? — Is the seller's receivable subject to future subordination?

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

An entity should not view these factors in isolation. Instead, the entity should evaluate the factors collectively and evaluate all relevant facts and circumstances. No single factor determines whether the customer is committed to perform or collectibility is probable. An entity that refers to the legacy guidance in Subtopic 360-20 on initial and continuing investments as an indicator of whether collectibility is probable under Topic 606 should not consider these thresholds as safe harbors or bright lines. The seller's ability to later repossess the property after it transfers control to the buyer at a point in time should not be considered when assessing its ability to mitigate its credit risk exposure. [606-10-55-3C]

If the transaction does not meet criteria in paragraph 606-10-25-1, the arrangement is not a contract and the seller:

— needs to continue to report the nonfinancial asset on its statement of financial position;

— depreciates it if it is not held for sale under paragraphs 360-10-45-9 – 45-10; and

— tests it for impairment under Section 360-10-35. [360-10-40-3C]

The seller then accounts for cash collected as a deposit liability until the conditions for a contract exist and the seller transfers control of the property to the buyer or until it meets one of the following conditions: [606-10-25-6 – 25-8]

a. The seller has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the promised consideration has been received and is nonrefundable;

b. The contract has been terminated and the consideration received is nonrefundable; or

c. The seller has transferred control of the goods or services to which the consideration that has been received relates; the entity has stopped transferring goods and services to the customer (if applicable) and has no obligation under the contract to transfer additional goods or services; and the consideration received from the buyer is nonrefundable. [606-10-25-7]

If the transaction subsequently meets the criteria in paragraph 606-10-25-1, revenue or gain is recognized by applying the guidance in Topic 606 (customer transactions) or Subtopic 610-20 (noncustomer transactions).

Paragraphs 606-10-55-95 to 55-98 illustrate the collectibility analysis in the context of a real estate sale when a real estate developer sells a building and provides long-term, nonrecourse financing for 95 percent of the sales price. The buyer expects to repay the loan primarily from income derived from its restaurant business and lacks other income or assets to repay the loan. Additionally, the restaurant business faces significant competitive risks and the buyer has limited industry experience. Because of the uncertainty associated with the buyer's ability and intention to pay, the seller concludes that the criteria in paragraph 606-10-25-1 are not met.

At the sale date (and each reporting period), the seller must evaluate conditions (a) through (c) in paragraph 606-10-25-7 to determine how to account for the nonrefundable deposit, until it meets the criteria in paragraph 606-10-25-1.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

We believe the seller would conclude at the sale date that the first two conditions under paragraph 606-10-25-7 are not met because the:

a. seller has not received substantially all of the consideration; and

b. contract has not been terminated.

We also believe the third condition may not be met because the seller may conclude it has retained control of the building based on its analysis of the control indicators in paragraph 606-10-25-30. Paragraph 360-10-40-3C specifies that the seller does not derecognize the asset when the criteria for a contract in paragraph 606-10-25-1 are not met. See additional discussion of control transfer in Question F10.

The seller would recognize the nonrefundable deposit received from the buyer as a deposit liability. The seller would not derecognize the asset, and would not recognize a receivable for the remainder of the sales price. The seller must continue to assess the contract to determine whether the paragraph 606-10-25-1 criteria are subsequently met, or one of the conditions in paragraph 606-10-25-7 exists. We believe the following situations will most commonly occur in real estate sales when a contract does not exist at the sale date.

— A contract subsequently does exist under paragraph 606-10-25-1 because the buyer has established a consistent payment history, has established other sources of funds, or accumulated funds to reduce the risk of nonpayment. The seller derecognizes the building and recognizes revenue (or gain or loss) on the sale at the point in time control transfers.

— A contract does not exist under paragraph 606-10-25-1, but the parties terminate the arrangement and the seller repossesses the property. The seller recognizes the nonrefundable deposit in income.

The guidance on evaluating the existence of a contract (and the accounting if a contract does not exist) applies to both customer and noncustomer transactions.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Comparison to legacy US GAAP

Paragraph 360-20-40-5 requires, among other things, that a buyer's initial and continuing investments are adequate to demonstrate a commitment to pay for the property to be able to recognize profit by the full accrual method. Adequacy of the buyer's initial investment is measured both by its composition and size compared with the sale price of the property. [360-20-40-10, 40-13, 40-18]

The buyer's continuing investment does not qualify unless it meets certain conditions. The buyer must be contractually required to pay annually on its total debt incurred to buy the property an amount at least equal to the level annual payment that it would be required to pay, including interest, over (a) no more than 20 years for land, or (b) the customary amortization term of a first mortgage loan extended by an independent, established real estate lending institution. [360-20-40-19]

If the buyer's initial or continuing investment is not adequate, the seller must apply the installment, cost recovery or deposit method to account for the sale, depending on the likelihood of recovery if the buyer defaults. [360-20-40-31]

Topic 606 changes the accounting for transactions where a contract exists based on qualitative considerations, but would not otherwise meet the initial and continuing investment requirements of Subtopic 360-20. Under Topic 606, this contract results in revenue recognition (or gain recognition in a noncustomer transaction under Subtopic 610-20) when or as control transfers to the buyer. In contrast, under Subtopic 360-20 this contract results in application of the installment, cost recovery or deposit method.

The results of applying Topic 606 may also differ from the current accounting under Subtopic 360-20, even when a contract does not exist. Topic 606 prohibits using the installment or cost recovery methods. Instead, it requires that the entity use a form of the deposit method. However, the application of the deposit method differs between Subtopic 360-20 and Topic 606/ Subtopic 610-20.

When an entity applies the deposit method under Subtopic 360-20, if a portion of the cash received is contractually designated as interest (versus principal) and is nonrefundable, then those interest receipts offset the seller's carrying charges (property taxes and interest on existing debt) on the property. An entity records its receipts of principal (and interest in excess of carrying charges on the property) as a deposit liability.

Under Topic 606/Subtopic 610-20, all amounts received are recorded as a deposit liability.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

C Step 2: Identify the performance obligations

C10. Is the sale of an undivided interest in the common areas where the seller/developer may build future amenities considered a separate performance obligation from the sale of a condominium unit or residential lot when the undivided interest is transferred to the customer in the sales transaction? Does the answer change if the seller/developer does not transfer the undivided interest but it will transfer future amenities to a third party?

A seller accounts for a good or service as a performance obligation if the good or service promised to the customer is distinct from other goods or services promised in the contract. A good or service is distinct if the:

a. customer can benefit from the good or service either on its own or with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct), and

b. entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. distinct in the context of the contract). [606-10-25-19]

Capable of being distinct

A good or service meets criterion (a), capable of being distinct, if it could be "used, consumed, sold for an amount that is greater than scrap value, or otherwise held in a way that generates economic benefits." The fact that the entity regularly sells a good or service separately indicates that a customer could benefit from the good or service on its own or with other readily available resources. [606-10-25-20]

Distinct in the context of the contract

The seller's objective when assessing whether a promise is distinct in the context of the contract (criterion (b)) is to determine whether the nature of its overall promise is to transfer each of the goods or services, or whether the promise is to transfer a combined item to which each of the promised goods or services are inputs. [606-10-25-21]

These factors indicate a good or service is not distinct in the context of the contract:

— the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract;

— one or more of the goods or services significantly modifies or customizes, or is significantly modified or customized by, one or more of the other goods or services promised in the contract; or

— the goods or services are highly interdependent or highly interrelated (i.e. each one is significantly affected by the other goods or services).

We do not believe the seller/developer's undivided interest in the common areas is capable of being distinct because it cannot generate economic benefits on its own or with other readily available resources.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

The common areas, regardless of whether the amenities have been completed, generally:

a. cannot generate independent economic benefits to the buyer (the undivided interest is not practically separable from the fee interest in the unit or lot); and
b. the buyer is unable to purchase (or not purchase) the undivided interest without the condominium unit or lot.

Therefore, the sale of the unit or lot and the accompanying transfer to the customer of the undivided interest in the common area would be a single performance obligation.

We believe this conclusion is consistent with the FASB's guidance that says that a developer may need to include in its measure of progress toward completely satisfying its performance obligation to construct an individual unit within a multi-unit residential complex its progress on completing construction of the common areas. [606-10-55-180]

We also believe this conclusion is consistent with the cost guidance in Subtopic 970-340 that requires developers to allocate to the benefitted land parcels the common costs of the amenity. This guidance was not amended by Topic 606 or Topic 340.

Accounting for amenity costs

The FASB's industry guidance in Subtopic 970-340 on accounting for amenity costs applies because the future amenity is being sold or transferred in connection with the sale of individual units by transferring an undivided interest. In this situation, the developer should allocate the costs that exceed the anticipated proceeds as common costs to the land parcels that benefitted from the development, or probably will benefit, because the amenity is clearly associated with the sale of the project. The common costs include the developer's expected future operating costs until the amenity is assumed by the buyers of the units. Before the amenity is substantially complete and available for use, operating income (loss) is included as a reduction of (or addition to) common costs. See additional discussion in Question F40 about the timing of revenue recognition for sales of condominium units (and other similar structures). [970-340-25-9 – 25-11]

Transferring future amenities to a third party

When the seller/developer transfers future amenities to a third party (e.g. a homeowner's association (HOA), municipality or community development district) instead of transferring them to the customer as an undivided interest, it analyzes the transfers differently. Based on discussions with the FASB staff, we believe that those third parties generally are not extensions of the customer because they are unrelated to the customer and the customer does not control the amenities before or after the transfer.

While an individual homeowner often has an obligation to pay fees to third-party transferees such as HOA dues or municipal taxes, and may have some rights to participate in their operation, such as becoming a board member, appealing fee or tax assessments, or obtaining and reviewing governing documents or financial data, the individual generally does not have an equity interest or the ability to control the third party or the amenity either before or after the transfer. In this situation, the promise associated with the future amenity would not be considered part of the customer's contract to purchase the property because the amenities will be transferred to an unrelated party. Therefore, delivery of the amenity would not be considered a performance obligation in the contract with the customer.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Accounting for amenity costs

We believe the guidance in paragraph 970-340-25-9(b) on accounting for amenity costs applies to these situations because the developer is selling or transferring the future amenity separately to the third party. The amount of capitalizable costs (incurred before the amenity is substantially complete and available for use) that exceeds the estimated fair value at the date of substantial physical completion should be allocated as common costs to the land parcels that benefitted and to those for which development is probable. Capitalizable costs are reduced for operating income (or are increased for operating loss) generated by the amenity before it is substantially complete and available for use. Operating income (or loss) generated by the amenity after it is substantially complete and available for use is included in operating results. A later sale of the amenity at an amount different than the estimated fair value at substantial completion, less any depreciation, results in a gain or loss in net income in the period in which the sale occurs. [970-340-25-10 – 25-11]

In the scenario described, the third party typically pays little or no consideration on transfer of the amenity. Therefore, we believe that the developer would treat as common costs all the costs associated with the amenity that are not expected to be recovered on transfer to the HOA or municipality.

C20. Does the sale of land and the agreement to construct property improvements comprise multiple performance obligations? Is the analysis different if the buyer is not a customer?

It depends. As discussed in Question C10, a seller accounts for a good or service as a performance obligation under paragraph 606-10-25-19 only if the good or service promised to the customer is distinct (i.e. capable of being distinct and distinct in the context of the contract) from other goods or services in the contract.

Capable of being distinct

When evaluating whether the transfer of the land and the construction contract are capable of being distinct, the seller/developer considers whether the land alone could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefit. For example, could the land alone be sold, developed by another party or leased to others?

The seller/developer also considers whether the property improvements that are the output of the construction contract could independently generate economic benefits. For example, could the property improvements be sold independently (perhaps if a buyer leased the underlying land) or leased?

The seller/developer also considers whether it (or a similar party) regularly sells land or construction services separately. [606-10-25-20]

We believe a seller/developer often may conclude that the sale of the land and construction service contract are capable of being distinct, but it needs to consider all the facts and circumstances. See Question C10 about how a seller/developer may evaluate this criterion in a property sale with an accompanying undivided interest in the common areas.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Distinct in the context of the contract

When the seller/developer evaluates whether the sale of the land and the construction contract are distinct in the context of the contract, its objective is to determine whether the nature of its overall promise is to transfer each of the goods or services, or whether the promise is to transfer a combined item to which the promised goods or services are inputs.

Factors that indicate a good or service is *not* distinct in the context of the contract, include, but are not limited to:

- **Indicator a** – the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract;
- **Indicator b** – one or more of the goods or services significantly modifies or customizes, or is significantly modified or customized by, one or more of the other goods or services promised in the contract; or
- **Indicator c** – the goods or services are highly interdependent or highly interrelated (i.e. each one is significantly affected by the other goods or services).

Indicator a

While land appears to be an input to delivering a property improvement, the land with the property improvements may not be the combined output specified in the contract. The land transfer and property improvement construction may be separate promises in the contract.

For example, these contract terms may suggest the promises are separate:

- the stated contract consideration (not necessarily the transaction price) for the land sale may be independent of the construction service consideration;
- the timing for delivery of each promise may be different because the title to the land transfers to the buyer before construction begins; or
- there are dispute resolution or default provisions associated with the land sale, the construction contract, or both, that do not affect the terms of the other promise.

Indicator b

Whether property improvements significantly modify or customize the land may depend, in part, on the nature of the improvement and the characteristics of the land. For example, certain land parcels may be expected to have largely the same value with or without the property improvements (e.g. one in a unique location and/or zoned for a particular use). Other land parcels may not require significant site preparation (demolition, clearing, grading or excavation) so the construction of the improvements may not significantly modify or customize the land.

Indicator c

This indicator focuses on whether the promises affect each other to such an extent that delivery/satisfaction of one without the other, and vice versa, would significantly affect the value or utility of the delivered/satisfied promise.

The FASB's guidance provides one example of highly interrelated promises when an entity grants a customer an antivirus software license along with when-and-if-available updates. The updates occur frequently and are critical to the continued utility of the software because without them the customer's ability to benefit from the software would decline significantly. These promises are not distinct in the context of the contract because the license and its updates are inputs to a combined output of antivirus protection. The updates significantly modify the functionality of the

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

software to ensure that it protects the customer from new viruses and are integral to maintaining the software's utility. The license and the updates fulfill a single promise to the customer, which is to provide protection from computer viruses for three years. We believe that the FASB intended this example to illustrate a very narrow fact pattern that is specific to certain software-license arrangements. [606-10-55-140D – 55-140F]

The FASB provides another example of an entity contracting with a customer to sell a piece of equipment with installation services that are not complex and are capable of being performed by alternative service providers. In this scenario, the promises are distinct in the context of the contract for the following reasons.

a. The entity is not providing a significant integration service. Instead, the entity has promised to deliver the equipment and install it. The entity would be able to fulfill its promise to transfer the equipment separately from its promise to install it. The entity has not promised to combine the equipment and the installation services in a way that would transform them into a combined output.
b. The installation services will not significantly customize or modify the equipment.
c. Although the customer can benefit from the installation services only after it has obtained control of the equipment, the installation services do not significantly affect the equipment because the entity would be able to fulfill its promise to transfer the equipment independently from its promise to provide installation services. Because the equipment and the installation services do not significantly affect each other, they are not highly interdependent or highly interrelated. [606-10-55-150A – 55-150D]

Even if the customer is contractually required to use the entity's installation services, the promises are still distinct because the contractual requirement does not change the characteristics of the goods or services, nor does it change the entity's promises to the customer. [606-10-55-150E – 55-150F]

When applying this guidance to land sales with accompanying development contracts, we believe seller/developers often will conclude that the land and construction services are not highly interdependent or highly interrelated because generally a customer could benefit independently from the land and construction services. For example, a customer could purchase the land and hire another party to perform the construction services and conversely could purchase, lease or redeploy other land on which the developer could construct the improvements. While the contract allows the customer to benefit from the construction services only after it has obtained control of the land, generally the seller/developer can fulfill its promise to transfer the land independently of its promise to perform the construction services.

