Working Draft:
Time-share Revenue Recognition Implementation Issue

Issue #16-2: Collectibility of Sales of Time-Sharing Interests

Expected Overall Level of Impact to Industry Accounting:
Significant

Wording to be Included in the Revenue Recognition Guide:

Background

1. Time-sharing transactions are characterized by a number of attributes that distinguish them from other revenue transactions in other industries and present unique revenue recognition considerations. Such characteristics have led to the need for specific accounting guidance in FASB ASC 978, Real Estate Time-sharing Transactions.

2. Time-sharing transactions are typically characterized by the following:
   a. Volume-based, homogeneous sales
   b. Seller financing
   c. Relatively high selling and marketing costs
   d. Upon default, recovery of the time-sharing interval by the seller and forfeiture of principal by the buyer

3. Most sales of time-sharing interests[1] are to retail consumers, who often choose to use seller-provided financing. Although certain financial institutions will participate in the securitization or hypothecation of portfolios of time-sharing receivables, financial institutions typically will not finance the purchase of individual time-sharing interests. Therefore, a majority of the sales price is often financed by the time-sharing interval seller through a promissory note (generally, with a term of five to ten years) signed by the buyer. The promissory note is typically a recourse note secured by the time-sharing interval. Delinquency and default rates on promissory notes vary widely among individual time-sharing entities. Selling and marketing costs are significant in relation to sales revenue, and sales incentives and inducements are common. Underwriting requirements, in determining customer's eligibility for seller financing, vary among time-sharing entities.

4. Furthermore, under typical time-share arrangements:

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[1] Also denoted time-sharing interval or time-share in certain arrangements. Under ASC 978-10-20, interval is defined as "the specific period (generally, a specific week) during the year that a time-sharing unit is specified by agreement to be available for occupancy by a particular customer." Time-sharing interest incorporates other time-sharing arrangements which include but are not limited to floating time, undivided interests and points programs.

a. It is the common business practice of most time-share entities to repossess time-share intervals once the buyer defaults. Once a time-share seller forecloses on a time-share interval, the seller typically stops pursuing the buyer for collection of the unpaid note, even if the note balance exceeds the fair value less costs to sell of the interval to the seller. This is because it is not cost-effective for time-share sellers to pursue the buyer and because they can re-sell the interval at a similar or even higher price than they sold the interval to the original buyer. Under this arrangement, buyers are not entitled to any of the re-sale proceeds in excess of the loan balance if the seller repossesses the interval and resells it.
b. Repossessed intervals are essentially "good as new." Time-share entities refer to the repossessed interval as "good as new" because the interval can be resold at substantially the same price as an interval that never was sold and is often in the same or similar condition as it was originally sold in.

5. A time-sharing entity typically assesses collectability of the transaction price based on pools of receivables, because it holds large numbers of homogenous notes receivable. Prior to the adoption of FASB ASC 606, time-sharing entities typically estimate default activity based on historical activity for similar time-share notes receivable using a technique referred to as a static pool analysis ("static pool"), which tracks defaults for each year's sales over the entire life of those notes.

6. FASB ASC 978 specifically addressed the accounting for uncollectibility and the accounting for relieving inventory and recognizing cost of sales in time-sharing transactions. Under the accounting guidance in FASB ASC 978-330, a time-sharing entity accounts for costs of sales and the reduction of inventory using the relative sales value method and time-sharing revenue used in the relative sales value method is calculated as total revenue adjusted for uncollectibles (whether that estimate is included in revenue or as bad debt expense as amended after the adoption of FASB ASC 606). Under FASB ASC 978-330-35-2, the recording of an adjustment for expected uncollectibles is accompanied by a corresponding adjustment to cost of sales and inventory that is effected through the application of the cost-of-sales percentage in the relative sales value calculation. However, under the time-share relative sales value method in FASB ASC 978-330, there is no accounting effect on inventory if a time-sharing interval is repossessed upon default as inventory includes an estimate for those intervals the entity expects to take back and re-sell upon default. The accounting for time-share inventory and cost of sales under FASB ASC 978-330 will remain after the adoption of FASB ASC 606.

