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Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

Ms. Susan M. Cosper
Technical Director
File Reference No. 2016-250
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

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Proposed Accounting Standards Update, *Other Income — Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets (File Reference No. 2016-250)*

Dear Ms. Cosper:

We appreciate the opportunity to comment on the proposed Accounting Standards Update (ASU), *Other Income — Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets* (the Proposal), issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's objective of clarifying the guidance on how to account for derecognition of nonfinancial assets and in substance nonfinancial assets. We believe the proposed ASU would reduce the cost and complexity of accounting for derecognition of nonfinancial assets by aligning it further with the accounting for the derecognition of a business. The Proposal also would reduce the number of derecognition models applied in practice. However, the Proposal would result in the remeasurement of any retained noncontrolling interest to fair value, which may lead to a higher risk of future impairment and may raise further questions regarding the technical merits of recording gains on retained interests.

Our responses to questions raised in the Proposal are in the appendix.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst & Young LLP

Appendix — Responses to specific questions raised in the Proposed Accounting Standards Update, *Other Income — Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*

> **Question 1:** Is the list of transactions that are excluded from Subtopic 610-20 in paragraph 610-20-15-3 complete? If not, please describe what is missing.

We believe that an entity could conclude that the proposed amendments would apply to certain common control transactions. We are unclear as to whether the Board intended to require fair value measurement for common control transactions and whether they would be in the scope of this Proposal. If those transactions are in scope, we recommend that the Board clarify that any gain recognized would be eliminated in the consolidated financial statements. If the transferring entity is permitted to recognize a gain in certain common control transactions, we note that would be inconsistent with the guidance in Accounting Standards Codification (ASC) 805-50 for a receiving entity.

It is unclear to us whether the Proposal would apply to the sale of undivided interests, which are economically similar to sales of partial interests in an entity. The Board decided in February 2016 not to provide any explicit guidance on sales of an undivided interest in an asset in ASC 610-20. However, the Board did not specifically exclude such transactions from the scope of the Proposal. Prior to the adoption of ASU 2014-09, entities account for sales of undivided interests of real estate under ASC 360-20. However, ASU 2014-09 deletes this guidance. We believe that the Board should clarify whether the Proposal should apply to the sale of an undivided interest. If it doesn't, we recommend that the Board clarify which derecognition model would apply to such a transaction.

ASC 720-25 provides measurement guidance on the contribution (i.e., donation in which commensurate value is not received) of cash and other assets, including nonfinancial assets, which may conflict with the measurement guidance in the Proposal. The Board should consider whether transactions that would be within the scope of ASC 720-25 should be excluded from the scope of ASC 610-20, or how to best resolve this potential conflict.

> **Question 2:** Do you agree that transfers of all businesses (including real estate businesses) or nonprofit activities should be excluded from the scope of Subtopic 610-20? If not, please describe the types of businesses that should be included in Subtopic 610-20 and how you would define them

We agree that the derecognition of all businesses (including real estate businesses) or nonprofit activities should be excluded from the scope of ASC 610-20. Our understanding is that ASC 810 would apply to the **entire** transaction, even when multiple subsidiaries are involved and only one subsidiary holds a business while the others hold assets. We believe that explicit guidance should be provided, especially if the final guidance in ASC 610-20 requires an entity-by-entity approach to evaluate the existence of in substance nonfinancial assets. See our response to question 5 for our views on the entity-by-entity approach.

Question 3: Given that the amendments in this proposed Update would require all businesses to be excluded from Subtopic 610-20, do you have any further comments on the appropriateness or operability of the amendments in the proposed Accounting Standards Update, Business Combinations (Topic 805): Clarifying the Definition of a Business?

We do not have comments other than those provided in our 21 January 2016, comment letter on the appropriateness or operability of the amendments in the proposed ASU, *Business Combinations (Topic 805): Clarifying the Definition of a Business*.

Question 4: The scope of Subtopic 610-20 includes in substance nonfinancial assets, which are defined in the Master Glossary and described in paragraphs 610-20-15-4 through 15-10 in this proposed Update. Is it appropriate to include those transactions within the scope of Subtopic 610-20, and would the guidance be operable? If not, why and what other alternatives would you suggest?