However, there may be situations when the land sale and the development contract are highly interdependent or interrelated. This could occur when the entire project is so complex or specialized that the value of the combined output (i.e. the completed property) relies primarily on the seller/developer's proprietary knowledge, skill or position in the market. In these unusual situations, the parties to the contract also likely would conclude that indicator (a) is met because the seller/developer performs a significant service of integrating the land purchase and the construction services to deliver a transformed combined output for which the buyer has contracted.

A contractual requirement to use the same seller/developer for the land sale and construction services does not affect the conclusion about whether the promises are distinct. [606-10-55-150E – 55-150F]

Careful consideration of the total contract and all relevant facts and circumstances about the delivery of goods or services to the customer are critical when evaluating the principle and applying the indicators in paragraph 606-10-25-21.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

We believe the guidance on identifying performance obligations for a customer transaction also applies by analogy to noncustomer transactions even though Subtopic 610-20 currently does not specifically refer to paragraphs 606-10-25-14 to 25-22. The proposed ASU, *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*, clarifies that a seller would apply the revenue guidance on identifying distinct goods and services and allocating consideration to those distinct goods and services in noncustomer sales of nonfinancial assets or in-substance nonfinancial assets. The proposal also would require that the seller separately account for parts of a contract that are not assets of the entity to be derecognized such as guarantees or revenue contracts. See additional discussion of this project in Question A20.

See additional discussion in Question F30 about the timing of revenue recognition for land sales with accompanying construction contracts.

Comparison to legacy US GAAP

Paragraphs 360-20-40-61 to 40-64 address real estate sale contracts with future development required by the seller/developer. If the future costs of development can be reasonably estimated at the time of sale, the seller/developer allocates the profit at the same rate to the sale of the land and the development services. Profit allocated to the land sale is recognized when the land is sold, assuming the other criteria for recognition of profit by the full accrual method are satisfied. Profit allocated to the development services is recognized after the sale using the percentage-of-completion method as development and construction proceed.

Under Topic 606, a seller/developer first determines if the contract comprises one or two performance obligations (see Question C20 in Step 2). After the performance obligations are identified and the overall transaction price is determined (Step 3), the seller/developer allocates the transaction price to each performance obligation (Step 4). The seller/developer evaluates each performance obligation to determine whether it is satisfied (and therefore revenue should be recognized) over time or at a point in time (Step 5). See additional discussion in Question F30.

The evaluation process may result in differences from the accounting prescribed by paragraphs 360-20-40-61 to 40-64 for the following reasons.

a. Subtopic 360-20 requires identification of a single unit of account compared to the Step 2 process in Topic 606 that may result in more than one unit of account.
b. Step 3 of Topic 606 defines the overall transaction price differently than Subtopic 360-20 including the requirement to estimate variable consideration in the contract.
c. Subtopic 360-20 requires an entity to recognize the same rate of profit on the land sale and the development contract. In contrast, Step 4 of Topic 606 requires the entity to allocate the transaction price to the performance obligations (if there is more than one) based on relative stand-alone selling prices. This allocation can result in different profit margins on each performance obligation.
d. Subtopic 360-20 requires the use of percentage-of-completion to recognize revenue, while Step 5 of Topic 606 requires an entity to evaluate each performance obligation to determine if it is satisfied over time or satisfied at a point in time. [360-20-40-61]

This accounting may create differences in the amount and timing of revenue recognized on the property sale and the development contract, particularly when the seller/developer identifies two performance obligations. In the less likely scenario that the sale and development are a single performance obligation satisfied over time and the seller/developer uses a cost-to-cost input method for measuring the progress, the accounting under Topic 606 and Subtopic 360-20 may be similar (see Question F30).

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

C30. How should any entity analyze the number of performance obligations in a typical property management services contract?

As discussed in Question E10, the manager first must determine whether the nature of the property management services is to provide a single, integrated service offering for a defined period of time or to perform a specified set of activities during the period. Important to this determination is whether the activities the manager will perform to fulfill the performance obligation are indeterminate (e.g. even if the type of activities are generally understood, the quantity and mix of activities that will need to be performed to fulfill the obligation are unknown), or are known upfront (e.g. the manager will do X, Y and Z activity once each week for three years).

The manager must then determine whether the contractual service period can be subdivided into smaller time increments during which the manager's activities are substantially the same in each time increment. For example, could a three-year property management services contract be subdivided into time periods like three annual periods or 36 monthly periods?

After subdividing the service period into time increments, the manager must evaluate whether those identified increments are distinct from each other under paragraphs 606-10-25-19 and 606-10-25-21. If so, the manager considers the services a series of distinct services that are accounted for as a single performance obligation.

The FASB illustrates this guidance in an example where property management services are accounted for as a single performance obligation under the series guidance in paragraphs 606-10-25-14 to 25-15. [606-10-55-157B – 55-157E, Ex 12A]

The example reaches its conclusion because:

a. each day's property management services are substantially the same because the manager provides the same overall service each day, even if the underlying tasks or activities vary (e.g. cleaning services, leasing or reservation services, property maintenance);
b. each day of property management services meets the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time because the customer simultaneously receives and consumes the benefits provided by the manager as it performs (see the discussion of the over-time criteria in Question F20); and
c. the same method is used to measure progress toward complete satisfaction of the performance obligation because each day's obligation to provide property management services typically is measured using a time-based approach. [606-10-25-15]

For more information see the following questions:

— D30 – determining the transaction price when the property management services contract accompanies a property sale;

— E10 – allocating the transaction price when the property management services contract accompanies a property sale; and

— F30 – recognizing revenue for variable consideration in a property management services contract.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

D Step 3: Determine the transaction price

D10. How does a seller's right to participate in a property's future profits affect the determination of the transaction price for the sale of that property?

The seller generally treats its right to future profits as variable consideration and estimates it upfront to determine the transaction price (the amount of consideration to which it expects to be entitled). The seller would not estimate its right to future profits upfront as part of the property sale's transaction price if:

a. it must allocate it entirely to another performance obligation, or to distinct goods or services within a series of distinct goods or services that are accounted for as a single performance obligation under paragraph 606-10-32-40, or

b. it may recognize revenue in the amount to which the entity has a right to invoice under the paragraph 606-10-55-18 practical expedient.

Variable consideration included in the transaction price is subject to a constraint (see paragraphs 606-10-32-11 to 32-14) and is regularly reassessed until the uncertainty is resolved. A seller may only include its estimate of its share of future profits to the extent that it is probable that a significant reversal in the cumulative revenue recognized will not occur when the uncertainty is subsequently resolved.

Paragraph 606-10-32-12 requires a seller to consider both the likelihood and the magnitude of a potential revenue reversal and includes the following factors that could increase the likelihood or the magnitude of a revenue reversal.

- The amount of consideration is highly susceptible to factors outside the seller's influence. Those factors may include market volatility, the judgment or actions of third parties, weather conditions, and a high risk of obsolescence of the promised good or service.
- The seller does not expect resolution to the uncertainty about the amount of consideration for a long time.
- The seller's experience or other evidence with similar 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 seller must estimate the transaction price in light of the specific facts and circumstances of the arrangement and cannot default to a conclusion that the variable consideration is fully constrained until the uncertainty is resolved. The seller will update the estimated transaction price each reporting period to reflect the current circumstances at each reporting date.

The guidance on determining the transaction price applies to both customer and noncustomer transactions.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Comparison to legacy US GAAP

If the seller will participate in future profits from the property without risk of loss (such as participation in operating profits or residual values without further obligation), and the sale otherwise qualifies for recognition of profit by the full accrual method, the contingent future profits are recognized when realized. Application of Topic 606/Subtopic 610-20 may result in earlier revenue (or gain) recognition for these provisions when the cumulative revenue recognized, inclusive of an estimate of the seller's share of future profits, is probable of not being subject to a risk of significant revenue reversal. In many cases, the constraint will not reduce the variable consideration associated with the future profits interest all the way to zero. [360-20-40-64]

When inclusion of those future amounts in the transaction price is not appropriate because a significant revenue reversal could occur, the accounting under Topic 606/Subtopic 610-20 may be substantially equivalent to current accounting under Subtopic 360-20. However, we believe that in many cases, variable consideration will not be fully constrained until the uncertainty is resolved.

Example D10: Sale of property with future profits interest

Description of the arrangement

ABC Corp. sells a newly constructed retail property with a cost of $1,200,000 to DEF Corp. for $2,000,000 in cash and a right to receive 5% of future operating profits from the property over a 10-year earn-out period. ABC has no ongoing performance obligation related to the operations of the property.

Because the in-place leases have fixed payments for the first two years of the earn-out period, ABC concludes it is probable that it will receive a payout of $50,000 in variable consideration for years one and two. It bases its belief on the contractual, fixed lease payments in those years and its experience with similar properties and tenants.

However, ABC is less certain about its expected payouts in years 3 through 10 because the lease payments that the property buyer will receive shift from fixed payments to contingent payments based on the lessees' underlying third-party sales. While ABC is not guaranteed a minimum payout in years 3-10, it can estimate its expected payout based on its experience with similar properties and tenants.

ABC believes it will collect at least $110,000 in earn-out payments in years 3-10 and concludes it is probable that a significant reversal of $2,160,000 will not occur. This amount is the contractual selling price of $2,000,000 plus $160,000 of the variable consideration for the earn-out period. ABC does not believe it has a basis to reasonably estimate any additional earn-out amounts because of its level of uncertainty about receipts in excess of $160,000.

Evaluation

Profit of $960,000 ($2,000,000 contractual selling price + $160,000[6] in variable consideration – $1,200,000 cost) is recognized when control of the property transfers. The $160,000 of variable consideration is included in the transaction price because it is probable a significant reversal in revenue of $2,160,000 (the cumulative revenue recognized) will not occur.

ABC continually assesses the variable consideration, considering the constraint, and revises its estimates accordingly.

[6] Note the impact of the time value of money is not analyzed when consideration is variable and the timing of that consideration varies based on the occurrence or nonoccurrence of a future event that is not substantially within the control of the customer or entity (see paragraph 606-10-32-17(b)).

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

D20. Is a change in estimate relative to the measure of progress toward satisfaction of the performance obligation on a construction contract subject to the revenue recognition constraint?

The objective of the constraint on variable consideration is to recognize revenue only to the extent it is probable the cumulative amount of revenue recognized is not subject to a risk of significant revenue reversal *due to variability in the transaction price*. While a construction contractor may experience revenue reversals when it changes its estimate of progress toward complete satisfaction of a performance obligation, these reversals do not represent changes in the ultimate consideration to which the developer is entitled. [606-10-32-11 – 32-14]

The risk associated with a change in timing of total revenue is not evaluated under the constraint. However, significant changes in timing may:

a. call into question the contractor's ability to reasonably estimate its progress as discussed in paragraphs 606-10-25-36 to 25-37;
b. result in a reassessment of whether performance bonuses or penalties in the contract may occur, which would affect the transaction price; and
c. suggest that the contractor should evaluate the need to recognize a provision for anticipated losses on the contract under paragraphs 605-35-25-45 to 25-49, which largely have been retained from current guidance.

D30. What discount rate does an entity use when determining the time value of money to include in the transaction price for a property management service contract that is prepaid as part of an all-cash operating property sale?

This question assumes that the property sale and the property management service contract[7] are two performance obligations.

The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognize revenue at an amount that reflects the price the customer would have paid if it had paid cash for the promised goods or services when or as they transfer. Therefore, a seller determines the discount rate by identifying the rate that would discount the stand-alone selling price (and related timing) of the property management services to the allocated transaction price. [606-10-32-15, 32-20]

The discount rate should be the rate that would exist in a separate financing transaction between the buyer and the seller at contract inception that reflects the credit characteristics of the party receiving financing in the contract (the seller), as well as any collateral or security provided by the buyer or the seller, including assets transferred in the contract.

The seller adjusts the transaction price to reflect the time value of money only if the financing component is significant to the *contract*, not necessarily significant to one or more of the separate performance obligations. In this case, the seller would evaluate the significance of the financing component associated with the prepayment of the property management services relative to the transaction price of the contract (i.e. the transaction price for the sale of the property and property management services combined).

[7] The property management services are determined to be a single performance obligation because the entity is providing a series of distinct services that are substantially the same with the same pattern of transfer (606-10-25-14(b)). See additional discussion in Question C30.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

A contract does not have a significant financing component even if the timing of payments and the transfer of control of the goods or services differs significantly if one of these factors exist:

— the customer makes an advance payment, and the timing of the transfer of goods or services is at the customer's discretion;

— a substantial amount of the consideration is contingent on a future event outside the parties' control; or

— the difference between the promised consideration and the cash-selling price arises for reasons other than financing.

As a practical expedient, a seller does not need to account for a financing component when the period is expected to be one year or less between when the seller transfers a good or service and when the customer pays for the good or service. [606-10-32-17 – 32-18]

The guidance on determining the transaction price applies to both customer and noncustomer transactions.

Comparison to legacy US GAAP

Paragraph 360-20-40-43(d) addresses the accounting when a seller agrees to manage the property for the buyer after the property is sold without compensation or receives compensation that is less than prevailing rates. When the seller recognizes the sale, it must impute the compensation for the services and recognize it in income as it performs the services over the management contract period. Additionally, the seller attributes the remaining sales price (i.e. the residual) to the sale.

While the seller also recognizes the property management fee revenue over the service period under Topic 606:

a. the imputed value (which represents the present value of the market rate of the services) likely will differ from the allocated transaction price (based on relative stand-alone selling prices); and

b. the seller must gross-up the revenue amount and recognize interest expense if the financing component associated with the prepayment of the management services is significant to the contract. See Question E10 for further discussion. [606-10-32-29]

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Example D30: Sale of property with prepaid property management services

Description of the arrangement

ABC Corp. sells an office building with a carrying amount of $1,500,000 to a customer and agrees to manage the office building for three years. The buyer pays $2,000,000 in cash at the date of sale for the office building and the management services. ABC identifies two performance obligations and allocates $1,714,286 of the transaction price to the sale of the office building and $285,714 to the future property management services (see Example E10 for illustration).

ABC makes these allocations based on the stand-alone selling prices of $1,800,000 for the office building without the services and $100,000 per year for the property management services. ABC determines that the financing component is significant to the contract,[8] and that the property management services will be delivered ratably over the three-year service period.

Evaluation

Because ABC has determined that the financing component is significant to the contract, it establishes an initial contract liability of $285,714 and accrues interest expense each period on the principal balance. ABC calculates the interest rate by determining what rate discounts the cash selling price of the property management services ($300,000 or $100,000 per year for 3 years of monthly payments) to the promised consideration (i.e. $285,714).

The interest rate implicit in the contract is 3.19%. This rate (and the resulting interest expense amounts below) assume monthly payments on the contract liability equal to $8,333.33 ($300,000 over 36 months) to reflect the property management services being delivered over time.

One way to account for this would be as follows:

At inception:

	Debit	Credit
Cash	285,714[(1)]	
Contract liability		285,714
To reflect the cash received that is allocated to the property management services		
Cash	1,714,286[(2)]	
Cost of sales	1,500,000	
Property and equipment		1,500,000
Revenue		1,714,286
To record revenue and cost of sales on the sale of the office building (note that revenue and cost of sales would be reported net as a gain if the sale is to a noncustomer)		

Notes:

(1) + (2) = $2,000,000 cash consideration received from buyer

[8] ABC adjusts the transaction price for the time value of money only if the financing component is significant to the contract. This illustration also assumes the rate implicit in the contract is reasonable relative to what ABC's borrowing rate would be in a separate financing transaction.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Year 1:

	Debit	Credit
Interest expense	7,783	
Contract Liability		7,783
To accrue the aggregate annual interest expense (based on the hypothetical monthly payments) on the contract liability		
Contract liability	100,000	
Revenue		100,000
To recognize the year one property management service revenue		

Year 2:

	Debit	Credit
Interest expense	4,794	
Contract Liability		4,794
To accrue the aggregate annual interest expense (based on the hypothetical monthly payments) on the contract liability		
Contract liability	100,000	
Revenue		100,000
To recognize the year two property management service revenue		

Year 3:

	Debit	Credit
Interest expense	1,709	
Contract Liability		1,709
To accrue the aggregate annual interest expense (based on the hypothetical monthly payments) on the contract liability		
Contract liability	100,000	
Revenue		100,000
To recognize the year three property management service revenue		

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

D40. In an exchange of real estate, does the transferor of the real estate apply the guidance for nonmonetary transactions or the guidance on noncash consideration?