7. Although time-sharing entities sell intervals through various legal structures and standard legal agreements and contracts may vary across entities, the majority of time-sharing entities utilize standardized written sales and financing contracts in executing such transactions.

Determining Whether Collection of the Transaction Price is Probable at Contract Inception

8. FASB ASC 606-10-25-1 states that certain criteria must be met in order to account for a contract as a contract with a customer under FASB ASC 606. While an entity should evaluate whether each of the criteria have been met, FinREC believes that a signed, written contract that is customary for the time-sharing industry will generally result in a straightforward assessment of the requirements outlined in ASC 606-25-1(a) – (d). Also included in the criteria is the requirement in FASB ASC 606-10-25-1(e) that it must be "probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer".

9. Basis for Conclusion BC 43 of ASU 2014-09 states:

   The Boards decided that a collectibility threshold is an extension of the other guidance in paragraph 606-10-25-1 on identifying the contract. In essence, the other criteria in paragraph 606-10-25-1 require an entity to assess whether the contract is valid and represents a genuine transaction. The collectibility threshold is related to that assessment because a key part of assessing whether a transaction is valid is determining the extent to which the customer has the ability and the intention to pay the promised consideration. In addition, entities generally only enter into contracts in which it is probable that the entity will collect the amount to which it will be entitled.

10. BC 265 of ASU 2014-09 further notes that:

   However, the Boards were also concerned that for some transactions in which there is significant credit risk at contract inception, an entity might recognize revenue for the transfer of goods or services and, at the same time, recognize a significant bad-debt expense. The Boards decided that in those cases, "grossing up" revenue and recognizing a significant impairment loss would not faithfully represent the transaction and would not provide useful information. Consequently, the Boards included the criterion in paragraph 606-10-25-1(e).

11. Significant judgment will be necessary by time-sharing entities to apply the collectibility criterion included in FASB ASC 606-10-25-1(e). This represents a change for entities that previously applied the prescriptive rules-based guidance in FASB ASC 360-20. The criteria in FASB ASC 360-20 for evaluating the sufficiency of the buyer's initial and continuing investment, as well as the nature of any continuing involvement by the seller, are not included in FASB ASC 606.

12. As described in FASB ASC 606-10-25-1(e), an entity should assess whether it is probable that it will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. If the transaction price includes an estimate of variable consideration (for example a right of return or price concession), the transaction price may be less than the stated price in the contract. Therefore, entities should first determine if there is any variable consideration included in transaction price before evaluating the collectibility of that transaction price. Refer to paragraphs 16 through 46 identified below for further considerations with respect to determining the transaction price and variable consideration.

13. When seller financing is provided, entities will need to consider a variety of factors when evaluating collectibility of substantially all of the consideration to which it will be entitled or the estimated transaction price. Those factors may include analysis of commercially available lending terms for similar transactions, down payment sufficiency, borrower creditworthiness and historical experience of the seller in similar transactions with similar customers. As described in FASB ASC 606-10-55-3c, an entity should not consider whether it can repossess an asset it transferred to a customer in this assessment.

14. It is the practice of most entities in the time-share industry to evaluate buyer credit worthiness and require minimum down payments to support the customer's ability and intent to pay for the purchased time-sharing interval and to mitigate credit risk. Most time-sharing entities also have significant sales and loan performance history that is used to estimate collectibility based on historical activity for similar time-share notes receivable because they typically hold large numbers of homogeneous time-share notes receivable. Entities should use this history, as well as consideration of business practices and knowledge of customers with similar characteristics, as a basis for determining whether it is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that the entity expects to transfer to the customer.

15. Time-sharing entities should use their evaluations of buyer credit worthiness and historical collections experience to assess whether collection of substantially all of the consideration is probable and a valid contract exists, if all other criteria in FASB ASC 606-10-25-1 are met. The assessment of the collectibility of a portfolio of contracts with similar characteristics as the individual contract may then be used to support that collection is probable for an individual contract. For example, if an entity has history to support that collection of substantially all of the transaction price is probable once a customer with certain credit quality has provided a 10% down payment, that history (including collection history with a specific buyer from previous transactions with such buyer) may support that there is not significant credit risk at contract inception for similar contracts. Alternatively, if an entity initiated sales with zero down payments and had no history to support that such contracts did not present a significant credit risk at inception, the entity may be unable to support that a valid contract with a customer exists, in the context of FASB ASC 606. If a valid contract with a customer does not exist, consideration received would not be accounted for as revenue until collection is probable, under the requirements of FASB ASC 606-10-25-1, or one of the requirements of FASB ASC 606-10-25-7 is met.

