

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2016-11
May 2016

Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815)

Rescission of SEC Guidance Because of Accounting
Standards Updates 2014-09 and 2014-16 Pursuant to
Staff Announcements at the March 3, 2016 EITF Meeting

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Please ask for our Product Code No. ASU2016-11.

FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published monthly with the exception of January and October by the Financial Accounting Foundation, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is \$255 per year. POSTMASTER: Send address changes to Financial Accounting Standards Board, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 435**

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Amendments to the *FASB Accounting Standards Codification*[®]

Securities and Exchange Commission (SEC) Content

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–13. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Added text is underlined, and deleted text is ~~struck out~~.

Amendments Pursuant to the March 3, 2016 SEC Staff Announcements

This Accounting Standards Update rescinds SEC paragraphs pursuant to two SEC Staff Announcements at the March 3, 2016 Emerging Issues Task Force (EITF) meeting.

2. SEC Staff Announcement, “Rescission of Certain SEC Staff Observer Comments upon Adoption of Topic 606, Revenue from Contracts with Customers,” was announced at the March 3, 2016 EITF meeting. In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The SEC Staff is rescinding the following SEC Staff Observer comments that are codified in Topic 605, Revenue Recognition, and Topic 932, Extractive Activities—Oil and Gas, effective upon adoption of Topic 606. Specifically, registrants should not rely on the following SEC Staff Observer comments upon adoption of Topic 606:

- a. Revenue and Expense Recognition for Freight Services in Process, which is codified in paragraph 605-20-S99-2
- b. Accounting for Shipping and Handling Fees and Costs, which is codified in paragraph 605-45-S99-1
- c. Accounting for Consideration Given by a Vendor to a Customer (including Reseller of the Vendor’s Products), which is codified in paragraph 605-50-S99-1
- d. Accounting for Gas-Balancing Arrangements (that is, use of the “entitlements method”), which is codified in paragraph 932-10-S99-5.

Amendments to Subtopic 605-20

3. Supersede paragraphs 605-20-S25-1 and 605-20-S99-2 and their related headings, with a link to transition paragraph 606-10-65-1, as follows:

Revenue Recognition—Services

Recognition

> ~~Revenue and Expense Recognition for Freight Services in Process~~

~~605-20-S25-1 Paragraph superseded by Accounting Standards Update No. 2016-11. See paragraph 605-20-S99-2, SEC Observer Comment: Revenue and Expense Recognition for Freight and Services in Process, for SEC Staff views on recognition of revenue and expenses by freight service entities.~~

SEC Materials

> SEC Staff Guidance

>> ~~Comments Made by SEC Observer at EITF Meetings~~

>>> ~~SEC Observer Comment: Revenue and Expense Recognition for Freight Services in Process~~

~~605-20-S99-2 Paragraph superseded by Accounting Standards Update No. 2016-11. The following is the text of SEC Observer Comment: Revenue and Expense Recognition for Freight Services in Process.~~

~~Paragraph 605-20-25-13 states that recognition of revenue when freight is received from the shipper or when freight leaves the carrier's terminal with expenses recognized as incurred is not an acceptable method of recognizing revenue and expense for freight carriers. However, a registrant should not change, as a result of that guidance, to recognition of revenue when freight is received from the shipper or when freight leaves the carrier's terminal with accrual of the estimated direct costs to complete delivery of freight in transit as this method would not be appropriate because revenue is recognized in advance of performance and liabilities are recognized before they are incurred.~~

Amendments to Subtopic 605-45

4. Supersede paragraphs 605-45-S45-1 and 605-45-S99-1 and their related headings, with a link to transition paragraph 606-10-65-1, as follows:

Revenue Recognition—Principal Agent Considerations

Other Presentation Matters

~~> Presentation of Shipping and Handling Fees and Costs~~

~~605-45-S45-1 Paragraph superseded by Accounting Standards Update No. 2016-11. See paragraph 605-45-S99-1, SEC Observer Comment: Accounting for Shipping and Handling Fees and Costs, for SEC Staff views on presentation of shipping and handling costs.~~

SEC Materials

~~> SEC Staff Guidance~~

~~>> Comments Made by SEC Observer at Emerging Issues Task Force (EITF) Meetings~~

~~>>> SEC Observer Comment: Accounting for Shipping and Handling Fees and Costs~~

~~605-45-S99-1 Paragraph superseded by Accounting Standards Update No. 2016-11. The following is the text of SEC Observer Comment: Accounting for Shipping and Handling Fees and Costs.~~

~~Paragraphs 605-45-45-20 and 605-45-50-2 require that shipping and handling fees billed to a customer should be classified as revenue (only for those entities that record revenue based on the gross amount billed to the customer) and states that the classification of shipping and handling costs incurred by the seller is an accounting policy decision. The SEC staff expects SEC registrants to evaluate the significance of shipping and handling costs for the purpose of applying this guidance based on the significance of those costs to each line item on the income statement that includes them and on their significance in total to gross margin.~~