Topic 606 supersedes most of the real estate-specific exchange guidance in Topic 845. The scope of Topic 845 also was amended to exclude transactions within the scope of Topic 606 (i.e. transactions with customers) regardless of the form of the consideration received, as well as most transactions within the scope of Subtopic 610-20 (i.e. sales or transfers of nonfinancial assets to noncustomers). What remains in the scope of Topic 845 (paragraphs 845-10-15-19 and 15-20) are transactions where the noncash consideration received in exchange for a nonfinancial asset to a noncustomer is a noncontrolling ownership interest in the buyer of the nonfinancial asset unless the transaction is (see additional discussion below):

a. a capital contribution of real estate in return for an unconsolidated real estate investment that is in the scope of Subtopic 970-323, *Real Estate-General – Investments – Equity Method and Joint Ventures;* or

b. a transfer of a subsidiary or a group of assets that constitutes a business (see paragraph 845-10-30-25) that is in the scope of Subtopic 810-10.

Topic 845 also still applies to nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers (e.g. exchanges of similar land lots between real estate developers) because paragraph 606-10-15-2(e) scopes those transactions out of Topic 606.

See additional discussion of proposed changes to this guidance in the section *Proposed Clarifications to the Scope of Asset Derecognition Guidance*.

Nonmonetary Transactions in the Scope of Topic 606 (transfers with customers) or Subtopic 610-20 (transfers of nonfinancial assets involving the receipt of nonmonetary consideration *other than* a noncontrolling interest in the buyer/transferee)

For transactions accounted for under Topic 606 or Subtopic 610-20, the seller/transferor will need to determine whether the transaction has commercial substance when it evaluates whether a contract exists (Step 1). When a contract exists, because it meets the criteria in paragraph 606-10-25-1, the seller/transferor measures the noncash consideration at fair value (or the stand-alone selling price of the promised goods or services if it cannot make a reasonable estimate of the fair value). See Question B10 for discussion about the accounting when a contract does not exist.

Paragraph 606-10-32-21 specifies the measurement date for noncash consideration is at contract inception (i.e. the date at which a contract exists). Paragraph 606-10-32-23 also states that changes in the fair value of the consideration after contract inception are:

— not included in the transaction price if they are due to the form of the consideration (e.g. changes in the share price of securities or changes in the fair value of land which the entity is entitled to receive from a customer); or

— variable consideration if they are caused by something other than the form of the consideration (e.g. the exercise price of a share option changes because of the entity's performance).

If the changes in the fair value of the consideration are due to both the form of the consideration and some reason other than the form of the consideration, then the seller applies the variable consideration guidance only to the variability resulting from reasons other than the form of the consideration.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Nonmonetary transactions involving the receipt of a noncontrolling interest in the buyer (noncustomer)

For noncustomer transactions involving the transfer of a nonfinancial asset in exchange for a noncontrolling interest in the buyer, the seller/transferor first evaluates whether the transaction is a contribution of real estate in exchange for an unconsolidated real estate investment within the scope of Subtopic 970-323. If it is, the guidance in that Subtopic applies (see paragraph 845-10-15-20(b)). An investor contributing real estate to a venture records its investment at the cost of the contributed real estate (with no profit recognized) regardless of what other investors may contribute because the transaction is a contribution of capital. In some cases, however, these transactions may be in substance sales; see Question F90 for additional discussion on applying Subtopic 970-323. [970-323-30-3]

If the transaction is not a contribution of real estate in exchange for an unconsolidated real estate investment within the scope of Subtopic 970-323, then the seller/transferor evaluates if the transaction is a transfer of a subsidiary or a group of assets that constitutes a business (see paragraph 845-10-30-25). If so, the seller accounts for the transfer under Subtopic 810-10. This accounting requires that the transaction be measured at fair value with recognition of gain or loss in income if the seller/transferor no longer controls the subsidiary or group of assets or in equity attributable to the seller/transferor if the seller/transferor retains control of the subsidiary or group of assets. [810-10-40-5, 45-23]

Proposed changes to noncustomer nonmonetary exchange guidance

The FASB has proposed changes to this guidance that would require that all transactions in which an entity sells/transfers a nonfinancial asset (or an in-substance nonfinancial asset) to a noncustomer in exchange for a noncontrolling ownership interest be accounted for under Subtopic 610-20.

This includes:

a. exchanges where the noncontrolling interest received (or retained) is a noncontrolling ownership interest in the post-sale owner of the property;
b. transfers to an existing equity method investee; and
c. contributions of nonfinancial assets to form joint ventures, including real estate joint ventures.

Under the proposal, when a noncontrolling interest in the buyer/transferee is received/retained, it is considered noncash consideration (see paragraph 606-10-32-21) and its fair value at contract inception is included in the transaction price. The carrying amount of liabilities assumed by the buyer/transferee (subject to the constraint on estimating variable consideration in paragraph 606-10-32-11) also would be included in the consideration received for computing the gain or loss. The proposal would eliminate the guidance in Topic 845 on the transfer of a nonfinancial asset for a noncontrolling interest in the buyer.

For information about the proposed definition of in-substance nonfinancial asset, see Question A20 and Question F90.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Comparison to legacy US GAAP

Paragraph 845-10-15-4(e) excludes from the scope of Topic 845 transactions that involve a nonmonetary exchange in which the transferor of an asset receives an equity interest in the transferee, except in certain exchanges of a nonfinancial asset for a noncontrolling ownership interest. The guidance in the subsection of Topic 845 on exchanges of a nonfinancial asset for a noncontrolling ownership interest does not apply to:

— transfers between a joint venture and its owners;

— capital contributions of real estate in return for an unconsolidated real estate investment;

— transfers of real estate in exchange for nonmonetary assets other than real estate; and

— the deconsolidation (or derecognition) of a subsidiary (or group of assets) that constitutes a business that is in the scope of Subtopic 810-10 (see paragraph 845-10-15-20).

Under current US GAAP, most nonmonetary transactions where the transferor receives an ownership interest in the transferee in exchange for real estate are outside the scope of Topic 845, and the nature of the inbound asset determines how the exchange will be accounted for:

— If the inbound asset is a controlling financial interest in the transferee and the transferee is a business, Topic 805, Business Combinations, applies (and the gain on the outbound real estate is deferred).

— If the inbound asset is an equity interest in the buyer but the transferee is not a business, Subtopic 970-323 applies (unless the asset received is an equity security with a readily determinable fair value accounted for under Topic 320, *Investments–Debt and Equity Securities;* in those cases, we believe the transaction is monetary and accounted for under Subtopic 360-20).

As discussed above, Subtopic 970-323 requires that the investor contributing real estate to a venture record its investment in the venture at the cost of the contributed real estate (with no profit recognition) regardless of what other investors may contribute because the transaction is a contribution of capital (unless the transaction is in-substance a sale).

When the transferor does not receive an equity interest in the transferee (including when the transferor receives an equity interest in a real estate entity other than the transferee), the transaction generally is measured at fair value. When the inbound interest is a controlling financial interest in a business (as defined by Section 805-10-20), the transaction is accounted for as a business combination under Topic 805. Topic 805 requires the inbound asset to be measured at fair value and the timing of profit recognition on the transfer of the outbound real estate is accounted for under Subtopic 360-20.

When the transferor does not receive an equity interest in the transferee and the inbound asset is not a controlling financial interest in a business, the transferor needs to evaluate whether the inbound asset is real estate (including in-substance real estate). If the inbound asset is not real estate, Topic 845 governs the measurement of the exchange, but profit recognition would be evaluated under Subtopic 360-20 (or Subtopic 976-605). If the inbound asset is real estate and the transaction qualifies as an exchange as defined under Topic 845, then that guidance applies[9] to both recognition and measurement. If the inbound asset is a financial asset, like cash or an equity security with a readily determinable fair value that is accounted for under Topic 320, we believe it would make the transaction monetary and subject to Subtopic 360-20.

[9] While paragraph 360-20-15-10(c) states that the guidance in Subtopic 360-20 does not apply to real estate for real estate exchanges, we believe that if the exchange would not result in profit recognition under Subtopic 360-20 (or Subtopic 976-605), it raises the question of whether the conclusion on fair value measurement under Topic 845 is appropriate.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

E Step 4: Allocate the transaction price

E10. How does the seller allocate the transaction price in a contract that transfers control of a property and also requires the seller to provide ongoing property management services to a customer? What if the buyer is not a customer?

When the sale of the property and the property management services[10] are separate performance obligations, the seller generally allocates the transaction price based on relative stand-alone selling prices (i.e. the price at which an entity would sell a promised good or service separately to a customer). However, in some cases the seller attributes variable consideration and discounts to some, but not all, performance obligations or distinct goods and services within a series of distinct goods or services that comprise a single performance obligation under paragraph 606-10-25-14(b). [606-10-25-15]

The seller should first consider the guidance on allocating variable consideration. If the contract includes consideration that is variable, the seller will need to determine if the variable consideration should be allocated to one or both performance obligations. The seller must allocate variable consideration (and subsequent changes to that amount) entirely to a single performance obligation (or to distinct goods or services within a series of distinct goods or services that are accounted for as a single performance obligation) if the:

a. terms of the variable payment relate specifically to the entity's efforts to satisfy the performance obligation or the distinct good or service within the series, and
b. allocation of the variable amount entirely to the performance obligation or the distinct good or service within the series is consistent with the objective to allocate the transaction price in an amount that depicts the consideration that the entity expects to be entitled to in exchange for the promised goods or services after considering the contract's performance obligations and payment terms. [606-10-32-28, 32-40]

It is not uncommon for stand-alone property management service contracts to include a base fee and a variable fee that may depend on the property's operations. A real estate sale with an accompanying property management services contract also may include variable consideration. The seller/property manager needs to consider the guidance in paragraph 606-10-32-40 when concluding whether it should allocate the variable component entirely to the property management services or to both the property management services and the property sale.

If the seller allocates the variable consideration entirely to the property management services, it will need to determine if those services constitute a series of distinct time increments of property management services. If the seller concludes the property management services are

[10] See Question C30 on accounting for a series of distinct, daily property management services as a single performance obligation.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

a series of distinct services (i.e. a series of daily, weekly, monthly management services), it must further allocate the variable consideration to the distinct service periods within the single, series performance obligation if the:

a. variable consideration earned for a given distinct service period relates specifically to the seller's services for that period (or an outcome from those services), and
b. allocation of that amount specifically to the distinct service period is consistent with the allocation objective in paragraph 606-10-32-40(b).

The seller follows these steps in allocating the variable consideration:

— First, the seller must determine whether the nature of the property management services is to provide a single, integrated service offering for a defined period of time, or to perform a specified set of activities during the period. Important to this determination is whether the activities the seller will perform to fulfill the performance obligation are indeterminate (e.g. even if the type of activities are generally understood, the quantity and mix of activities that will need to be performed to fulfill the obligation are unknown), or are known upfront (e.g. the seller will do X, Y and Z once each week for three years).

— Second, the seller must determine whether the contractual service period can be subdivided into smaller time increments during which the seller's activities are substantially the same in each time increment. For example, could a three-year property management services contract be subdivided into time periods like three annual periods or 36 monthly periods?

— Third, the seller must conclude that those determined time increments of service are distinct from each other under paragraphs 606-10-25-19 and 606-10-25-21. If they are not distinct, then the series provision cannot apply to the property management services performance obligation.

— Lastly, if there is a series of distinct service periods within the single property management services performance obligation, the seller must determine whether allocating the variable fees earned during each distinct service period only to that service period is consistent with the allocation objective in paragraph 606-10-32-40.

If the seller must allocate the variable consideration entirely to the property management services performance obligation, *and* that performance obligation is a series of distinct service periods to which the variable consideration earned each period can be allocated, the seller will not need to estimate the total variable fees that will be earned during the performance obligation period. The variable fees earned each period will be allocated to, and recognized in, each period.

If the seller (a) cannot allocate the variable consideration entirely to the property management services performance obligation, (b) the obligation is not a series of distinct service periods, or (c) the variable consideration earned each distinct service period within a series cannot be allocated to that distinct service period, the seller generally will need to estimate the total transaction price associated with that performance obligation (including the variable consideration) to which the seller expects to be entitled for performing the property management services over the full performance obligation service period subject to the constraint. The constraint limits

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

the seller to only including estimates of variable consideration in the transaction price to the extent that it is probable that a significant reversal in the cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. See additional discussion about the constraint in Question D10. [606-10-32-11 – 32-14]

The seller will recognize the transaction price (which may include fixed and variable consideration) allocated to the property management services over time based on an appropriate measure of progress as the performance obligation is satisfied. For additional discussion about recognizing property management service revenue, see Question F130.

If the sale and accompanying property management services contract also include a future profits interest (see Question D10), the seller would perform a similar analysis because of the variable consideration and existence of more than one performance obligation.

After the seller allocates variable consideration, it will need to determine if any discount should be allocated entirely to one of the performance obligations or allocated proportionately. The discount is the difference between the transaction price and the sum of the stand-alone selling prices. The guidance on the allocation of variable consideration discussed above differs from the guidance on the allocation of a discount to some, but not all, performance obligations or to distinct goods or services within a series of distinct goods or services that are accounted for as a single performance obligation. An entity should allocate a discount entirely to one or more, but not all, of the performance obligations if all of the following conditions exist:

— the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;

— the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and

— the discount attributable to each bundle of goods or services described is substantially the same as the discount in the contract, and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation to which the discount in the contract belongs. [606-10-32-37]

In our experience, most real estate companies do not offer a wide range of bundled goods or services. Therefore, in most cases, these conditions will not exist, and the seller will allocate the discount to all performance obligations in the contract on a relative stand-alone selling price basis. See Example E10.

We believe the guidance on allocating the transaction price for customer transactions also applies by analogy to noncustomer transactions even though Subtopic 610-20 currently does not address transactions with a noncustomer with more than one performance obligation. The proposed ASU, *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets,* clarifies that a seller would apply the revenue guidance on identifying distinct goods and services and allocating consideration to them for noncustomer sales of nonfinancial assets or in-substance nonfinancial assets. The proposal also would require that the seller separately account for parts of a contract that are not assets of the entity to be derecognized, for example, guarantees or ongoing service contracts. See additional discussion of this project in Question A20.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Comparison to legacy US GAAP

Paragraph 360-20-40-43(d) addresses the accounting when a seller agrees to manage the property for the buyer after the property is sold without compensation or receives compensation that is less than prevailing rates. When the seller recognizes the sale, it must impute the compensation for the services and recognize it in income as it performs the services over the management contract period. Additionally, the seller attributes the remaining sales price (i.e. the residual) to the sale.

While the seller also recognizes the property management fee revenue over the service period under Topic 606:

a. the imputed value (which represents the present value of the market rate of the services) likely will differ from the allocated transaction price (based on relative stand-alone selling prices); and
b. the seller must gross up the revenue amount and recognize interest expense, if the financing component associated with the prepayment of the management services is significant to the contract. [606-10-32-29]

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Example E10: Sale of property with ongoing property management services

Description of the arrangement

ABC Corp. sells an office building with a carrying amount of $1,500,000 to a customer and agrees to manage the office building for three years for total consideration of $2,000,000 payable in cash upon closing of the sale. The estimated stand-alone selling price of the office building and the series of management services are $1,800,000 and $100,000 per year, respectively. Assume that:

a. the customer makes no ongoing payments for the services;
b. the financing component is not significant to the contract;[11] and
c. the criteria for allocating the overall discount entirely to one of the performance obligations are not met. [606-10-32-37]

Evaluation

The seller allocates the total transaction price of $2,000,000 to the two separate performance obligations[12] based on relative stand-alone selling prices.