Identification of and Accounting for Variable Consideration, Including an Implicit Right of Return

16. Before determining whether a contract with a customer exists in FASB ASC 606-10-25-1, ASC 606 requires an entity to first estimate the transaction price so the appropriate values can be assessed for collectibility. If an entity determined that it is not probable that it will collect substantially all of the consideration to which it will be entitled, which is the estimated transaction price from the customer, it cannot account for the arrangement as a revenue contract with a customer. In such circumstances, an entity should account for the consideration received from the customer in accordance with FASB ASC 606-10-25-7 and 25-8.

17. As described in FASB ASC 606-10-32-2, an entity should consider the terms of the contract and its customary business practices to determine the transaction price. When determining the transaction price, entities should consider the effects of "variable consideration" (among other factors, including constraining estimates of variable consideration as outlined in FASB ASC 606-10-32 -11 through 32-13). As indicated in FASB ASC 606-10-32-6, variable consideration is defined broadly and may occur in many forms. Included as forms of variable consideration under FASB ASC 606 are products sold with a right of return, price concessions, which may be present if an entity believes it will be entitled to receive an amount of consideration that is less than the price stated in the contract, and other similar items.

18. To determine if it is probable that the time-sharing entity will collect substantially all of the consideration to which it will be entitled as required under FASB ASC 606-10-25-1(e), a time-sharing entity will need to determine the transaction price as described in FASB ASC 606-10-32-2. FASB ASC 606-10-32-7 indicates that variable consideration may be explicitly stated in a contract. However, an entity should also look to its customary business practices or other facts and circumstances that could indicate that the contract includes variable consideration in the form of either (or both) an implicit right of return (i.e. the ability to, in effect, return the time-share interval in exchange for the time-share entity ceasing to pursue the customer for the remaining financial obligation) or an anticipated price concession (either implicit or explicit). Judgment is required in determining whether an expectation of receiving less than the stated consideration in the contract is the result of that consideration including a variable component or whether the entity has chosen to accept the risk of default by the customer (credit risk). Variable consideration identified, whether implicit or explicit, should be evaluated in determining the estimated transaction price, resulting in revenue (transaction price) which will be less than the contractually-stated price in the contract with the customer.

19. BC194 of ASU 2014-09 states:

> The Boards observed that in some cases it may be difficult to determine whether the entity has implicitly offered a price concession or whether the entity has chosen to accept the risk of default by the customer of the contractually agreed-upon consideration (that is, customer credit risk). The Boards noted that an entity should use judgment and consider all relevant facts and circumstances in making that determination. The Boards observed that this judgment was being applied under previous revenue recognition guidance. Consequently, the Boards decided not to develop detailed guidance for differentiating between a price concession and impairment losses.

20. In accordance with FASB ASC 606-10-55-23, to account for the transfer of products with a right of return, an entity should recognize revenue for the transferred product in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognized for the products expected to be returned).

21. At the onset of the contract and at the end of each reporting period, time-sharing entities should consider all relevant facts and circumstances when analyzing the nature of collectibility issues to determine whether an implicit sales return exists in the arrangement which would be considered variable consideration. Further, an entity should assess whether the estimate of variable consideration is considered constrained, in accordance with FASB ASC 606-10-32-14.