Please see our response to Question 5.

Question 5: Paragraph 610-20-15-3(k) in this proposed Update excludes subsidiaries that do not have in substance nonfinancial assets entirely from the scope of Subtopic 610-20. Alternatively, the Board could have decided to apply the guidance in paragraph 606-10-15-4 and separate each asset in a subsidiary that is not a business into different derecognition models. Would this alternative approach be operable for partial sales in which the seller retains an interest in the former subsidiary (see also paragraph BC34)? If yes, please provide examples of how this would be applied. If operable, do you support such an approach?

We generally agree with the definition of in substance nonfinancial asset in the Proposal and the "substantially all" threshold. However, we are concerned about the entity-by-entity approach described in the Proposal. We believe that it should focus on the assets promised in the contract rather than the assets held by each entity. Therefore, we suggest deleting bullet (b) from the definition of in substance nonfinancial assets and modifying bullet (a) to state that the assets promised in the contract could be held by an entity or entities.

We believe that if all of the analysis is performed at the entity level, economically similar transactions would be accounted for differently based on the assets held by each subsidiary. As a result, the accounting could be driven by the transaction's form rather than its substance. We have concerns that entities could shift assets between entities just to achieve a preferable accounting treatment (as illustrated in Cases B and C in paragraphs 610-20-55-10 through 55-15 of the Proposal). Instead, we believe that the reporting entity should first identify the individual entities (if any) in which it has a controlling financial interest under ASC 810 after the transfer of the nonfinancial assets. Then, we believe that an entity should collectively evaluate whether the assets promised in the contract that are not in controlled entities are in substance nonfinancial assets and in the scope of the Proposal. If the collective assets are not in substance nonfinancial assets, we believe an entity should account for each asset promised in the contract in accordance with the applicable derecognition guidance (e.g., ASC 610-20 for nonfinancial assets, ASC 860 for financial assets). We believe that this approach would both alleviate the risk of abuse and make the guidance easier for entities to understand and apply.

We believe that for the transactions that we see most frequently in practice, a transfer of a group of assets that includes both nonfinancial assets and financial assets would be a business or an in substance nonfinancial asset. While applying different derecognition models to assets held within one subsidiary under our alternative approach may introduce complexity, we believe that accepting the complexity in those situations would be more appropriate than creating a model in which the form rather than the substance of the transaction drives the accounting conclusion.

Also, we observed that the Proposal repeatedly refers to the transfer of assets and ownership interests. We believe that the guidance should refer not only to a transfer but also to transactions or other changes in facts and circumstances that could result in the derecognition of an asset. For example, an entity could lose control of an asset due to the expiration of an existing management contract, a dilution event or a government action.

Question 6: When transferring an ownership interest in a subsidiary that is an in substance nonfinancial asset, do you agree that the unit of account should be each distinct nonfinancial asset in the subsidiary?

Yes, we agree that when a reporting entity transfers an ownership interest in a subsidiary that holds in substance nonfinancial assets, and it is determined that the reporting entity does not have a controlling financial interest in the subsidiary under ASC 810, the unit of account should be each distinct nonfinancial asset or in substance nonfinancial asset.

Question 7: Do you agree that an entity should measure a retained interest in a nonfinancial asset at fair value? If not, why?

We believe the Proposal better aligns the accounting for the derecognition of nonfinancial assets to accounting for the derecognition of businesses in ASC 810 and transactions with customers in ASC 606 and reduces the number of derecognition models applied in practice and in that context are supportive of this change. This would reduce the complexity of current GAAP and minimize the distinction as to whether a transaction is with a customer or involves assets that meet the definition of a business. However, we believe that the Proposal will put added pressure on the technical merits of recording gains on retained interests in all transactions.

However, accounting differences will remain even after the final guidance is issued (e.g., measurement of noncash consideration, variable/contingent consideration). We encourage the Board to address those differences as part of Phase 3 of this project. Further, we recommend that the Board highlight to stakeholders in the Background Information and Basis for Conclusions that the fair value of any retained noncontrolling interest would likely be higher than its proportionate carrying amount, increasing the likelihood of future impairments.