Combined stand-alone selling price: $2,100,000 $1,800,000 (property stand-alone selling price) + $300,000 (property management services stand-alone selling price at $100,000 each year for 3 years)
Transaction price allocated to property sale: $1,714,286 ($1,800,000 ÷ $2,100,000) × $2,000,000
Transaction price allocated to property management services: $285,714 ($300,000 ÷ $2,100,000) × $2,000,000
Profit – recognized when control of the property is transferred: $214,286 $1,714,286 – $1,500,000
Property management service fee revenue – recognized over the three-year service period as the performance obligation is satisfied: $285,714

[11] See Example D20 for an illustration of the accounting if the financing component is significant to the contract.

[12] The property management services are determined to be a single performance obligation because the entity is providing a series of distinct services that are substantially the same with the same pattern of transfer (606-10-25-14(b)). See further discussion in Question C30.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

If the arrangement also included ongoing payments of $10,000 per year for the property management services, the process for allocating the total transaction price of $2,030,000 ($2,000,000 payable at closing + $30,000 in ongoing payments of $10,000 per year for three years) would follow the same approach as illustrated above. This approach also assumes that the financing component is not significant to the contract and the discount is not allocated entirely to one of the performance obligations.

The seller would allocate the total transaction price of $2,030,000 to the two separate performance obligations based on relative stand-alone selling prices:

Combined stand-alone selling price: $2,100,000 $1,800,000 (property stand-alone selling price) + $300,000 (property management services stand-alone selling price of $100,000 each year for 3 years)
Transaction price allocated to property sale: $1,740,000 ($1,800,000 ÷ $2,100,000) × $2,030,000
Transaction price allocated to property management services: $290,000 ($300,000 ÷ $2,100,000) × $2,030,000
Profit – recognized when control of the property is transferred: $240,000 $1,740,000 – $1,500,000
Property management service fee revenue – recognized over the three-year service period as the performance obligation is satisfied: $290,000

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

F Step 5: Recognize revenue

F10. At what point does control typically transfer in a real estate sale when the performance obligation is only the property that is transferred?

An entity recognizes revenue when it satisfies a performance obligation by transferring control of the good or service to the customer. An asset is considered transferred when, or as, the customer obtains control of the asset, which gives the customer the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. An entity must determine at contract inception whether it satisfies the performance obligation over time or at a point in time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. A performance obligation to deliver a single asset (or group of assets) on a single settlement date is typically satisfied at a point in time because it does not meet any of the over-time control transfer criteria and there is no progress to measure. [606-10-25-23 – 25-24, 25-27]

For performance obligations satisfied at a point in time, these indicators suggest that control has transferred:

- the entity has a present right to payment for the asset;
- the customer has legal title to the asset;
- the entity has transferred physical possession of the asset;
- the customer has the significant risks and rewards of ownership of the asset; and
- the customer has accepted the asset. [606-10-25-30]

We believe in the context of US property sales that the guidance generally suggests that control transfers at closing because the closing date is the point in time when most of the indicators typically are met. The Board reached a view consistent with this when it addressed the issue of control transfer in real estate transactions within the scope of ASU 2011-10, *Derecognition of in Substance Real Estate*:

FASB excerpt: ASU 2011-10

BC10. Therefore, an entity would look to the definition and indicators of control in the proposed revenue recognition guidance to determine when the counterparty to the transaction obtains control of the asset (that is, real estate) and when to derecognize the real estate. Under the proposed revenue recognition guidance, indicators that the customer has obtained control of a good or service include, among others, the fact that the customer has legal title and physical possession.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

While transfer of control for sales of existing property often occurs at closing, the seller needs to consider the facts and circumstances of the particular transaction. For example, as discussed in Question B10, paragraphs 606-10-55-95 to 55-98 illustrate a situation where a real estate developer sells a building and provides long-term, nonrecourse financing for 95 percent of the sales price. The buyer expects to repay the loan primarily from income derived from its restaurant business. This business faces significant risks because of the high competition in the industry, and the buyer lacks other income or assets that it could use to repay the loan and lacks industry experience.

The seller may conclude that although it has transferred legal title and physical possession of the building to the buyer at closing, it has retained control of the building based on its analysis of the control indicators in paragraph 606-10-25-30.

Question F50 and Question F70 address other situations where control may not reside with the party with legal title and physical possession.

The guidance on control transfer applies to both customer and noncustomer transactions.

Comparison to legacy US GAAP

FASB excerpt: 360-20

40-7 A sale shall not be considered consummated until all of the following conditions are met:

a. The parties are bound by the terms of a contract.

b. All consideration has been exchanged.

c. Any permanent financing for which the seller is responsible has been arranged.

d. All conditions precedent to closing have been performed. Paragraph 360-20-40-28 provides an exception to this requirement if the seller is constructing office buildings, condominiums, shopping centers, or similar structures.

Usually, a sale meets those four conditions at closing or after the closing, and not when an agreement to sell is signed or at a pre-closing. We believe the conditions required to support consummation of a sale under Subtopic 360-20 are similar to the indicators of the point in time when control transfers under Topic 606.

However, Subtopic 360-20 prevents derecognition in certain circumstances even when a sale is consummated. Even if a sale has been consummated, the initial and continuing investment requirements may not be met or certain types of continuing involvement may be present suggesting that the risks and rewards of ownership have not transferred. In those situations, the seller may be unable to derecognize the property or recognize full profit on the sale.

In contrast, Topic 606 requires revenue recognition (and therefore derecognition) at the point in time control transfers, which is based on indicators and not criteria as long as a contract exists. Consequently, derecognition and revenue/profit recognition under Topic 606/Subtopic 610-20 may occur earlier than under Subtopic 360-20.

Topic 606 does not provide an exception for a seller constructing office buildings, condominiums, shopping centers or similar structures (like paragraph 360-20-40-7(d) above). See Question F40 for additional discussion of when control of a condominium unit (or similar structure) transfers under Topic 606.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

F20. When does control typically transfer in a real estate construction contract (e.g. for the development of property improvements such as a building) when the contract represents a single performance obligation for the construction services?

An entity recognizes revenue when it satisfies a performance obligation by transferring control of the good or service to the customer. An entity considers an asset or service transferred when, or as, the customer obtains control of the asset. An entity determines at contract inception whether it satisfies the performance obligation over time or at a point in time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. [606-10-25-23 – 25-24]

An entity transfers control of a good or service over time if the transaction meets at least one of the following criteria: [606-10-25-27]

a. The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;

This criterion primarily applies to traditional service contracts (e.g. property management services) when the customer is benefitting on a periodic basis as the entity performs (e.g. as the property is being managed) as opposed to service contracts when an asset is being constructed or enhanced on the customer's behalf. When a customer's asset is being constructed or enhanced, further analysis is necessary under criterion (b), and criterion (c) if criterion (b) is not met.

b. 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; or

We believe this criterion generally will be met in a real estate construction contract when the customer owns the underlying land and takes control of the property improvements as construction progresses. In that case, the customer generally is able to direct the use of, and obtain substantially all of the remaining benefits from, those improvements during construction.

The customer generally is able to use the property improvements to enhance the value of other assets during the construction period. The ability to use the property improvements includes selling the land the customer owns on which the improvements are built; selling or exchanging the property, including the partially completed improvements; and pledging the property with the partially completed improvements to secure a loan.

This analysis applies when the customer controls and holds legal title to the land on which improvements are constructed. A similar analysis also may apply if the customer leases the underlying land on a long--term basis and will own the property improvements. A developer will not meet criterion (b) however, if it (as opposed to the customer) controls the property and/or the improvements until construction is complete. This may occur in constructing condominium units (or similar structures). See Question F40 for additional discussion.

c. 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.

An entity only needs to meet one criterion in paragraph 606-10-25-27 to conclude that a performance obligation is satisfied over time. We believe this criterion may also be met in a real estate construction contract if the customer owns the underlying land and takes control of the property improvements as construction progresses because the developer's performance generally does not create an asset with alternative use to the developer. Usually the customer controls the property improvements being constructed and those improvements are affixed to land controlled by the customer. Therefore, the developer likely is legally and practically prohibited from directing the improvements for any other use. [606-10-25-27 – 25-28]

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

However, to meet this criterion, the developer also must have an enforceable right to payment for performance completed to date, which often is the case when a contract includes payment provisions that protect the developer in the event of a termination for convenience by the customer.

If the entity meets at least one of the criteria in paragraph 606-10-25-27, revenue on the construction services performance obligation is recognized over time as satisfaction of the performance obligation progresses.

The guidance on control transfer applies to both customer and noncustomer transactions.

Comparison to legacy US GAAP

Contractors currently apply either the percentage-of-completion method or the completed-contract method under paragraph 605-35-25-1. A contractor can use Subtopic 605-35's percentage-of-completion method if it has the ability to make reliable estimates of the progress toward completion. Typically a contractor can estimate contract revenues and costs, and in those circumstances percentage-of-completion is the preferable method. [605-35-25-57]

The percentage-of-completion method recognizes income as work on a contract progresses.

Method A	Method B
Multiply the total estimated contract revenue by the percentage of completion (based on an input or output measure) and *subtract* from it the revenue recognized in prior periods.	*Multiply* the total estimated gross profit by the percentage-of-completion, and *subtract* from it the gross profit recognized in prior periods. *Add* that periodic gross profit to the costs incurred during the period to arrive at revenue for the period.

If an entity is using the cost-to-cost method for measuring progress, it generally will arrive at substantially the same periodic revenue recognition under either approach.

Topic 606 does not allow an entity to elect an accounting policy for its pattern of revenue recognition. An entity recognizes revenue over time for performance obligations meeting one of the criteria in paragraph 606-10-25-27 using the pattern that best depicts the entity's satisfaction of its performance obligation.

If a contractor had historically been accounting for those contracts under the completed-contract method, the change to Topic 606's over-time revenue recognition will be significant. If the contractor had been using the percentage-of-completion method, the effect of transitioning to Topic 606's pattern of revenue recognition will, in part, depend on whether it meets the over-time criteria; how it measures its progress; and whether it currently uses Method A or Method B. (Method B is not permissible under Topic 606.)

A contractor using the cost-to-cost method to measure progress under Topic 606 may arrive at a similar revenue and gross profit recognition pattern for its contracts satisfied over time if it had historically used a cost-to-cost measure. However, a contractor using a measure other than cost-to-cost, or historically using Method B, may not arrive at a similar revenue and gross profit recognition because Topics 606 and 340 de-link the accounting for contract revenue and contract costs so the profit margin may not be constant.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

F30. When does control typically transfer in a contract with a customer that includes a property sale and an accompanying construction contract (e.g. for the development of property improvements for the customer, such as a building on the land)?

As discussed in Question C20, a seller/developer first needs to determine whether the contract contains one or two performance obligations.

In the more common scenario when the property sale and the construction services are two performance obligations, the seller/developer usually allocates the transaction price to those two performance obligations based on relative stand-alone selling prices (see Question E10). The seller/developer evaluates each performance obligation to determine whether it recognizes revenue over time or at a point in time. As discussed in Question F10, control of property often transfers at a point in time, and as discussed in Question F20, construction services (as a stand-alone performance obligation) are often, but not always, satisfied over time.

In the less common scenario when the property sale and the construction contract comprise a single performance obligation, the entity will need to analyze whether the single performance obligation is satisfied:

— at a point in time – upon delivery of the completed property, including improvements, or

— over time – as title to the land transfers and construction progresses on the improvements affixed to the customer-owned land.

If title to the land transfers to the customer before construction begins, and the customer owns the improvements during construction, we believe the analysis of the over-time criteria relative to the single combined performance obligation may be similar to the analysis in Question F20. This analysis shows that the contract will often meet the criterion in paragraph 606-10-25-27(b) because the seller/developer's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.

When there is just one performance obligation for both the land sale and the construction services, however, the total revenue recognized over time represents the total transaction price (including the contract consideration for both elements). Progress toward satisfaction of that single performance obligation is measured relative to both elements (see Example F30).

When there is a single performance obligation and the customer does not hold title to the land or have legal ownership of the improvements affixed to the land as construction progresses (e.g. in some contracts to construct condominium units or similar structures), it may be difficult to conclude the performance obligation is satisfied over time. See additional discussion in Question F40.

The guidance on control transfer applies to both customer and noncustomer transactions.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Example F30: Sale of land with construction contract

Description of the arrangement

ABC Corp. sells land with a carrying amount of $400,000 to DEF Corp. for $1,000,000. Additionally, ABC agrees to build a fitness center for an additional $500,000 (estimated cost of $400,000). Assume the sale of the land and the construction of the fitness center comprise two separate performance obligations (see additional discussion in Question C20) and DEF obtains the title to the land at closing (before construction of the fitness center begins). ABC allocates $950,000 (of the total $1,500,000 transaction price) to the sale of the land and $550,000 to the construction contract, based on their relative stand-alone selling prices.

Evaluation

Because the sale of the land and construction of the fitness center comprise two separate performance obligations, ABC will need to determine when, or over what period, it satisfies each of the performance obligations. ABC concludes that control of the land transfers at a point in time (when DEF takes legal and physical possession of the land) and control of the fitness center on DEF's land transfers over time because ABC is creating and enhancing an asset that DEF controls as it is created or enhanced.

For the land sale, ABC recognizes $550,000 in profit (allocated transaction price of $950,000 less the $400,000 carrying amount) at closing.

For the construction services, ABC uses an input method to recognize revenue based on its periodic efforts relative to the total expected effort to completely satisfy the performance obligation.

Assume at the end of period one that the accumulated costs for constructing the fitness center are $200,000. Using costs incurred to measure its progress, ABC recognizes $275,000 of revenue ($550,000 x ($200,000 ÷ $400,000)) in period one. ABC recognizes the remaining revenue of $275,000 over time as it constructs the fitness center.

F40. Can the seller/developer of a condominium unit (or similar structure) recognize revenue over time as construction of the unit progresses if title to the completed unit does not transfer until construction is completed?

To recognize revenue over time, the transaction must meet at least one of the following criteria in paragraph 606-10-25-27:

a. The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;

As discussed in Question F20, this criterion primarily applies to traditional service contracts (e.g. property management services) when the customer benefits on a periodic basis as the entity performs (e.g. as the property is being managed) in contrast to service contracts when an asset is being constructed or enhanced on the customer's behalf. When an asset is being constructed or enhanced on a customer's behalf, further analysis is necessary under criterion (b), or under criterion (c) if criterion (b) is not met.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

b. 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; or

In many cases, we believe the buyer of a condominium unit is unable to direct the use of, and obtain substantially all of the remaining benefits from, the unit during construction because title to the real estate typically does not transfer until construction of the unit is complete and the sale closes. When considering the benefits identified in paragraph 606-10-25-25, the buyer does not hold title to the real estate until the sale closes and generally is unable to use the unit to:

— produce goods or provide services;

— enhance the value of other assets, settle liabilities or reduce expenses;

— sell or exchange the unit; or

— pledge the unit to secure a loan.

The buyer also generally does not direct the use of the unit during construction because it does not hold legal title or have physical possession.

c. 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.

Paragraphs 606-140-55-173 through 55-182 illustrate various scenarios when a seller/developer is constructing a unit in a multi-unit residential complex with differing customer payment structures.

Example 1 presumes the customer pays a deposit on entering into the contract, and the remainder of the contract price is payable upon completion of construction when the customer obtains physical possession of the unit. If the customer defaults on the contract before completion, the seller/developer only has a right to the deposit. The seller/developer does not have a right to payment for work completed to date so it does not meet criterion (c). [606-10-55-174 – 55-175]

Example 2 presumes the buyer makes progress payments during construction, and the contract has substantive terms that preclude the seller/developer from directing the unit to another customer. In addition, the contract precludes the buyer from terminating the contract unless the seller/developer does not perform, and if the buyer defaults on its payments, the seller/developer has the right to all of the consideration promised in the contract if it completes the unit. In this fact pattern, the seller/developer concludes that it meets criterion (c) because the:

— unit does not have an alternative use (i.e. the contract precludes the seller/developer from transferring the unit to another customer – see additional discussion below), and

— seller/developer has an enforceable right to payment for performance completed to-date because the customer must pay all of the consideration promised in the contract if the seller/developer completes the unit.