22. In its assessment of time-sharing arrangements, FinREC believes that the amount of consideration that is not probable of collection from financed time-sharing transactions due to defaulted amounts are akin to an implicit right of return which should be accounted for as variable consideration in determining the transaction price. Such conclusions are based on the following:
    a. Industry participants typically view time-share defaults as having an element of a right of return (though buyers typically do not have an explicit "right of return" beyond the rescission period), because, typically, it is not cost-effective for a time-sharing entity to pursue buyers for collection after a certain point. Once a time-sharing entity forecloses on an interval, the entity typically stops pursuing the buyer for collection of the unpaid note, even if the note balance exceeds the fair value less cost to sell of the interval to the seller. Another similarity with a right of return is that the repossessed interval is essentially as "good as new" and can be resold at substantially the same price as an interval that never was sold. In contrast to the uncollectible that results from most trade receivables, the sold item (that is, the time-sharing interval) is repossessed in the time-sharing arrangement. As a result, the foreclosure and release of the associated loan from the buyer is akin to a sales return that reduces revenue. Accordingly, FinREC believes that time-share arrangements should be accounted for as a sale of a product with a right of return. However, given that no portion of the cash purchase price is returned to the customer in a time-share transaction, there is no refund liability; just an allowance against the loan receivable.

    b. Furthermore, if defaulted amounts related to repossessed units are recorded as bad debt expense, the seller records revenue for more than 100 percent of the available interests, because foreclosed interests are resold. In fact, the worse the collection experience, the greater the number of interests that are repossessed and resold, leading to higher reported revenue.

    c. A time-sharing entity accounts for costs of sales and the reduction of inventory using the relative sales value method under FASB ASC 978-330. Under FASB ASC 978-330, time-sharing revenue used in the relative sales value method is calculated as total revenue adjusted for uncollectibles (whether that estimate is included in revenue or as bad debt expense as amended after the adoption of FASB ASC 606). Under the time-share relative sales value method in FASB ASC 978-330, there is no accounting effect on inventory if a time-sharing interval is repossessed upon default as inventory includes an estimate for those intervals the entity expects to take back upon default (accounted for as a return). The accounting guidance in FASB ASC 978-330 does not change upon the adoption of FASB ASC 606. FinREC believes that time-share entities should account for estimates of defaults as returns that would reduce the transaction price (reduction of revenue). Such treatment would better align the revenue and cost model for time-sharing transactions.

d. Industry participants have concluded that defaults are typically more the result of buyer's remorse (and thus more representative of a sales return granted in exchange for return of the property) than the inability to pay (credit risk).

23. TRG Agenda Ref. 35: *Accounting for Restocking Fees and Related Costs*, addresses how an entity should account for restocking fees related to goods that are expected to be returned and for which the entity retains a fee for restocking such goods. Paragraph 54 of TRG Agenda Ref. No. 44: *July 2015 Meeting – Summary of Issues Discussed and Next Steps*, states:

> TRG members generally agreed that restocking fees for goods expected to be returned by the customer should be included as part of the transaction price when control of the product transfers to the customer. That is, the accounting for estimated product returns should, in determining the transaction price for the contract, consider the portion of the transaction price that will not be refunded to the customer as a restocking fee. The TRG paper explained that the staff view is significantly influenced by the staff's view that restocking fees are not substantively different from the entity granting a partial refund on returned products. TRG members also agreed with the staff view that an entity's expected costs of restocking should be recognized as a reduction of the carrying amount of the asset expected to be recovered at the point in time control of the product transfers to the customer.

24. Generally, contracts in the time-share industry do not provide the time-share holder an explicit right of return; however, an implicit return right may exist because the timeshare entity will always repossess the property for resale in the event of a customer default with a penalty to the customer (i.e., the amount of principal paid up to the time of default). In effect, the customer can elect to "return" the property by choosing to no longer make the required payments because, at that point, the timeshare entity's only substantive recourse is to repossess the time-share interval and retain the customer payments made up to that point. The partial refund right illustrated in TRG Memo No. 35 for restocking fees further supports time-share financed sales and defaults accounted for as variable consideration because upon customer default, the time-share seller will repossess the time-share interval and the remaining portion of the loan receivable not yet paid is derecognized, but some money (i.e. cash paid by the buyer to date) is retained by the seller even though the buyer no longer retains the asset. FinREC believes that payments made by the customer before the customer defaults should be included in transaction price in the same manner as restocking fees for goods to be returned are considered a partial refund right and included in the transaction price. However, given that no portion of the cash purchase price is returned to the customer in a time-share transaction, there is no refund liability. FinREC believes that customer payments retained by the entity (which the time-share entity expects to be entitled to) and defaulted amounts from implicit return rights should be accounted for under the variable consideration guidance-. Additionally, the repossessed time-share interval may be sold to a new customer for substantially the same value as the original sale (thus, the asset typically has not depreciated in value at the time of repossession).