Amendments to Subtopic 605-50

5. Supersede paragraphs 605-50-S45-1 and 605-50-S99-1 and their related headings, with a link to transition paragraph 606-10-65-1, as follows:

Revenue Recognition—Customer Payments and Incentives

Other Presentation Matters

~~> Accounting by a Customer (Including Reseller) for Certain Consideration Received from a Vendor~~

~~605-50-S45-1 Paragraph superseded by Accounting Standards Update No. 2016-11. See paragraph 605-50-S99-1, SEC Observer Comment: Accounting for~~

~~Consideration Given by a Vendor to a Customer (Including Reseller of the Vendor's Products), for SEC Staff views on presentation issues related to the expense associated with a "free" product or service delivered at the time of sale of another product or service.~~

SEC Materials

> SEC Staff Guidance

>> Comments Made by SEC Observer at Emerging Issues Task Force (EITF) Meetings

>>> SEC Observer Comment: Accounting for Consideration Given by a Vendor to a Customer (Including Reseller of the Vendor's Products)

~~605-50-S99-1 Paragraph superseded by Accounting Standards Update No. 2016-11. The following is the text of SEC Observer Comment: Accounting for Consideration Given by a Vendor to a Customer (Including Reseller of the Vendor's Products).~~

~~As it relates to consideration given by a vendor to a customer the SEC staff believes that the expense associated with a "free" product or service delivered at the time of sale of another product or service should be classified as cost of sales.~~

Amendments to Subtopic 932-10

6. Supersede paragraphs 932-10-S25-1, 932-10-S50-2, and 932-10-S99-5 and their related headings, with a link to transition paragraph 606-10-65-1, as follows:

Extractive Activities—Oil and Gas—Overall

Recognition

> Gas-Balancing Arrangements

~~932-10-S25-1 Paragraph superseded by Accounting Standards Update No. 2016-11. See paragraph 932-10-S99-5, SEC Observer Comment: Accounting for Gas-Balancing Arrangements, for SEC Staff views on the methods of accounting for gas-balancing arrangements.~~

Disclosure

> Gas-Balancing Arrangements

~~932-10-S50-2 Paragraph superseded by Accounting Standards Update No. 2016-11. See paragraph 932-10-S99-5, SEC Observer Comment: Accounting for Gas-Balancing Arrangements, for SEC Staff views on disclosures pertaining to gas-balancing arrangements.~~

SEC Materials

> SEC Staff Guidance

>> ~~Comments Made by SEC Observer at Emerging Issues Task Force (EITF) Meetings~~

>>> ~~SEC Observer Comment: Accounting for Gas-Balancing Arrangements~~

932-10-S99-5 Paragraph superseded by Accounting Standards Update No. 2016-11. The following is the text of SEC Observer Comment: Accounting for Gas-Balancing Arrangements.

~~The SEC staff has not taken a position on whether the entitlements method (each unit of gas is assumed to be jointly owned by the well partners. Sales revenue is recognized only to the extent of each partner's proportionate share of gas sold regardless of which partner sold the gas) or sales method (sales revenue is recognized for all gas sold by a partner to its customer notwithstanding the fact that the partner's ownership is less than 100% of the gas sold) is preferable with respect to accounting for gas-balancing arrangements, as defined in paragraphs 932-815-55-1 through 55-2, that do not meet the definition of a derivative in accordance with those paragraphs. A receivable or liability recorded using the entitlements method should be valued at the lower of (1) the price in effect at the time of production, (2) the current market value, or (3) if a contract is in hand, the contract price. Receivables should be net of selling expenses. If the sales method is used by the overtaker and reserves are insufficient to offset the imbalance, the overtaker should record a liability for the amount of shortfall in reserves valued at current market price unless a different price is specified in the contract in which case the contract price may be used.~~

~~Registrants should account for all significant gas imbalances consistently, using one accounting method. SEC registrants should disclose their method of accounting, as well as the amount of any imbalance in terms of units and value, if significant.~~

7. SEC Staff Announcement, "Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or Equity," was announced at the March 3, 2016 EITF meeting. On November 3, 2014, the FASB issued Accounting Standards Update No. 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity* (amendments to Subtopic 815-15), which requires entities that issue hybrid instruments in the form of a share to determine the nature of the host contract by considering all the stated and implied substantive terms and features of the hybrid financial instrument. As a result of the amendments in Update 2014-16, the SEC staff is rescinding its SEC Staff Announcement, "Determining the Nature of a Host

Contract Related to a Hybrid Instrument Issued in the Form of a Share under Topic 815,” which is codified in paragraph 815-10-S99-3. Paragraph 815-10-S99-3 is rescinded to coincide with the effective date of Update 2014-16.