Paragraph 606-10-55-179 indicates the legal practices in the particular jurisdiction are relevant in arriving at this conclusion. This is the case because if the contract terms provide for the right to payment for performance completed to date but the legal practices in the particular jurisdiction do not allow for enforcement of that right, criterion (c) would not be met. [606-10-55-176 – 55-180]

Example 3 presumes the same facts as Example 2 except in the event of the customer's default, the seller/developer can require the customer to perform as required under the contract, or it can cancel the contract and retain the unit under construction and assess a penalty in proportion to the contract price. The seller/developer has the right to payment for performance completed to date because it could enforce that right, even if the seller/developer also could choose to accept the unit under construction and assess a penalty instead. That choice does not affect the assessment as long as the seller/developer's right to require the customer to continue to perform under the contract is enforceable. [606-10-55 –181 – 55-182]

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

While the examples primarily focus on the right to payment, even if a seller/developer does have the right to payment for performance completed to date (see Examples 2 and 3), it still needs to conclude the unit cannot be directed to another customer either contractually during construction or practically without incurring significant economic loss when it is completed. Paragraph 606-10-55-10 discusses significant economic loss. [606-10-25-28]

We believe in many cases, buyers of condominium units cannot specify major structural changes to the design of the unit and the seller/developer often will be able to practically direct the unit to another buyer after completion. In those cases, a substantive contractual restriction during construction would need to be in place to conclude the seller/developer's performance does not create an asset with an alternative use to the seller/developer. If so, over time revenue recognition would be appropriate (and required) under criterion (c), assuming the seller/developer is entitled to payment for the work performed to date throughout the contract. The seller/developer should consider all facts and circumstances.

If the seller/developer does not meet the criteria in paragraph 606-10-25-27 for satisfying a performance obligation over time, the performance obligation is satisfied at a point in time. Then the seller/developer would recognize revenue on the sale of a unit when control transfers to the customer, generally at closing as discussed in Question F10. In our experience, US condominium sales contracts generally are structured similar to Example 1, which results in point in time revenue recognition when control of the completed unit transfers to the customer at closing.

If the seller/developer has a further obligation to develop an amenity in connection with the sale of the unit, the seller/developer would consider the guidance in Questions C10 and C20 on determining the number of performance obligations in the contract with the customer and Question F30 on the timing of revenue recognition.

See Question A60 for discussion about the unit of account for these sales under Topic 606.

Comparison to legacy US GAAP

If a seller/developer is separately selling individual units in condominium projects, paragraph 360-20-40-50 requires profit to be recognized by the percentage-of-completion method on the sale of individual units if:

— construction is beyond a preliminary stage;

— the buyer is committed to the extent of being unable to require a refund except for nondelivery of the unit;

— sufficient units have already been sold to assure that the entire property will not revert to rental property;

— sale prices are collectible; and

— aggregate sales proceeds and costs can be reasonably estimated.

Topic 606 changes the current guidance in Subtopic 360-20 for accounting for condominium sales. Sellers/developers may have historically applied the percentage-of-completion method by measuring progress on a cost-to-cost basis relative to the project as a whole, and applying that measure of progress to the estimated gross profit (revenue and expense) on an individual unit sale. The unit is considered sold if the above criteria are met, which typically occurs before closing.

Under Topic 606 sellers/developers generally are required to separately account for each contract with an individual customer unless they reasonably expect the effect on the financial statements of using a portfolio (or project) approach will not differ materially from applying the guidance to the individual contracts. As explained previously, we expect that the portfolio approach will not be available for most condominium projects.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Example F40: Sale of a condominium unit

Description of the arrangement

ABC Corp. is developing a condominium building and begins marketing individual units during construction. On January 1, 20X3, ABC enters into sales contracts with two customers to sell each one a unit at a sales price of $300,000 with an estimated cost of $180,000. Each customer provides a 5% down-payment. Construction on the building is 50% complete.

ABC expects the customers to take possession of the units (and settle all remaining consideration) on January 1, 20X4; however, during construction ABC retains control of the building and the improvements. If the customers cancel the contracts, ABC has a right to only the deposit amount.

Evaluation

Because the arrangement does not meet any of the criteria for satisfying a performance obligation over time, ABC recognizes revenue at the point in time control transfers to the customers, generally when the customers take possession of the units on January 1, 20X4.

F50. When does control transfer in a standstill arrangement in which the owner of a real estate entity that is an in-substance nonfinancial asset defaults on nonrecourse debt and loses its controlling financial interest in the entity, but the lender chooses to maintain the legal relationship until the owner can find a buyer?

An owner/borrower must apply Subtopic 610-20 to evaluate derecognition on the loss of a controlling financial interest (as described in Subtopic 810-10) in a subsidiary that is an in-substance nonfinancial asset because the subsidiary defaulted on its nonrecourse debt. The deconsolidation guidance in Subtopic 810-10 does not apply to those transactions. [810-10-40-3B]

The owner/borrower considers Topic 606's control indicators to determine when the lender obtains control, which is defined as the ability to direct the use of, and obtain substantially all of the remaining benefits from, the real estate. Because the entity generally would not meet the over-time criteria, an entity would need to determine the point in time the counterparty (the lender) obtains control of the asset. The following are indicators of the point in time that control has transferred to the customer:

— the entity has a present right to payment for the asset;

— the customer has legal title to the asset;

— the entity has transferred physical possession of the asset;

— the customer has the significant risks and rewards of ownership of the asset; and

— the customer has accepted the asset. [606-10-25-30]

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

While the transfer of legal title and physical possession often are key indicators of control in the context of real estate sale transactions (see Question F10), we believe further analysis is necessary. Paragraph 606-10-25-30(c) states that physical possession may not coincide with control of an asset, for example, in some repurchase or consignment arrangements when the customer has physical possession but the seller has control, and in some bill-and-hold transactions when the seller has physical possession but the customer controls. For a customer (or lender) to have obtained control of a product (or asset) in a bill-and-hold arrangement, the transaction must meet all of the following criteria:

a. The reason for the bill-and-hold arrangement must be substantive (e.g. the customer has requested the arrangement);
b. The product must be identified separately as belonging to the customer;
c. The product currently must be ready for physical transfer to the customer; and
d. The entity cannot have the ability to use the product or to direct it to another customer. [606-10-55-83]

We believe that in many standstill arrangements, the transaction will meet all of the criteria, which leads to the conclusion that the lender would have control even though the borrower maintains physical possession. In consideration of criterion (d), while the borrower continues to operate the property during the standstill period (and therefore uses it), the lender may have the right to receive as debt service payments substantially all of the cash flows arising from the property's operations.

In addition, the borrower generally does not have the ability to sell the property to another party, benefit from changes in the fair value of the property, or otherwise have the power to direct the activities that most significantly affect the property's economic performance (based on the guidance in Subtopic 810-10).

We believe the control analysis during the standstill period also is similar to the analysis performed when there is a repurchase option in place as discussed in paragraphs 606-10-55-66 to 55-71 that indicates that the holder of an option to acquire the asset (the lender) may presently control the asset even though the other party has physical possession.

The FASB has proposed amendments to Subtopic 610-20 to clarify when derecognition is appropriate for in-substance nonfinancial assets, which include the assets in a subsidiary in which substantially all of the fair value is concentrated in nonfinancial assets. Under the proposal, if control of the nonfinancial asset transfers before the associated liability meets the criteria to be derecognized under Topic 405, *Liabilities*, the entity would recognize a contract asset to the extent the carrying amount of the liability is included in the calculation of the gain or loss on derecognition of the asset. See additional discussion of the project in Questions A20 and F90.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Comparison to legacy US GAAP

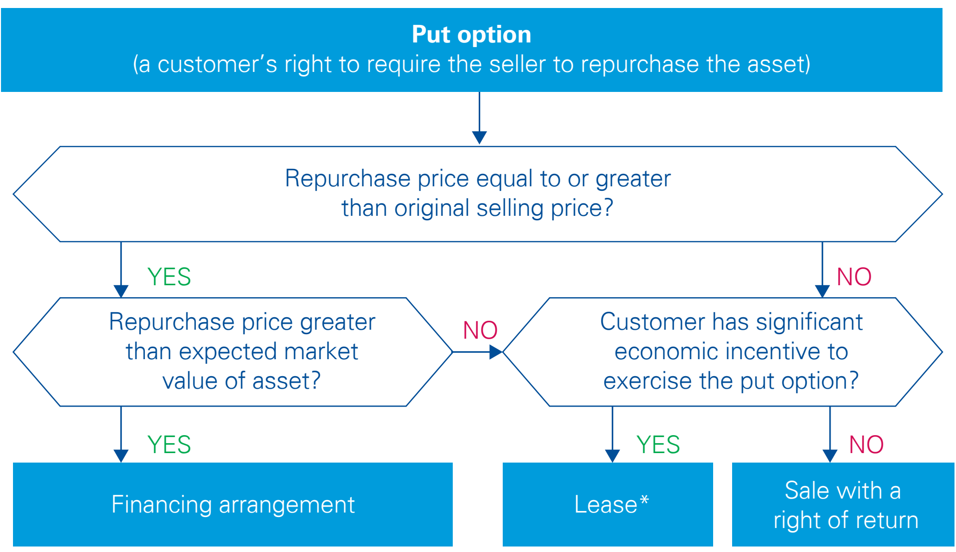
Paragraph 360-20-15-3(f) indicates the loss of a controlling financial interest in a subsidiary that is in-substance real estate because of a default by the subsidiary on its nonrecourse debt is evaluated using the derecognition of real estate guidance instead of the deconsolidation guidance under Subtopic 810-10. Topic 606 retained the scope exemption in the amendments to paragraph 810-10-40-3B for subsidiaries that are in-substance nonfinancial assets. However, rather than those transactions being subject to Subtopic 360-20, they now are subject to Subtopic 610-20.

While these transactions remain subject to the derecognition guidance applicable to transfers of nonfinancial assets and in-substance nonfinancial assets, the application differs from the existing guidance in Subtopic 360-20. Derecognition of the asset occurs under Subtopics 610-20/606-10 when control of the asset transfers, which may occur before derecognition occurs under Subtopic 360-20.

While a difference remains between how the borrower evaluates derecognition (under Subtopics 610-20/606-10) and how the creditor evaluates recognition (under the consolidation guidance in Subtopic 810-10), the concepts are much closer aligned than when the borrower applied Subtopic 360-20 for derecognition.

F60. Has control transferred under Topic 606 if, in connection with the sale of real estate, the seller provides the buyer with an option to put the property back to the seller?

Paragraphs 606-10-55-72 to 55-78 provide guidance on accounting for a seller's obligation to repurchase a property at the buyer's request (a put option). The accounting for these transactions generally depends on the relationships between the repurchase price, the original selling price and the market value of the property.



* If the contract is part of a sale-leaseback transaction, it is accounted for as a financing arrangement.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

To determine whether the buyer has a significant economic incentive to exercise its put right, the seller considers the facts and circumstances including the relationship of the repurchase price to the expected market value of the property at the date of the repurchase (including consideration of the time value of money) and the amount of time until the right expires. If the repurchase price is expected to significantly exceed the market value of the property, this may indicate the buyer has a significant economic incentive to exercise the put option.

If the seller accounts for the contract as a financing arrangement under paragraph 606-10-55-70, it continues to recognize the property and also recognizes a financial liability initially equal to the consideration received from the buyer. The seller recognizes amounts paid to the buyer above that amount as interest expense (see paragraphs 606-10-55-70 and 55-71). If the option lapses unexercised, the seller derecognizes the property and the liability and recognizes revenue (or gain).

The guidance on control transfer, including the consequence of buyer put options, applies to both customer and noncustomer transactions.

Comparison to legacy US GAAP

Paragraph 360-20-40-38 requires a sale of real estate to be accounted for as a financing, leasing or profit-sharing arrangement when the seller has an obligation to repurchase the property. Topic 606 results in a change for transactions with a put option when either the repurchase price is:

— lower than the original selling price of the property and the buyer does not have a significant economic incentive to exercise its option, or

— greater than or equal to the original selling price of the property but less than or equal to the expected market value of the property, and the buyer does not have a significant economic incentive to exercise its option.

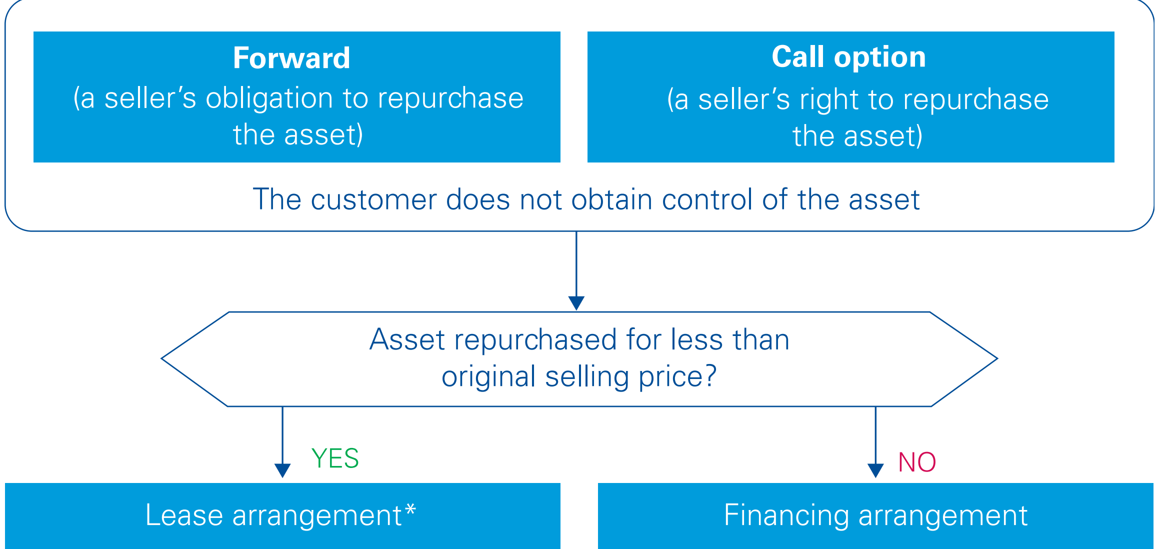
In these two circumstances, Topic 606 requires the seller to account for the put option as a right of return, which does not affect revenue recognition unless the seller expects the buyer to return the property.

However, in other circumstances, while Subtopic 360-20 and Topic 606 both may result in lease or financing accounting, there is no option under Topic 606 to apply a profit-sharing model.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

F70. Has control transferred under Topic 606 if, in connection with the sale of real estate, the seller obtains the right (or has an obligation) to repurchase the property?

Paragraphs 606-10-55-68 to 55-71 provide guidance on accounting for a seller's right to repurchase a property (a call option) and a seller's obligation to repurchase a property (a forward). A seller's right under a call option (or obligation under a forward agreement) to repurchase the property precludes transfer of control to the buyer because the buyer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the property even though it may have physical possession of the property. Whether the contract is accounted for as a lease or a financing depends on the relationship between the repurchase price and the original selling price.



* If the contract is part of a sale-leaseback transaction, it is accounted for as a financing arrangement.

While an option to repurchase the property at fair value arguably allows the buyer to obtain substantially all of the remaining benefits from the property, it limits the buyer's ability to direct the use of the asset. We believe sales subject to a seller's call option that is exercisable at fair value are accounted for as a leasing or financing arrangement depending on the expectation of the property's fair value over the option period relative to the original selling price. We expect these transactions generally will be accounted for as financing arrangements.

This guidance applies to both conditional and unconditional rights and does not permit or require an assessment of the probability that a conditional right will become unconditional. However, we believe if the condition that makes the right exercisable is controlled by the buyer, then a seller generally considers whether the buyer has the economic incentive to trigger the seller's right to repurchase (similar to the analysis on evaluating buyer put options described in paragraphs 606-10-55-72 to 55-78). An example of when the buyer controls whether the seller can exercise the repurchase right occurs in an anti-speculation clause in which the seller has the right to repurchase the property if the buyer fails to comply with certain provisions of the sales contract.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

As discussed in Question F60, if the buyer has an economic incentive not to comply with the contract that triggers the seller's right to repurchase the asset, or there is greater than a remote likelihood the buyer will not comply for other reasons (notwithstanding its ability to comply with the contract), the contract is accounted for as a lease or a financing arrangement. That accounting depends on the relationship between the repurchase price and the original selling price.