25. As described above, estimates of defaulted amounts in a financed time-sharing transaction represent implicit sales returns which should be accounted for as variable consideration. When a time-sharing entity determines consideration is variable, the entity would only include in the transaction price an estimate of the variable consideration to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved in accordance with FASB ASC 606-10-32-11 and 32-12.

26. As described in FASB ASC 606-10-55-3C, the ability to repossess an asset should not be considered in determining whether an entity has the ability to mitigate its exposure to credit risk. However, FinREC believes the ability of an entity to repossess the previously sold interval could be considered in determining whether the entity has given an implicit right of return.

27. FinREC believes it is not appropriate to consider time-share defaults as analogous to an arrangement in which the entity would not receive anything in the event of a customer default but allow the customer to retain the goods or services (i.e. bad debt expense). In a time-share entity fact pattern, upon customer default, the timeshare entity will repossess the timeshare interval, which can be sold to a different customer (typically at the same or higher sale price as the original sale). Therefore, the repossession activities are more akin to a sales return and thus, revenue should be recorded net of a sales return allowance. Typical time-share arrangements have a specific fact pattern that other industries would not be able to analogize to. For example, while other industries might repossess

an asset upon failure to pay the receivable (i.e. automobiles), those assets would typically not be re-sold or placed back into inventory without a change in value and/or depreciation. Foreclosures of other real estate transactions (i.e. condominiums or homes) also have different fact patterns as the re-sales are dependent on market conditions and buyers would typically be entitled to proceeds in excess of the loan balance. As noted above, under typical time-share fact patterns, the repossessed unit is re-sold at substantially the same price as if it had never been sold and the buyer is not entitled to any of the proceeds in excess of the loan balance once the time-share interval is re-sold. Finally, in other industries, the lender and the seller may be different parties while in most time-sharing transactions, the time-share seller is also the lender (the same party that sells the unit also forecloses and re-sells it). These characteristics further substantiate the time-share industry view that time-share defaults should be treated as implicit right of returns.

Application of the Portfolio Approach as a Practical Expedient

28. FASB ASC 606 specifies the accounting for an individual contract with a customer, but ASC 606-10-10-4 allows an entity, as a practical expedient, to apply the guidance to a portfolio of contracts with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying the guidance to the individual contracts within that portfolio.

29. In accordance with FASB ASC 606-10-32-9, time-sharing entities should consider all information (historical, current and forecast) that is reasonably available to the entity to estimate variable consideration when determining the transaction price whether the guidance in ASC 606 is applied on a portfolio basis or contract by contract basis.

30. At the July 2015 FASB IASB TRG meeting, the TRG discussed if an entity is applying the portfolio practical expedient when it considers evidence from other, similar contracts to develop an estimate using the expected value method. As noted in paragraph 25 of TRG Agenda Ref 44: *July 2015 Meeting – Summary of Issues Discussed and Next Steps*:

    In some circumstances, an entity will develop estimates using a portfolio of data to account for a specific contract with a customer. For example, to account for a specific contract with a customer, an entity might consider historical experience with similar contracts to make estimates and judgments about variable consideration and the constraint on variable consideration for that specific contract. On question 1, TRG members agreed with the staff's view that the use of a portfolio of data is not the same as applying the portfolio practical expedient.

31. Thus, in accordance with the discussion at the July 2015 TRG meeting on the portfolio practical expedient, an entity is not required to apply the portfolio practical expedient when considering evidence from other, similar contracts to develop an estimate of variable consideration. An entity could choose to apply the portfolio practical expedient, but it is not required to do so. At each reporting period, in accordance with FASB ASC 606-10-32-14, a time-share entity should compare the characteristics of the contracts included in the historical experience to the characteristics of the portfolio or individual contract that the historical evidence is being applied to. The entity's considerations of the applicable historical experience to apply to a contract (or portfolio) may be similar to its determination of which portfolios it may use as discussed above.