Amendments to Subtopic 815-10

8. Supersede paragraphs 815-10-S55-1 and 815-10-S99-3 and their related headings, with a link to transition paragraph 815-15-65-2, as follows:

Derivatives and Hedging—Overall

Implementation Guidance and Illustrations

> ~~Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share~~

~~815-10-S55-1 Paragraph superseded by Accounting Standards Update No. 2016-11. See paragraph 815-10-S99-3, SEC Staff Announcement: Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share Under Topic 815, for SEC Staff views on the determination of whether the characteristics of a host contract related to a hybrid financial instrument issued in the form of a share are more akin to a debt instrument or more akin to an equity instrument.~~

SEC Materials

> SEC Staff Guidance

>>> ~~SEC Staff Announcement: Determining the Nature of a Host Contract Related to a Hybrid Instrument Issued in the Form of a Share Under Topic 815~~

~~815-10-S99-3 Paragraph superseded by Accounting Standards Update No. 2016-11. The following is the text of SEC Staff Announcement: Determining the Nature of a Host Contract Related to a Hybrid Instrument Issued in the Form of a Share under Topic 815.~~

~~The SEC Observer made the following announcement of the SEC staff's position relating to the determination of whether the characteristics of a host contract related to a hybrid financial instrument issued in the form of a share are more akin to a debt instrument or more akin to an equity instrument.~~

~~Consistent with Section 815-15-25, the SEC staff believes that the determination of the nature of the host contract for a hybrid financial instrument issued in the form of a share (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument) should be based on a consideration of economic characteristics and risks. The SEC staff also believes that in performing an evaluation of an embedded derivative feature under paragraph 815-15-25-1(a), the consideration of the~~

~~economic characteristics and risks of the host contract should be based on all of the stated or implied substantive terms and features of the hybrid financial instrument. FN 1 In evaluating the stated and implied substantive terms and features, the existence or omission of any single term or feature is not necessarily determinative of the economic characteristics and risks of the host contract (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument). Although the consideration of an individual term or feature may be weighted more heavily in the evaluation, judgment is required based upon an evaluation of all the relevant terms and features. For example, the SEC staff believes that the fact that a preferred stock contract without a mandatory redemption feature would be classified as temporary equity under paragraph 480-10-S99-3A is not in and of itself determinative of the nature of the host contract (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument). Rather, the SEC staff believes that the nature of the host contract depends upon the economic characteristics and risks of the preferred stock contract. FN 2~~

~~FN 1 The “hybrid financial instrument” includes the terms and features pertaining to other embedded derivatives that are separately evaluated under paragraph 815-15-25-1. However, the SEC staff understands that as an accounting policy some registrants exclude the terms and features pertaining to the individual embedded derivative being evaluated under paragraph 815-15-25-1 in determining the nature of the host contract for that particular embedded derivative.~~

~~FN 2 The SEC staff does not believe the guidance pertaining to the paragraph 815-10-15-74(a) scope exception in paragraph 815-10-15-76 is applicable, by analogy, to the determination of the nature of the host contract under paragraph 815-15-25-1(a).~~

~~This staff announcement is limited to the SEC staff’s position regarding the determination of whether a host contract related to a hybrid financial instrument issued in the form of a share is considered to be a debt instrument or an equity instrument for purposes of the evaluation of an embedded derivative (or multiple embedded derivatives) under paragraph 815-15-25-1(a). It is not intended to address when an embedded derivative (or multiple embedded derivatives) should be separated from the host contract under Topic 815 or the accounting under Topic 815 when such separation is required. Topic 815 provides the relevant guidance for these matters. For example, paragraphs 815-15-25-24 through 25-25 provide guidance on how an entity determines the characteristics of a debt host contract once a conclusion has been reached that the host contract is a debt instrument.~~

Amendments to Status Sections

9. Amend paragraph 605-20-S00-1, by adding the following items to the table, as follows:

605-20-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
605-20-S25-1	Superseded	2016-11	05/02/2016
605-20-S99-2	Superseded	2016-11	05/02/2016

10. Add paragraph 605-45-S00-1 as follows:

605-45-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
605-45-S45-1	Superseded	2016-11	05/02/2016
605-45-S99-1	Superseded	2016-11	05/02/2016

11. Add paragraph 605-50-S00-1 as follows:

605-50-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
605-50-S45-1	Superseded	2016-11	05/02/2016
605-50-S99-1	Superseded	2016-11	05/02/2016

12. Amend paragraph 815-10-S00-1, by adding the following items to the table, as follows:

815-10-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-10-S55-1	Superseded	2016-11	05/02/2016
815-10-S99-3	Superseded	2016-11	05/02/2016

13. Amend paragraph 932-10-S00-1, by adding the following items to the table, as follows:

932-10-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
932-10-S25-1	Superseded	2016-11	05/02/2016
932-10-S50-2	Superseded	2016-11	05/02/2016
932-10-S99-5	Superseded	2016-11	05/02/2016

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*[®] in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2017 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.