If the buyer does not have a significant economic incentive to trigger the seller's right to repurchase the asset, and it is remote that the buyer would trigger the seller's repurchase right for other reasons, the seller follows the guidance on sales with a right of return that prevents recognition of revenue only if the seller expects the buyer to return the property. [606-10-55-22 – 55-29]

Comparison to legacy US GAAP

Paragraph 360-20-40-38 requires a sale of real estate to be accounted for as a financing, leasing or profit-sharing arrangement if the seller has a right to repurchase the property (except for anti-speculation clauses). Topic 606 does not substantially change the accounting for these transactions, except there is no option to apply a profit-sharing model.

Specifically with respect to anti-speculation clauses:

FASB excerpt: 360-20

40-39 Land sale agreements sometimes contain anti-speculation clauses that require the buyer to develop the land in a specific manner or within a stated period of time. Anti-speculation clauses may also prohibit certain uses of the property. If the buyer fails to comply with the provisions of the sales contract, the seller has the right, but not the obligation, to reacquire the property. The seller's contingent option described would not preclude recognition of a sale if the probability of the buyer not complying is remote. A number of factors might lead one to conclude that buyer noncompliance is remote, including the economic loss to the buyer from repurchase and the buyer's perceived ability to comply with the provisions of the sales contract. A probability test would not be appropriate if the seller's repurchase option is not contingent upon compliance by the buyer.

We believe Topic 606 does not substantially change the accounting for transactions with anti-speculation clauses, if the buyer does not have a significant economic incentive to trigger the seller's repurchase right and it is remote the buyer will trigger the seller's repurchase right for other reasons.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

F80. Is a right of first refusal (or a right of first offer) considered an obligation or right to repurchase the property?

We do not believe a right of first refusal based on a bona fide offer by a third party constitutes an obligation or right to repurchase the property because the buyer can act in its best interest and is not economically or contractually compelled to accept the seller's offer. Therefore, the buyer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the property.

We believe a similar conclusion applies to a right of first offer that allows the seller to make an offer to the buyer before the buyer solicits or receives offers from third parties. However, the buyer must be able to act in its best interest and must not be economically or contractually compelled to accept the offer, nor can the seller be economically compelled to make an offer.

The guidance applies to both customer and noncustomer transactions.

Comparison to legacy US GAAP

Paragraph 360-20-40-38 (and paragraph 840-40-25-13 in the context of sale-leaseback transactions, that are effective only until Topic 842 becomes effective) indicates a right of first refusal based on a bona fide offer by a third party ordinarily is not an obligation or an option to repurchase. We do not believe there will be any change to the accounting for rights of first refusal or rights of first offer in real estate sale contracts under Topic 606.

F90. How should a seller evaluate transfer of control in the context of a partial sale; for example, on the sale of less than 100 percent of the seller's ownership interest in an entity considered an in-substance nonfinancial asset?

Partial sales of real estate typically occur in the following ways.

Transaction 1. A seller contributes a wholly owned property (or an interest in a real estate entity considered an in-substance nonfinancial asset) to a newly formed venture and simultaneously receives cash from a third party to buy a partial ownership interest in that newly formed venture. The cash may come directly from the third party to the seller, or may be contributed by the third party to the venture and distributed from the venture to the seller. The seller retains a controlling financial interest in the venture post-sale and no interest in the third party.

Transaction 2. Assume the same facts as Transaction 1 except the seller retains only a noncontrolling interest in the venture post-sale.

Transaction 3. A seller contributes a wholly owned property (or an interest in a real estate entity considered an in-substance nonfinancial asset) to a newly formed, wholly owned venture. Sometime later, it sells a partial ownership interest in the venture to a third party for cash. The cash may come directly from the third party to the seller, or may be contributed by the third party to the venture and distributed from the venture to the seller. The seller retains a controlling financial interest in the venture post-sale and no interest in the third party.

Transaction 4. Assume the same facts as Transaction 3 except the seller retains only a noncontrolling interest in the venture post-sale.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Paragraph 970-323-30-3 states an investor contributing real estate to a venture records its investment at the cost of the contributed real estate (with no profit recognized) regardless of what other investors may contribute because the transaction is a contribution of capital. In some cases, however, these transactions may be in-substance sales because the seller withdraws the other investors' contributed cash from the venture to compensate it for the sale of the partial interest, and the seller has no commitment to reinvest the cash.

The seller should look to the revenue recognition guidance to determine if revenue/profit recognition is appropriate (Topic 606 for customer transactions or Subtopic 610-20 for noncustomer transactions). Paragraph 970-323-30-3 includes an example of an in-substance sale when the seller receives cash for a 50 percent interest in the venture and accounts for the transaction as a sale of 50 percent of its interest to the third party. [360-10-40-3A – 40-3C]

There are several views about how to apply the revenue recognition guidance in Transactions 1 through 4.

View A asserts that the control transfer provisions of Topic 606 apply to the partial ownership interest sold without regard to whether the seller retains a controlling financial interest in the venture. Under View A, all the transactions described above (1 through 4) would be accounted for similarly. The initial contribution of the real estate (or in-substance real estate) results in no immediate profit recognition, but when the partial ownership interest is sold for cash (either simultaneously or sometime later), the seller applies Topic 606's control transfer principles relative to the partial ownership interest without regard to whether it retains a controlling financial interest in the venture. When (or as) control of the partial ownership interest is transferred, the seller recognizes profit equal to the transaction price received from the third party (i.e. the buyer of the partial ownership interest) minus the carrying amount of the partial interest sold.

View B, similar to View A, believes that the control transfer provisions of Topic 606 apply to the partial ownership interest sold, but only if the seller no longer retains a controlling financial interest in the venture. Under View B, partial profit (i.e. profit on the partial interest sold) would be recognized for Transactions 2 and 4, similar to View A, but the profit would be deferred until realized through sale or operations of the underlying real estate for Transactions 1 and 3.

View C says that the seller must relinquish its controlling financial interest in the venture under Subtopic 810-10 to recognize profit. Unlike View B though, upon loss of the controlling financial interest in the venture, the seller treats the fair value of its retained interest similar to consideration received and recognizes 100 percent profit at the sale date and the retained interest at fair value (versus only partial profit for the portion sold under View B). Alternatively, if the seller retains a controlling financial interest (sells a noncontrolling interest), no profit is recognized and the difference between the consideration received and the amount by which the noncontrolling interest needs to be adjusted is recorded in additional paid-in capital (versus a deferred profit on the partial interest sold under View B).

View D concludes that the control transfer provisions of Topic 606 apply to the underlying real estate. The seller recognizes no profit unless/until the third-party investor can direct the use of, and obtain substantially all of the remaining benefits of, the underlying property. While the total amount of profit may be the same as the amount recognized under View C, profit recognition may be delayed even beyond deconsolidation of the venture. The delay may occur because the seller could lose its controlling financial interest in the venture (as described in Subtopic 810-10) before the third-party investor could direct the use of, and obtain *substantially all* the remaining benefits from, the property under Topic 606.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

View E is a hybrid view that says that Topic 845 applies to Transactions 2 and 4 and Subtopic 810-10 applies to Transactions 1 and 3. As discussed in Question D40, paragraphs 845-10-30-24 to 30-26 require that an exchange involving the receipt of a noncontrolling interest in the buyer (Transactions 2 and 4) be measured at fair value with recognition of full gain (if the retained interest is a cost method investment), or partial gain (if the retained interest is an equity method investment) if these conditions are met:

— fair value is reasonably determinable;

— the transaction is **not** an exchange of products or properties held for sale in the ordinary course of business to facilitate sales to customers; and

— the transaction has commercial substance (i.e. none of the conditions in paragraph 845-10-30-3 are met).

Application of Topic 845 to Transactions 2 and 4 would result in profit recognition similar to Views A and B (assuming the seller accounts for the retained interest under the equity method).

Application of Subtopic 810-10 to Transactions 1 and 3 (similar to View C) would not result in profit recognition, and the difference between the consideration received and the amount by which the noncontrolling interest needs to be adjusted would be recorded in additional paid-in capital because the seller retains its controlling financial interest.

The following table summarizes the results of applying each of the views assuming the seller owns 100 percent of the real estate venture before the transaction and 60 percent after selling 40 percent. The transaction price (equal to the fair value of the 40 percent interest) is $120, and the carrying amount of the seller's 100 percent interest at the time of sale is $100. The seller continues to consolidate the venture post-transaction.

View	Profit recognized in income at sale date	Notes
A	$80 = $120 – ($100 × 40%)	Immediate profit recognition on the partial interest sold
B	$0	No immediate profit recognition because the seller retains a controlling financial interest; gain of $80 is deferred until realized through third-party sale of the property or operations
C	$0	No immediate profit recognition because the seller retains a controlling financial interest; gain is recognized at the sale date through an adjustment to equity of $80
D	$0	No immediate profit recognition because the buyer does not have control (i.e. substantially all of the remaining benefits) of the underlying property and the seller retains a controlling financial interest; gain is recognized at the sale date through an adjustment to equity of $80
E	$0	No immediate profit recognition because the seller retains a controlling financial interest; gain is recognized at the sale date through an adjustment to equity of $80

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

The following table summarizes the results of applying each of the views assuming the seller owns 100 percent of the real estate venture before the transaction and 40 percent after selling 60 percent. The transaction price, which is equal to the fair value of the 60 percent interest, is $180, and the carrying amount of the seller's 100 percent interest at the time of sale is $100.

The seller holds only a noncontrolling interest post-transaction. Assume also that fair value is reasonably determinable, the transaction is **not** an exchange of products or properties held for sale in the ordinary course of business to facilitate sales to customers, and the transaction has commercial substance.

View	Profit recognized in income at sale date	Notes
A	$120 = $180 – ($100 × 60%)	Immediate profit recognition on the partial interest sold; retained interest accounted for under the equity method
B	$120 = $180 – ($100 × 60%)	Immediate profit recognition on the partial interest sold because seller no longer holds a controlling financial interest; retained interest accounted for under the equity method
C	$200 = ($180 ÷ 60%)[13] – $100	Immediate profit recognition based on a sale of the entire 100% interest with the fair value of the 40% retained interest treated as consideration received; retained interest accounted for under the equity method
D	$0	No immediate profit recognition because the buyer does not have control (i.e. substantially all of the remaining benefits) of the underlying property; seller continues to recognize the property and recognizes a liability for any cash received.
E	$120 = $180 – ($100 × 60%)	Immediate partial profit recognition on the nonmonetary exchange because the seller no longer holds a controlling financial interest and the retained interest is accounted for under the equity method

[13] This calculation results in the implied fair value of a 100% interest. If the fair value of a 60% interest is $180, the implied fair value of the 100% interest is $180 ÷ 60%, or $300.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

We believe the accounting for these transactions would be the same regardless of whether the third party is a customer or a noncustomer.

While the views described above reflect possible interpretations of Subtopics 610-20, 810-10 and 970-323 as issued, the FASB is reconsidering this guidance in its project on *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets,* formerly *Clarifying the Definition of a Business Phase 2*[14] (Phase 2).

In its *Clarifying the Definition of a Business (Phase 1)* project, the FASB proposed to change the definition of a business[15], which would result in many more real estate transactions being considered purchases or sales of nonfinancial assets rather than businesses.

In Phase 2, the FASB proposed that Subtopic 610-20 would apply when the property (in the form of a single nonfinancial asset or multiple, distinct in-substance nonfinancial assets) does not meet the definition of a business (and none of the other scope exceptions apply, see additional discussion in Question A20).

An asset would be an *in-substance nonfinancial asset* when (a) it is included either in a group (by contract) or a subsidiary, and (b) substantially all of the fair value (recognized and unrecognized, but excluding cash and cash equivalents) of that group or subsidiary is concentrated in nonfinancial assets (e.g. real estate and intangibles).

When substantially all of the fair value of the group or subsidiary is concentrated in nonfinancial assets, *all* the assets in the group or subsidiary are considered in-substance nonfinancial assets, even if individual assets would be considered financial assets if they were sold independently.

The proposed scope includes transactions in which an entity sells/transfers a nonfinancial asset (or an in-substance nonfinancial asset) in exchange for a noncontrolling ownership interest. These transactions would include when the noncontrolling interest received (or retained) is a noncontrolling ownership interest in the post-sale owner of the property (including sales to an existing equity method investee), and when the noncontrolling interest is received because of contributing a nonfinancial asset to form a venture.

Under the Phase 2 proposal, when a noncontrolling interest in the buyer/transferee is received or retained, it would be considered noncash consideration (paragraph 606-10-32-21), and its fair value at contract inception would be included in the transaction price. The carrying amount of liabilities assumed by the buyer/transferee also would be included in the consideration received for computing the gain or loss (subject to the constraint on estimating variable consideration in paragraph 606-10-32-11). The seller/transferor's gain on the sale would be equal to the amounts previously illustrated in View C.

The Phase 2 proposal would eliminate the guidance in Topic 845 related to the transfer of a nonfinancial asset for a noncontrolling interest in the buyer (see Question D40).

The proposed unit of account in these transactions would be each distinct asset (or in-substance nonfinancial asset) as opposed to the partial interest transferred. If the transaction does not result in the seller relinquishing control of the nonfinancial asset (or a distinct in-substance nonfinancial asset), the seller/transferor would:

a. record an equity transaction if retention of control results from retaining a controlling financial interest in the entity that owns the asset post-sale (similar to View C previously illustrated), or
b. apply the guidance in 360-10-40-3C.

---

[14] For more information on this project, see Defining Issues 16-21, FASB Proposes to Clarify Scope of Derecognition of Nonfinancial Assets.

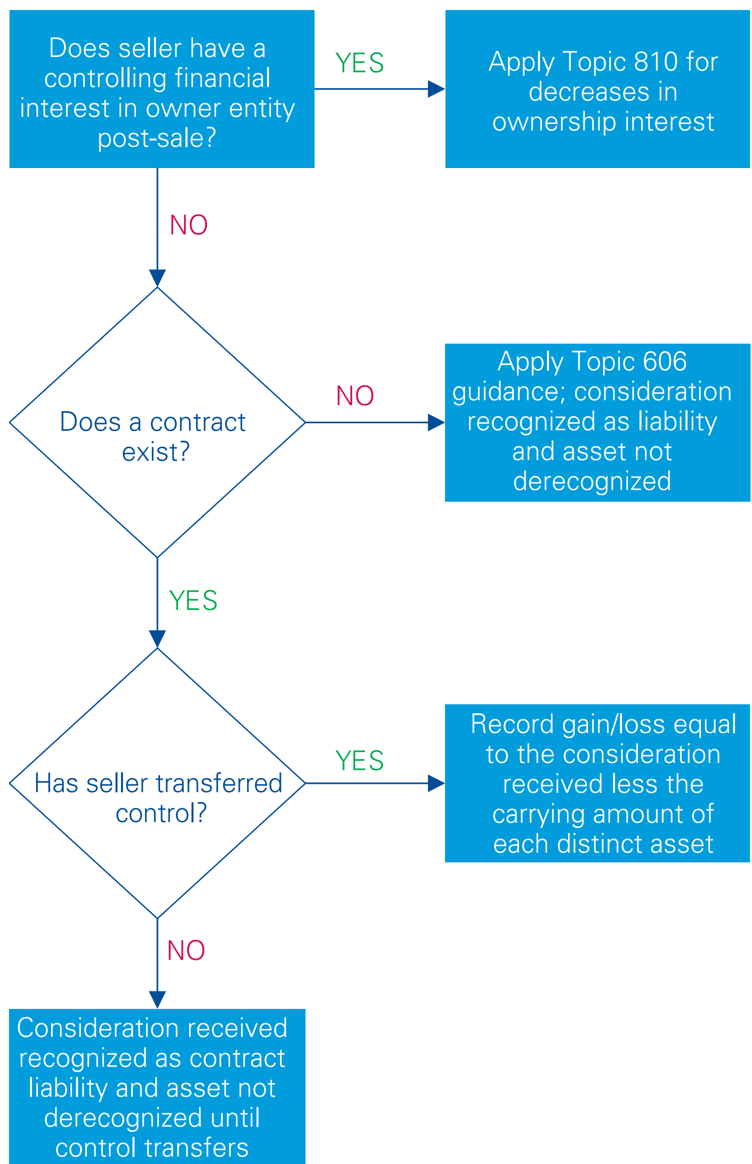
[15] For more information on this project, see Defining Issues 15-56, FASB Proposes to Clarify the Definition of a Business.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Paragraph 360-10-40-3C indicates that a seller should consider the guidance in (a) 606-10-25-6 to 25-8, which would result in recognition of a deposit liability for the cash received, if failure to relinquish control results from not having a contract, or (b) 610-10-25-30, if failure to relinquish control results from not transferring control of the asset to the entity that owns the asset post-sale. [606-10-25-1 – 25-8, 25-30, 610-20-40-1]

Because in most cases the subsidiary owns and controls the asset before it sells the third-party ownership interest in the entity, we believe most of these partial ownership sales would qualify for full profit recognition when the seller relinquishes its controlling financial interest in the subsidiary.