32. BC 70 of ASU 2014-09 states:

    The Boards observed that because it is a practical way to apply Topic 606, the portfolio approach may be particularly useful in some industries in which an entity has a large number of similar contracts and applying the model separately for each contract may be impractical.

33. Time-sharing transactions are characterized by the industry as volume-based, homogeneous sales. A majority of the sales price is often financed by the time-sharing seller through a mortgage note (generally, with a term of five to ten years) signed by the buyer. The mortgage note is typically a recourse note secured by the time-sharing interval. Most time-sharing entities have significant sales and loan performance history to estimate the amount that is collectible based on historical activity for similar time-share sales or notes receivable. Time-sharing entities typically use a static pool, which tracks defaults for each year's sales over the entire life of the related mortgage notes. Entities typically pool contracts through the use of a static pool (or multiple static pools) based on similar risk characteristics to establish default rates in estimating uncollectible amounts at contract inception. Delinquency and default rates in the industry are strongly correlated with the underlying risk characteristics of the buyers, including the percentage down payment made, overall term of the financing arrangement and creditworthiness of the buyer.

34. Prior to the adoption of FASB ASC 606, the industry practice of pooling a portfolio of contracts with similar characteristics supports the industry's view that it reasonably expects that the effects on the financial statements

of applying this guidance to the portfolio to estimate variable consideration would not differ materially from applying the guidance to the individual contracts within the portfolio. In accordance with FASB ASC 606-10-4, when accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

35. Time-sharing entities may use the portfolio practical expedient in estimating variable consideration. FinREC believes that the static pool method may be used to estimate expected defaults on a portfolio of time-share contracts to estimate the consideration to which the time-sharing entity will be entitled. This approach is consistent with the expected value method in estimating variable consideration as described in FASB ASC 606-10-32-8. This approach is also consistent with Example 22- Right of Return in FASB ASC 606-10-55-202 through 55-207, whereby the entity applies historical experience to a portfolio of contracts to estimate products that will be returned and therefore does not recognize revenue for those products.

Reassessment of Variable Consideration in Subsequent Reporting Periods

36. As described in FASB ASC 606-10-32-14, during each subsequent reporting period an entity should update its estimate of variable consideration (including updating its assessment of whether an estimate of variable consideration is constrained). An entity may apply the same static pool method in updating such estimate. FinREC believes that subsequent changes to the estimate for defaults (variable consideration for an implicit right of return) should generally be accounted for as increases or decreases in the transaction price (as adjustments to time-share revenue) in accordance with FASB ASC 606-10-32-42 through 32-45. Because the assessment of variable consideration from financed transactions inherently considers the amount the entity expects to collect from the customer (or pool of customers), FinREC believes the changes in the entity's expectation of the amount it will receive from the customer (or pool of customers) will be recorded in revenue unless there is a customer-specific event that is known to the entity that suggests that the customer (or pool of customers) no longer has the ability and intent to pay the amount due and therefore the changes in its estimate of variable consideration better represents an impairment (bad debt).

37. Example: Estimating Variable Consideration in Time-Share Contracts. The following example is meant to be illustrative, and the actual accounting under FASB ASC 606 should be based on the facts and circumstances of an entity's specific situation.

    A time-sharing entity enters into contracts for the sale of time-sharing intervals with 100 customers. Each contract includes the sale of an interval for $10,000. The entity also agrees to provide financing to such customers through a recourse promissory note, collecting 10% of the contract price as a non-refundable deposit and financing the remaining sales price. The time-share entity performs credit scoring and only sells to customers with a certain credit score, and has business practices and history (through use of a static pool) to support that collection is probable for this customer class. The customer does not have an explicit right to return the product beyond the rescission period described in the contract; however, it is the time-sharing entity's customary business practice to repossess such intervals from its customers upon the event of default given it can resell such intervals at a price that is equal to or greater than the original sales price. Total inventory cost of the 100 units is $250,000 (25% cost-of-product percentage as calculated using the relative sales value). Further, the entity has concluded that all other requirements for recognizing revenue, as described in FASB ASC 606-10-25-1, have been met and control of the time-sharing interval has been transferred to the customer.