Paragraph 67 of the Basis for Conclusions states that "the Board generally believes that it would be inappropriate to remeasure a retained interest if the asset continued to be consolidated or was proportionately consolidated because the nature of the asset would be the same before and after the transaction." While we don't object to this view, we do not believe it is clear that proportionately consolidated equity method investments would be excluded from the scope of the Proposal and would not have to be remeasured. We believe that the Board's views should be included in the body of the standard. In addition, the Board should consider whether transfers of proportionately consolidated equity method investments should be within the scope of ASC 860.

Also, as discussed in our response to Question 1, it is not clear whether a retained interest in a nonfinancial asset would be in the scope of the Proposal because it would be an undivided interest.

Question 8: Paragraphs 610-20-40-3 through 40-10 provide guidance that would assist an entity in determining when it transfers control of distinct nonfinancial assets in a subsidiary. Would this guidance be operable? If not, why?

We believe that the principles in this guidance would be operable. However, these paragraphs assume that the entity that holds the nonfinancial assets being transferred was previously created or owned by the seller (e.g., the Proposal uses "subsidiary," "former," "retains," "no longer"). We recommend clarifying that these paragraphs also would apply to transactions in which the entity that holds the nonfinancial asset is not a subsidiary (e.g., a newly formed entity by the buyer). That is, we believe control of the entity should be evaluated under ASC 810 regardless of which party (buyer or seller) formed or previously owned the entity.

We also observe that these paragraphs use the phrase "ownership interest," which is a defined term in the master glossary that refers to real estate and that was superseded by ASU 2014-09. We recommend replacing it with "controlling financial interest" or "noncontrolling interest," as appropriate. We believe the terminology is important because the controlling financial interest may arise from a variable interest (e.g., a license) that is not an equity ownership interest.

We are concerned that the examples in paragraphs 610-20-55-6 through 55-21 do not adequately emphasize that the seller would have to first evaluate whether the derecognition guidance under ASC 810 (e.g., paragraph 610-20-55-17) has been met with respect to **all** of the other entities involved (including any newly formed entities by other party, and the buyer itself). We recommend stating that the entity has determined that it does not consolidate any of the other entities under ASC 810 in all of the examples.

Question 9: Do you agree with providing an entity with the option to apply different transition methods to Subtopic 610-20 and Topic 606? If not, why?

Please see our response to Question 10.

Question 10: The proposed amendments on clarifying the definition of a business would require prospective adoption. If those proposed amendments are finalized before Subtopic 610-20 becomes effective, should an entity utilize either:

a. The definition of a business effective at the time of the transaction

b. The revised definition of a business when implementing Subtopic 610-20

We believe that prospective adoption should be required for transactions other than with customers (including the original consequential amendments from ASU 2014-09). This would eliminate the cost and complexity of retrospectively adjusting the accounting for transactions that typically are infrequent, and entities would avoid having to use hindsight to determine fair value.

However, if the Board does not require prospective adoption, we agree with giving an entity the option to apply different transition methods for transactions with customers and those that are not with customers. We also believe that the Board should allow entities to prospectively adopt the new definition of a business as it relates to assessing acquisitions or business combinations, and retrospectively adopt it for purposes of applying these amendments when assessing loss of control and derecognition.

We do not believe the current definition of a business should be used when accounting for a transaction under the Proposal because we believe the decisions made by the Board in this project contemplated the application of this guidance using the proposed definition of a business, which has not been issued yet. Therefore, we believe the Proposal should be effective no earlier than the effective date of the proposed ASU, *Business Combinations (Topic 805): Clarifying the Definition of a Business*.

Question 11: Do you agree with the proposed amendments to eliminate the exception in Topic 860 for transfers of equity method investees that were formerly considered in substance nonfinancial assets or in substance real estate? If not, please describe the consequences of applying the guidance in Topic 860 instead of Subtopic 610-20.