The following flowchart depicts the proposed decision sequence:



The proposed guidance in Phase 2 applies only when the seller is transferring a nonfinancial asset or an in-substance nonfinancial asset (i.e. an asset that is included in a group, or subsidiary, in which substantially all of the fair value is concentrated in nonfinancial assets).

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

When substantially all of the fair value of *a group of assets* is not concentrated in nonfinancial assets (and is not a business), the seller first would apply the revenue guidance on identifying distinct goods and services and allocating consideration to those distinct goods and services. Then, the seller would account for each of the distinct goods and services under the applicable guidance, which generally would be Subtopic 610-20 for the sale of distinct nonfinancial assets.

When substantially all of the fair value of a *subsidiary* is not concentrated in nonfinancial assets (and is not a business), the seller would apply the guidance in Topic 810 on derecognition and decreases in ownership of businesses. This guidance is required for subsidiaries when no other guidance applies. Topic 810 requires full gain or loss in earnings when a controlling financial interest is sold, and no gain or loss in earnings when a controlling financial interest is retained (i.e. the gain or loss is recognized in equity).

See Question A20 for discussion of which sales of ownership interests in real estate entities are within the scope of Topic 606/Subtopic 610-20 versus Subtopic 810-10.

F100. Does the guidance on partial sales discussed in Question 5.9 apply when the venture owns operating real estate that meets the definition of a business?

Generally yes, because an ownership interest in a venture owning operating real estate often is an in-substance nonfinancial asset even if it also meets the definition of a business. As discussed in Question A20, land plus property improvements and integral equipment collectively are considered in-substance real estate, so their sale is accounted for under Subtopic 610-20 (or Topic 606 if the sale is to a customer, via the guidance in Section 360-10-40). This accounting would apply even if all (or part) of the operations of the property otherwise meet the definition of a business for which derecognition would normally be accounted for under Subtopic 810-10. Paragraphs 810-10-40-3A and 810-10-45-21A exclude the transfer of in-substance nonfinancial assets from Subtopic 810-10's guidance on accounting for the deconsolidation, and decrease in ownership, of a subsidiary or business.

If the interest in the venture is not considered an in-substance nonfinancial asset, and the venture is a business (after considering the guidance in Question A20), then partial sales would be accounted for under Subtopic 810-10 (illustrated as View C in Question F90). This would result in 100 percent profit recognition in income when the seller no longer consolidates post-transaction and $0 profit recognition in income when the seller continues to consolidate post-transaction.

While the guidance above reflects possible interpretations of Subtopics 610-20, 810-10 and 970-323 as it currently exists, the FASB is reconsidering this guidance in its project on *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*, formerly *Clarifying the Definition of a Business Phase 2* (Phase 2).

In its *Clarifying the Definition of a Business (Phase 1)* project, the FASB proposed to change the definition of a business, which will result in many more real estate transactions being considered purchases or sales of nonfinancial assets rather than businesses.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

In Phase 2, the FASB proposed that Subtopic 610-20 would apply when the property (in the form of a single nonfinancial asset or multiple, distinct in-substance nonfinancial assets) does not meet the definition of a business. If the asset (or subsidiary or group of assets) transferred does meet the definition of a business, Subtopic 810-10 would apply. In either case, this generally would result in 100 percent profit recognition in income when the seller no longer consolidates post-transaction, and $0 profit recognition in income when the seller continues to consolidate post-transaction. However, the amount of profit on the sale may differ depending on whether the asset (or subsidiary or group of assets) is a business or a nonfinancial asset because a seller would measure the consideration (a) at fair value in the derecognition of a business, and (b) at the transaction price (which may include an estimate of variable consideration) plus the carrying amount of liabilities assumed by the buyer in the derecognition of a nonfinancial asset.

Comparison to legacy US GAAP

Paragraphs 360-20-40-46 to 40-49 define a sale as a partial sale if the seller retains an equity interest in the property or has an equity interest in the buyer. Profit equal to the difference between the sales value and the proportionate cost of the partial interest sold is recognized if the:

- buyer is independent of the seller;
- collection of the sales price is reasonably assured; and
- seller will not be required to support the operations of the property or its related obligations to an extent greater than its proportionate interest.

If these conditions are not met and the:

- collection of the sales price is not reasonably assured – the seller applies the cost recovery or installment method of recognizing profit;
- buyer is not independent of the seller, for example, if the seller holds or acquires an equity interest in the buyer – the seller recognizes the part of the profit proportionate to the outside interests in the buyer at the date of sale;
- seller controls the buyer – no profit on the sale is recognized until it is realized from transactions with outside parties through sale or operations of the property; and
- seller is required to support the operations of the property after the sale — the accounting is based on the nature of the support obligation.

Paragraphs 970-323-30-3, 35-15 and 40-1 also address partial sales when (a) the buyer is not independent of the seller because it holds or acquires an equity interest in the buyer, and (b) the seller controls the buyer.

Currently there is some diversity in practice in the accounting for the sale of a noncontrolling interest in a real estate venture when the seller retains a controlling financial interest in the venture. Many sellers do not recognize a sale or immediate profit in such transactions, but some sellers recognize those transactions as partial sales with partial profit recognition. Under the new guidance as currently issued and absent any further direction from the FASB, diversity would likely increase as the interaction between the revenue standard and the deconsolidation guidance in Subtopic 810-10 is less clear. However, as discussed above, the FASB has proposed guidance intended to address these issues, among others, in connection with its *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets* project. See additional discussion in Question F90.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

F110. Is a buy-sell clause allowing either investor to make an offer to acquire the other's interest in an entity that holds real estate considered an obligation or a right to repurchase the property from the perspective of the investor that sold the real estate to the entity?

Frequently to facilitate a partial sale transaction, a seller will contribute property to a newly formed entity and a third party will contribute cash so that the seller can take a simultaneous cash distribution for the sale to that third party of an ownership interest in the entity. A contractual buy-sell clause may be included in the terms of the sale that enables both investors in the jointly-owned entity to offer to buy the other investor's interest. In some cases, a buy-sell clause may be executed at any time; in other cases, only at a specified future date or if specified circumstances arise. When an offer is made under the buy-sell clause, the recipient of the offer can elect to sell its interest for the offered amount or buy the offeror's interest at the offered amount. Generally, once an offer is made, the offeror is contractually required to buy the other investor's interest or sell its interest at the offered amount, depending on the other investor's election. A buy-sell clause can specify that the offer be at fair value, at a contractually specified amount, or at an amount determined by the offeror.

We do not believe a buy-sell clause, by itself, precludes the buyer from obtaining control unless it gives the buyer an in-substance option to put its interest back to the seller or gives the seller an in-substance right to reacquire the buyer's interest in the property. If the buy-sell clause is an in-substance put or call option, the seller applies the guidance in Question F60 or Question F70.

A buy-sell clause may be considered an in-substance option when the buyer cannot act independently from the seller, or the seller is economically compelled to reacquire the other investor's interest in the jointly owned entity (reacquiring the property). Those circumstances suggest that the buyer's ability to direct the use of, and obtain substantially all of the remaining benefits from, the property is limited.

We believe the following indicators (which are not all-inclusive) may suggest the buyer has not obtained control:

a. The price specified in the buy-sell agreement indicates that the parties have already negotiated for the seller to acquire the buyer's interest. This would occur when the fixed price specified in the buy-sell clause economically compels the seller to acquire the buyer's interest or economically compels the buyer to sell its interest to the seller.
b. The seller has a strategic necessity or an investment strategy that indicates that it cannot relinquish its ownership rights to the buyer. Therefore, the seller is compelled to reacquire full ownership of the real estate.
c. The seller has arrangements with the jointly-owned entity, such as management or third-party leasing arrangements, that may economically compel the seller to reacquire the real estate to retain the economic benefits (e.g. leasing commissions from lessees) or escape the negative economic consequences (e.g. a below-market contract with the entity).
d. Tax implications economically compel the seller to acquire the buyer's interest in the entity (thereby reacquiring the real estate).
e. Tax implications economically compel the buyer to sell its interest in the entity to the seller.
f. The buyer is financially unable to acquire the seller's interest.
g. The buy-sell clause stipulates a specified rate of return to the buyer (or seller), indicating that the buyer may not fully participate in the rewards of ownership from the real estate.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

h. The buyer has a strategic necessity or an investment strategy that requires it to sell its interest to the seller.

i. The buyer is legally restricted from acquiring the seller's interest.

j. The real estate is integrated into the seller's business, so the buyer does not have alternative means available, such as selling to an independent third party, to realize its economic interest.

We believe this guidance applies to both customer and noncustomer transactions.

Comparison to legacy US GAAP

Paragraphs 360-20-40-38 and 55-21A indicate that a buy-sell clause by itself does not constitute a prohibited form of continuing involvement that would preclude profit recognition on the sale of the partial interest. However, the clause would be evaluated in light of all the relevant facts and circumstances to determine whether its terms indicate that the seller has transferred the usual risks and rewards of ownership and does not have substantial continuing involvement. The buy-sell clause also must be evaluated to determine whether it gives the buyer an in substance option to put its interest back to the seller or gives the seller an in-substance option to acquire the buyer's interest in the real estate.

We believe the analysis of whether a buy-sell clause is an in-substance put or call option under Subtopic 360-20 is similar to the analysis under Topic 606, although the resulting accounting may differ depending on the facts and circumstances as discussed in Questions F60 and F70.

F120. What is the accounting consequence when a general partner in a limited partnership sells a property to the partnership for cash (contributed by the limited partners) and a significant receivable?

Under Topic 606, the seller first determines if a contract exists given the significance of the receivable (see Question B10 for discussion about evaluating whether a contract exists and the resulting accounting if it does not). Next, it determines if and when control transfers, which may depend on the facts and circumstances of the transaction and the FASB's final standard on the guidance on partial sales (see Question F90).

Comparison to legacy US GAAP

A seller must account for a sale as a financing, leasing or profit sharing arrangement if it:

— retains a general partnership interest in the entity that purchases its property, and

— holds a receivable from the limited partnership for a significant part of the sales price (defined as a receivable in excess of 15 percent of the maximum first-lien financing that could be obtained from an independent established lending institution for the property).

Topic 606 may result in a change because revenue/profit recognition may be appropriate if a contract exists and control has transferred. The existence of the general partner interest and significant receivable does not preclude revenue/profit recognition under Topic 606 as it does under Subtopic 360-20. [360-20-40-40]

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

F130. How should a manager recognize revenue associated with variable consideration in a property management services contract when the contract bases the variable consideration on a percentage of the property's operating results?

As discussed in Question E10, the manager will need to determine if the services comprise a series of distinct time increments of property management services. Question C30 provides additional discussion about identifying the performance obligations in a property management services contract. If the manager concludes the services are a series of distinct services (i.e. a series of daily, weekly or monthly management services), it must allocate the variable consideration to the distinct service periods within the single, series performance obligation if:

a. the variable consideration earned for a given distinct service period relates specifically to the manager's services for that period (or an outcome from those services), and
b. allocation of that amount specifically to the distinct service period is consistent with the allocation objective in paragraph 606-10-32-40(b).

If the property management services comprise a series of distinct service periods to which the variable consideration earned each period can be allocated, the manager will not need to estimate the total variable fees that will be earned during the performance obligation period. The variable fees earned each period will be allocated to, and recognized in, each period.

Paragraphs 606-10-55-157B to 55-157E provide an example of a 20-year hotel management service contract with a customer that pays the manager a monthly fee equal to 1 percent of the hotel's revenue. The manager concludes that it has a single performance obligation to provide a series of daily property management services and that its transaction price is entirely variable.

The property manager then must determine if and how to allocate the variable consideration to each of the distinct days of service in the series of daily services under paragraph 606-10-32-39(b). After considering the guidance in paragraph 606-10-32-40, the property manager concludes that the terms of the variable consideration relate specifically to the manager's efforts to transfer each distinct daily service. Therefore, allocating the variable consideration based on the activities performed each day is consistent with Topic 606's overall allocation objective. See Question E10 for additional discussion about allocating the variable consideration.

When determining the relative value of the activities performed each day, we believe in many cases property managers will be able to apply the paragraph 606-10-55-18 practical expedient and recognize revenue in the amount to which they have a right to invoice. They will be able to apply the practical expedient because the terms of the contract intend to provide the property manager the right to consideration in an amount that corresponds directly with the value to the customer of the performance completed each period. However, even if the property manager may apply the practical expedient, it still would need to consider the constraint on variable consideration in 606-10-32-11 to 32-14.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

G Other implementation matters

G10. For transition purposes, how would an entity apply the definition of a completed contract when a reduced profit method under legacy US GAAP is being used?

When a reduced profit method under legacy US GAAP is being used (e.g. installment method), for transition purposes an entity adopts Topic 606 using one of the following two methods:

Method 1

Retrospectively by restating each prior period before the date of initial application that is presented in the financial statements (full retrospective). An entity also may elect retrospective application with or without a number of practical expedients.

Method 2

Recording the cumulative effect of initially applying the new standard as an adjustment to the opening balance of equity at the date of initial application (no restatement of comparative prior periods). An entity may apply the cumulative-effect transition approach either to (a) only those contracts that are not completed contracts at the date of initial application, or (b) all contracts.

Paragraph 606-10-65-1(c)(2) defines a completed contract for transition purposes as one for which all (or substantially all) of the revenue was recognized under legacy US GAAP. Real estate sales that have occurred before the date of initial application and met the criteria for full accrual profit recognition under Subtopic 360-20 generally would be considered completed contracts[16] and therefore no adjustment to opening equity would be needed for those transactions (because the adjustment would only be necessary for contracts that are not completed).

---

[16] We believe, however, that a real estate sale qualifying for full accrual profit recognition under Subtopic 360-20 would not be considered a completed contract in circumstances where there is an ongoing earn-out or other interest in future profits that prevents the entity from concluding that substantially all of the revenue has been recognized before the date of initial application.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Example G10.1: Not a completed contract at transition

Description of the arrangement

ABC Corp. sells a property to DEF Corp. (a customer) for $10,000,000 with a carrying amount of $8,000,000. ABC receives $500,000 at closing on October 1, 2017 and finances the remaining $9,500,000 under a 30-year note receivable. Because DEF's initial investment of $500,000 is not adequate, ABC accounts for the transaction under the installment method prescribed by Subtopic 360-20 (assuming the criteria for the installment method are met). DEF makes its first principal payment on the note of $100,000 on December 31, 2017.

ABC has a calendar year-end, and for purposes of its 2017 annual financial statements, ABC recognizes $600,000 of revenue, $120,000[17] profit on the sale of the property, and deferred profit of $1,880,000.

Evaluation

ABC adopts the Topic 606 on January 1, 2018 and concludes its contract is not complete because it has not recognized substantially all of the $10,000,000 revenue under legacy US GAAP (Subtopic 360-20).

Under the retrospective method, ABC would recast its 2017 financial statements to reflect the property sale under the guidance of Topic 606. If ABC concludes that a contract exists (including that the collection of the note is probable) and control of the property has transferred, then its 2017 financial statements would be recast to reflect revenue of $10,000,000 and profit on the sale of the property for the full $2,000,000 (or gain on sale of $2,000,000 for a transaction with a noncustomer).