    The entity applies the guidance in FASB ASC 606 to the portfolio of 100 financed contracts because it reasonably expects that, in accordance with paragraph 606-10-10-4, the effects on the financial statements from applying this guidance to the portfolio would not differ materially from applying the guidance to the individual contracts within the portfolio.

    Because the time-share entity's customary business practices result in the entity repossessing time-share products upon default and re-selling the product "good as new", the entity would account for the arrangement as if it were the sale of a product with a partial right of return and the consideration received from the financing customer includes a variable amount. To estimate the consideration to which the entity will be entitled, the entity decides to use the expected value method because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled consistent with FASB ASC 606-10-32-8a. Using the expected value method from its static pool, the entity estimates that 90 percent of its financed sales will not default and 10 percent of the financed sold intervals will not be collected due to defaults and the product will be returned. The entity calculates variable consideration as $810,000 (100 contracts x $9,000 financed amount x 90%) to be included in transaction price plus $100,000 of non-refundable deposit for a total of $910,000 time-share revenue.

    The entity also considers the guidance in FASB ASC 606-10-32-11 through 32-13 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration ($810,000) can be included in the transaction price. The time-sharing entity concludes that, based on its significant experience in estimating defaults/returns for this customer class and it's underwriting financing practices, its process for applying the expected value method (utilizing a portfolio approach) in estimating variable consideration would already incorporate the principles in evaluating constraining estimates of variable consideration. Thus, the entity concludes that it is probable that it will collect 90 percent of the financed sales and that a significant reversal in the cumulative amount of revenue recognized will not occur.

The entity estimates that the costs of recovering the intervals will be immaterial and expects that the returned intervals can be resold at a profit and therefore no liability has been established for such costs.

Given the entity has concluded that all other requirements to recognize revenue have been met, upon transfer of control of the time-share intervals, the entity does not recognize revenue for the estimated defaulted amounts from repossessed units. Consequently, in accordance with FASB ASC 606-10-32-10 and 606-10-55-23, the entity recognizes the following:

Cash	$100,000		(100 x $1,000 non-refundable deposit)
Notes Receivable[2], net	$810,000		(100 x $9,000 - 900,000 x 10%)
Revenue		$910,000	(900,000 x 90% plus $100,000)

Cost of sales	$225,000	
Inventory		$225,000

The entity applies its cost-of-sales percentage calculated using the relative sales value method to time-sharing revenue in accordance with FASB ASC 978. FASB ASC 978-330-35-2 requires:

> The recording of an adjustment for expected uncollectibles is accompanied by a corresponding adjustment to cost of sales and inventory that is effected through the application of the cost-of-sales percentage. However, under the relative sales value method, there is no accounting effect on inventory if a time-sharing interval is repossessed or otherwise reacquired unless the repossession causes a change in expected uncollectibles.

Because the value of the returned inventory is already estimated for and included in inventory under the time-share cost guidance in FASB ASC 978-330 and the cost guidance does not change under FASB ASC 606, there is no accounting for the value of the returned asset in a time-sharing transaction. There is also no refund liability to account for in a time-sharing transaction.

Assume the same facts in this example except that for 10 of its customers, the time-share entity institutes a new program where it sells to customers with low FICO scores and does not require any down payment (finances the full $10,000 purchase price). For these customers, the time-share entity concludes that it does not have the history with this class of customer to meet the requirement in FASB ASC 606-10-25-1(e). For these contracts (or portfolio of customers), the time-share entity would not record revenue until collection of consideration received is probable, under the requirements of ASC 606-10-25-1, or one of the requirements of ASC 606-10-25-7 is met. The remaining 90 contracts are accounted for in accordance with the paragraphs above.

Comments should be received by June 1, 2017, and sent by electronic mail to Kim Kushmerick at kim.kushmerick@aicpa-cima.com, or you can send them by mail to Kim Kushmerick, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.

[2] Readers should be aware that upon adoption FASB ASC 2016-13: Financial Instruments – Credit Losses, Measurement of Credit Losses on Financial Instruments, the guidance should be applied to the note receivable.