We agree with the proposed amendments to eliminate the exception in ASC 860 for transfers of equity method investees that are in substance nonfinancial assets or in substance real estate. We believe that a consistent approach should be used for all transfers of equity method investments.

However, we believe that an entity must apply both ASC 860 and ASC 323 when selling or transferring an equity method investment. ASC 860 provides a framework for determining whether a sale or transfer has occurred and when to recognize a gain. ASC 323 provides guidance on the measurement of the gain and any retained investment. We believe this interaction is not well understood in practice today and should be clarified (e.g., in the third diamond of the flowchart, paragraph 323-10-35-35, paragraph 320-10-30-4).

Furthermore, ASC 860 has numerous scope exceptions. For example, it excludes investments by owners or distributions to owners of a business entity (including equity method investments). We understand that the references in ASC 845 to ASC 860 (e.g., in the table in paragraph 845-10-55-2) require an entity first to evaluate whether the investment is in the scope of ASC 860. We recommend clarifying this in the Proposal. Also, we recommend clarifying what guidance would apply (e.g., ASC 610-20, ASC 845) when ASC 860 is not applicable.

The FASB proposed edits to paragraph 970-323-40-1, but we recommend deleting that paragraph entirely because the concepts are covered elsewhere in the Codification, and we believe that GAAP is more complex and costly to apply when industry-specific guidance is retained but is no longer necessary.

Question 12: Overall, do you agree that the proposed amendments would reduce the cost and complexity of evaluating the derecognition of nonfinancial assets? Why or why not?

Yes, we agree that the proposed amendments would reduce the cost and complexity of evaluating the derecognition of nonfinancial assets in a transaction with a non-customer, including the partial sales of assets to non-customers. However, we have seen transactions in which a group of assets was transferred to a customer and a partial interest was retained in those assets (e.g., in the alternative energy sector). For these transactions, it is unclear whether the partial sales guidance in ASC 610-20 applies. If ASC 610-20 does not apply, it is not clear how an entity would account for such a transaction, because ASC 606 is silent on partial sales to customers. Additionally, it is unclear whether a transaction involving a partial sale and leaseback would be in the scope of the Proposal or in the scope of ASC 606, particularly since ASC 610-20 scopes out sale leaseback transactions.

In addition, we believe that the guidance in paragraphs 970-323-30-3 and 970-323-35-14 through 35-15 should be deleted because it does not illustrate all of the relevant concepts in ASC 610-20 (for example, the evaluation of whether the transaction is within the scope of ASC 606) and could be interpreted incorrectly. We believe that including guidance that is not identical could result in unintended consequences. We also believe that retaining industry-specific guidance that is no longer warranted creates complexity.

We recommend deleting the words "a minor amount of" in reference to accounts receivable in paragraph 610-20-55-6, and paragraph 24 in the Basis for Conclusions. We are concerned that users may perceive a conflict between that description and the "substantially all" threshold in paragraph 610-20-55-7, which we believe is sufficient. For similar reasons, we recommend deleting the references to "equal" fair value in paragraphs 610-20-55-13 through 55-14 and instead reference the "substantially all" threshold.

The proposed guidance does not include any presentation requirements, such as whether to include any gains or losses within income from operations (if such a subtotal is presented). Given the recent discussion in the FASB's April 2016 agenda prioritization meeting on the presentation of gains or losses upon deconsolidation of a business and the existing guidance in ASC 360, the Board should evaluate whether it should provide any presentation guidance to prevent diversity in practice.

ASC 845-10-15-4(b) would not apply to transactions between a "corporate joint venture and its owners." Paragraph 845-10-15-4(e) would not apply to "a transfer of assets to an entity in exchange for an equity interest in that entity." We believe that such transactions in practice are often likely to fall within the scope of ASC 610-20, and therefore would be covered by paragraph 845-10-15-4(k).

However, if ASC 610-20 does not apply to such transactions, we are unclear as to the guidance that would apply. To reduce complexity, we recommend deleting these scope exceptions so that the general principles in ASC 845 would apply in the rare circumstances in which ASC 610-20 does not apply.