Under the cumulative-effect method, ABC does not recast its 2017 financial statements (i.e. revenue of $600,000 and profit of $120,000 recognized in 2017 is unchanged). However, if ABC concludes that a contract exists (including that the collection of the note is probable) and control of the property has transferred, then it records a cumulative-effect adjustment of $1,880,000 to increase opening equity (retained earnings) and derecognizes the property on January 1, 2018.

Conversely, if it concludes that a contract does not exist, then it would record a cumulative-effect adjustment of $120,000 to decrease opening equity (retained earnings) on January 1, 2018 and would continue to recognize the property at its depreciated carrying amount.

---

[17] $2,000,000 profit ÷ $10,000,000 sales price x $500,000 received at closing plus $2,000,000 profit ÷ $10,000,000 sales price x $100,000 principal payment.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Example G10.2: Not a completed contract at transition

Description of the arrangement

ABC Corp. sells a newly constructed retail property with a cost of $1,200,000 to DEF Corp. (a customer) for $2,000,000 and a right to receive 25% of future operating profits from the property over a 10-year earn-out period. At closing, on October 1, 2017 ABC receives cash of $2,000,000 and expects to collect an additional $420,000 over the earn-out period. ABC has no other continuing involvement in the property and meets all the criteria for full accrual profit recognition under Subtopic 360-20.

In its 2017 financial statements, ABC recognizes revenue of $2,000,000 and profit of $800,000 on the sale of the property and $10,000 of contingent profits for the amounts realized in the period October 1 through December 31, 2017. ABC would recognize a gain of $800,000 on the sale if the transaction were with a noncustomer.

Evaluation

ABC adopts Topic 606 on January 1, 2018 and concludes its contract for the property sale on October 1, 2017 is not complete because it has not recognized substantially all of the expected revenue of $2,420,000 ($2,000,000 + $420,000) under legacy US GAAP (Subtopic 360-20).

Under the retrospective method, ABC would recast its 2017 financial statements to reflect the property sale under the guidance of Topic 606. If ABC concludes that a contract exists and control of the property has transferred, then it would recast its 2017 financial statements to reflect revenue of $2,420,000 and profit on the sale of the property for the full $1,220,000, assuming the variable consideration of $420,000 (representing the future profits interest) is not constrained. ABC would recognize a gain of $1,220,000 if the transaction were with a noncustomer.

Under the cumulative-effect method, ABC does not recast its 2017 financial statements (i.e. profit recognized in 2017 of $810,000 is unchanged). However, if ABC concludes that a contract exists and control of the property has transferred, then it records a cumulative-effect adjustment of $410,000 (total profit under Topic 606 of $1,220,000 minus $810,000 recognized before adoption) to increase opening equity (retained earnings) on January 1, 2018 and derecognizes the property.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

G20. How will Topic 606 interact with the new leasing standard when the lease is an operating lease and the lessee reimburses the lessor for certain costs?

As discussed in Question A30, the FASB recently issued ASU 2016-02[18], which creates a new Topic 842. Topic 842 will supersede Topic 840 in 2019 for calendar year end public business entities. (For more information on Topic 842's effective date, see Question A30.)

Topic 842, like Topic 840, includes guidance on separating lease and non-lease components. Paragraphs 842-10-15-28 to 15-32 and 15-38 to 15-42 require a lessor to separate a single contract into each separate lease component and non-lease component and allocate the consideration using the requirements in Topic 606 for allocating the transaction price (i.e. on a relative stand-alone selling prices basis under paragraphs 606-10-32-28 – 32-41).

Lease components will be accounted for under Topic 842, and non-lease components generally will be accounted for under Topic 606 unless other US GAAP is applicable. The lease component will include activities of the lessor that do not transfer a good or service to the lessee separate from the right to use the underlying asset. Those activities are not considered separate components and therefore are not allocated any portion of the consideration in the lease contract. [842-10-15-30]

Typical recurring charges/reimbursements in an operating lease contract include:

— real estate taxes;

— property insurance; and

— common area maintenance.

Real estate taxes and property insurance

As discussed above, reimbursement or payment of the lessor's costs of ownership are not separate components in the lease contract because they do not transfer a good or service to the lessee. For example, certain leases may require the lessee to reimburse the lessor for all or a portion of the real estate taxes or property insurance costs incurred by the lessor as the owner of the property.

Because the payments do not result from transferring a good or service to the lessee separate from the use of the underlying asset, they are not specifically allocated to those activities but are instead simply considered part of the overall consideration in the contract. In many cases, these payments vary based on the lessor's costs and are billed separately (i.e. a net lease). In those cases, the lessor considers the payments variable lease payments and recognizes them in the period in which the facts and circumstances on which the payments are based change. [842-30-25-11(b), 842-10-55-141 – 55-142)]

If the contract also includes a non-lease component (like common area maintenance), variable lease payments (including cost reimbursements) likely will be partially attributed to the non-lease component on the same basis as the fixed consideration under the lease was attributed to the lease and non-lease components. If instead the lessor structures the reimbursement through a fixed adjustment to the base lease payment (i.e. a gross lease), it would consider the adjustment part of the total consideration in the contract, like other fixed lease payments. The lessor then

[18] For more information on ASU 2016-02, see Leases: Issues in Depth.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

allocates the total consideration in the contract to the lease component and the non-lease component and generally recognizes the amount it allocated to the lease component over the lease term on a straight-line basis. This would apply even if the lessor itemized that portion of the fixed payment in the contract for cost reimbursement. [842-10-55-143, 842-30-25-11(a)]

Common area maintenance

Some leases also may require the lessee to pay the lessor for common area maintenance such as cleaning, parking lot maintenance and provision of utilities. Unlike real estate taxes and insurance, common area maintenance is not a cost of ownership of the leased property, but instead is a service the lessor provides or contracts for the lessee for its ongoing use of the property. [842-10-55-144 – 55-145]

Under Topic 842, common area maintenance is a non-lease component that will be separated from the lease component. As previously discussed, the overall contract consideration is allocated between the two components generally on a relative stand-alone selling price basis; the allocated revenue associated with the common area maintenance services will be accounted for under Topic 606 and the allocated lease income associated with the lease component will be accounted for under Topic 842.

Because Topic 842 and Topic 606/Subtopic 610-20 are effective at different dates (and the guidance on separating lease and non-lease components differs between Topic 840 (current leases Topic) and Topic 842 (new leases Topic)), lessors should consider whether early adoption of Topic 842 to coincide with the adoption of Topic 606/Subtopic 610-20 would reduce their total transition efforts.

G30. Does new Topic 340 change whether an entity can capitalize costs incurred to sell real estate projects?

Topic 340 supersedes the guidance in Subtopic 970-340 on accounting for costs incurred to sell real estate projects. Those costs generally will now be evaluated for capitalization using guidance on the incremental cost of obtaining a contract and costs to fulfill a contract. [340-40-25-1 – 25-8]

An incremental cost of *obtaining* a sales contract is a cost that would not have otherwise been incurred if the contract were not obtained. An entity capitalizes[19] those costs under Topic 340 if it expects to recover them. Costs that an entity would have incurred regardless of whether it obtained a sales contract are recognized under Topic 340 as an expense when incurred, unless those costs are capitalizable under other guidance or explicitly chargeable to the customer regardless of whether or not a contract was obtained.

In many cases, the seller would have incurred indirect costs of obtaining a sales contract such as model units and their furnishings, sales facilities, legal fees for preparation of prospectuses and semi-permanent signs regardless of whether the seller obtained a contract. The seller generally does not attribute these costs to a specific contract. As a result, the seller generally would expense these costs as incurred unless they are within the scope of another topic; for example, model units and sales facilities may be long-lived assets under Topic 360.

[19] As a practical expedient, an entity may recognize the incremental cost of obtaining a contract as an expense when incurred if the amortization period of the asset that would have otherwise been recorded is one year or less.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

If the costs incurred to *fulfill* a sales contract are in the scope of other guidance, then the entity accounts for them using the other guidance (e.g. Topic 360). Otherwise, an entity recognizes an asset only if the costs:

— relate directly to an existing contract or specific anticipated contract;

— generate or enhance resources of the entity that will be used to satisfy performance obligations in the future; and

— are expected to be recovered.

The current US GAAP guidance on the costs incurred to *rent* real estate projects other than initial direct costs is unchanged by ASU 2014-09. The costs associated with model units and their furnishings, rental facilities, semi-permanent signs, grand openings and unused rental brochures are capitalized if they relate to, and their recovery is reasonably expected from, future rental operations and rental overhead is expensed as incurred. Topic 310 defines initial direct costs and Subtopic 840-20 prescribes their accounting. [970-340-25-16 – 25-17]

As previously discussed, the FASB recently issued ASU 2016-02[20], which creates a new Topic 842. Topic 842 will supersede Topic 840 in 2019 for calendar year-end public business entities. (For more information on Topic 842's effective date, see Question A30).

Topic 842 also amends Topic 310 to require that initial direct costs associated with leasing activities be accounted for under Topic 842. That standard defines initial direct costs as incremental costs of a lease that the lessor would not have incurred if it had not obtained the lease (e.g. commissions, payments made to an existing tenant to incentivize that tenant to terminate its lease).

The guidance excludes from the definition of initial direct costs those costs that the lessor would have incurred regardless of whether it obtained the lease. These exclusions include the costs to negotiate or arrange a lease, such as fixed employee salaries, general overhead, advertising, tax and legal advice, and evaluating a prospective lessee's financial condition. [842-10-30-9 – 30-10]

Only those costs that are considered initial direct costs are eligible for deferral and, if deferred, recognized over the lease term. Many of the costs incurred to rent real estate projects that are currently capitalized under Subtopic 970-340 (and some costs that currently are considered initial direct costs under Topic 310), will be expensed as incurred when Topic 842 becomes effective. [842-30-25-1(c), 25-8, 25-10]

[20] For more information on ASU 2016-02, see Leases: Issues in Depth.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Index of questions and answers

		Page
A.	**Scope**	
A10.	How do you determine whether real estate sales, including sales of financial assets that are in-substance real estate, fall within the scope of Topic 606 or Subtopic 610-20?	3
A20.	When is a noncustomer real estate sale considered a sale of an in-substance nonfinancial asset that is accounted for under Subtopic 610-20, versus a sale of a business that is accounted for under Subtopic 810-10?	6
A30.	How is Topic 606 applied when an entity sells property improvements (or integral equipment) and leases the underlying land to a customer? Does the answer differ if the transaction is with a noncustomer?	11
A40.	How does a seller apply Topic 606 when it guarantees the return of a customer's investment (or a return on that investment) for a limited or extended period in connection with the sale of real estate? Is the answer different if the transaction is with a noncustomer?	13
A50.	How is Topic 606 applied when a seller is required to initiate or support the operations of a property that is sold to a customer? Is the answer different if the transaction is with a noncustomer?	15
A60.	What is the unit of account under Topic 606 for sales of condominium units within a condominium project (or similar structure)?	17
B.	**Step 1: Identify the contract**	
B10.	What consideration should an entity give to the buyer's initial and continuing investments when evaluating if a seller of real estate has a contract with a buyer?	18
C.	**Step 2: Identify the performance obligations**	
C10.	Is the sale of an undivided interest in the common areas where the seller/developer may build future amenities considered a separate performance obligation from the sale of a condominium unit or residential lot when the undivided interest is transferred to the customer in the sales transaction? Does the answer change if the seller/developer does not transfer the undivided interest but it will transfer future amenities to a third party?	22
C20.	Does the sale of land and the agreement to construct property improvements comprise multiple performance obligations? Is the analysis different if the buyer is not a customer?	24
C30.	How should any entity analyze the number of performance obligations in a typical property management services contract?	28

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

		Page
D.	**Step 3: Determine the transaction price**	
D10.	How does a seller's right to participate in a property's future profits affect the determination of the transaction price for the sale of that property?	29
D20.	Is a change in estimate relative to the measure of progress toward satisfaction of the performance obligation on a construction contract subject to the revenue recognition constraint?	31
D30.	What discount rate does an entity use when determining the time value of money to include in the transaction price for a property management service contract that is prepaid as part of an all-cash operating property sale?	31
D40.	In an exchange of real estate, does the transferor of the real estate apply the guidance for nonmonetary transactions or the guidance on noncash consideration?	35
E.	**Step 4: Allocate the transaction price**	
E10.	How does the seller allocate the transaction price in a contract that transfers control of a property and also requires the seller to provide ongoing property management services to a customer? What if the buyer is not a customer?	38
F.	**Step 5: Recognize revenue**	
F10.	At what point does control typically transfer in a real estate sale when the performance obligation is only the property that is transferred?	44
F20.	When does control typically transfer in a real estate construction contract (e.g. for the development of property improvements such as a building) when the contract represents a single performance obligation for the construction services?	46
F30.	When does control typically transfer in a contract with a customer that includes a property sale and an accompanying construction contract (e.g. for the development of property improvements for the customer, such as a building on the land)?	48
F40.	Can the seller/developer of a condominium unit (or similar structure) recognize revenue over time as construction of the unit progresses if title to the completed unit does not transfer until construction is completed?	49
F50.	When does control transfer in a standstill arrangement in which the owner of a real estate entity that is an in-substance nonfinancial asset defaults on nonrecourse debt and loses its controlling financial interest in the entity, but the lender chooses to maintain the legal relationship until the owner can find a buyer?	52

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

		Page
F.	**Step 5: Recognize revenue**	
F60.	Has control transferred under Topic 606 if, in connection with the sale of real estate, the seller provides the buyer with an option to put the property back to the seller?	54
F70.	Has control transferred under Topic 606 if, in connection with the sale of real estate, the seller obtains the right (or has an obligation) to repurchase the property?	56
F80.	Is a right of first refusal (or a right of first offer) considered an obligation or right to repurchase the property?	58
F90.	How should a seller evaluate transfer of control in the context of a partial sale; for example, on the sale of less than 100 percent of the seller's ownership interest in an entity considered an in-substance nonfinancial asset?	58
F100.	Does the guidance on partial sales discussed in Question 5.9 apply when the venture owns operating real estate that meets the definition of a business?	64
F110.	Is a buy-sell clause allowing either investor to make an offer to acquire the other's interest in an entity that holds real estate considered an obligation or a right to repurchase the property from the perspective of the investor that sold the real estate to the entity?	66
F120.	What is the accounting consequence when a general partner in a limited partnership sells a property to the partnership for cash (contributed by the limited partners) and a significant receivable?	67
F130.	How should a manager recognize revenue associated with variable consideration in a property management services contract when the contract bases the variable consideration on a percentage of the property's operating results?	68
G.	**Other implementation matters**	
G10.	For transition purposes, how would an entity apply the definition of a completed contract when a reduced profit method under legacy US GAAP is being used?	69
G20.	How will Topic 606 interact with the new leasing standard when the lease is an operating lease and the lessee reimburses the lessor for certain costs?	72
G30.	Does new Topic 340 change whether an entity can capitalize costs incurred to sell real estate projects?	73

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Keeping you informed

Where can you learn about the latest financial reporting changes?

The Financial Reporting Network (FRN) provides a single source for the latest, executive-level financial reporting information, as well as news and activity from standard setters and industry sources – all organized by topic.

It has been designed to help keep executives in front of critical issues in today's evolving financial reporting environment. We not only keep a close watch on the latest financial reporting developments, we report on them and interpret what they might mean for you.

From technical publications like *Defining Issues and Issues In-Depth* to timely live Webcasts and the CPE credits they provide, our FRN website should be the first place to look for up-to-the-minute financial reporting changes.

Click to subscribe to Defining Issues and other publications.

Subscribe

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

Acknowledgments

This edition of Questions and Answers has been produced by the Department of Professional Practice of KPMG LLP in the United States.

We would like to acknowledge the efforts of the main contributors to this publication:

Brian K. Allen

Kimber Bascom

Brandon Kano

Paul H. Munter

Angie Storm

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

kpmg.com/socialmedia

The *FASB Accounting Standards Codification®* material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856.

© 2016 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 596962

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.