MEMO

Memo No.	**Issue Summary No. 1, Supplement No. 3***
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Meeting Date	**EITF June 13, 2019**

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Project	**Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805**
Project Stage	**Research**
Dates previously discussed by EITF	**June 7, 2018; September 27, 2018 (considered as part of EITF Issue No. 18-A, "Recognition under Topic 805 for an Assumed Liability in a Revenue Contract")**
Previously distributed memo numbers	**Issue Summary No. 1, dated May 24, 2018; Issue Summary No. 1, Supplement No. 1, dated September 13, 2018**

Background and Memo Purpose

1. On March 28, 2018, the Board added Issue No. 18-A, "Recognition under Topic 805 for an Assumed Liability in a Revenue Contract," to the EITF agenda. The Board also directed the EITF to provide educational information on measurement topics that may arise from the application of Topic 606, Revenue from Contracts with Customers, to a business combination.

2. At the June 7, 2018 EITF meeting, the Task Force reached a consensus-for-exposure on Issue 18-A on recognition that would require that an entity use the Topic 606 performance obligation definition in determining whether an assumed contract liability from a revenue contract represents a liability that is recognized in a business combination at the acquisition date. As a part of the consensus-for-exposure, the Task Force decided that the timing of payment of consideration (or payment terms) should not affect the amount of revenue recognized by the acquirer related to the acquired revenue contract. The Task Force also reached a consensus-for-exposure that it would be inappropriate for an acquirer to default to a carryover basis when measuring an assumed liability and that an acquirer would consider the

* **The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

assets acquired and liabilities assumed in the acquired set when determining the fair value of an assumed contract liability. Before the expected issuance of a proposed Update, Task Force members identified potential unintended consequences of their decisions on payment terms and the acquired set measurement concept and decided to redeliberate Issue 18-A at a future EITF meeting.

3. At the September 27, 2018 EITF meeting, the Task force affirmed its consensus-for-exposure that an acquirer should recognize a liability assumed in a business combination from a contract with a customer if that liability represents an unsatisfied performance obligation under Topic 606 for which the acquiree has received consideration (or the amount is due) from the customer (that is, a contract liability). The Task Force discussed different alternatives for the recognition and measurement of an assumed liability from a revenue contract in a business combination to address the potential unintended consequences of the decisions reached on payment terms and the acquired set measurement concept at the June 2018 EITF meeting, but the Task Force determined it needed additional feedback from stakeholders. Therefore, the Task Force recommended that the Board direct the staff to issue an Invitation to Comment (ITC) to solicit input about measurement and other topics related to revenue contracts acquired in a business combination.

4. At the October 10, 2018 Board meeting, the FASB chairman authorized the staff to prepare a Discussion Paper in the form of an ITC (separate from the proposed Update for Issue 18-A) to solicit input about measurement and other topics related to the Task Force's consensus-for-exposure on recognition. On February 14, 2019, the FASB issued proposed Accounting Standards Update, *Business Combinations (Topic 805): Revenue from Contracts with Customers—Recognizing an Assumed Liability*, and Invitation to Comment, *Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805.* The comment deadline for both documents was April 30, 2019.

5. At the June 13, 2019 EITF meeting, the Task Force will have the opportunity to consider the feedback received on the ITC as it redeliberates the proposed Update and to provide its own feedback and any recommendations for the Board on the issues described in the ITC. This Issue Summary Supplement summarizes the feedback received through comment letters on the ITC.

High Level Summary of Comment Letters and Responses

Comment Letter Demographics

6. The following table provides a summary of the 17 comment letters received listed by type of respondent. Not all respondents addressed all questions; some focused only on specific targeted areas, and some provided broader responses.

Respondent Type	
Preparer/Preparer Association	6
Accounting Firm	8
Certified Public Accountant (CPA) Professional Association/State Society	3

Overview of Feedback Received

7. Almost all respondents indicated that, conceptually, payment terms should not affect the subsequent amount of revenue recognized by an acquirer for two otherwise identical performance obligations. However, many respondents identified concerns related to the costs of operationalizing that concept. Some respondents suggested that the Board consider approaches other than those illustrated in the ITC. Respondents expressed mixed views on how variable consideration should affect the subsequent amount of revenue recognized by the acquirer and how the sales- and usage-based royalty constraint and variable consideration constraint guidance should be applied in a business combination. However, respondents generally agreed that the interaction between the contingency guidance in Topic 606 and the guidance in Topic 805 should be addressed by the Board.

8. A majority of respondents who addressed what costs to fulfill a performance obligation should be included in measuring the fair value of a contract liability of an acquired revenue contract in a business combination indicated that a contributory charge should be included in circumstances in which an asset is used to satisfy the obligation. Almost all respondents who addressed whether the Board should issue guidance on measuring the fair value of assets used to fulfill a performance obligation supported including additional guidance in the Codification. Some respondents who commented on the appropriate unit of valuation of revenue contracts under Topic 805 indicated that the performance obligation unit of account under Topic 606 should be used as the unit of valuation while other respondents indicated that the individual contract or remaining activities to be performed should be the unit of valuation under Topic 805.

Chapter 1—Payment Terms and Their Effect on Subsequent Revenue Recognized

Issue Background

9. At the June 2018 EITF meeting, the Task Force considered whether the timing of the payment of consideration should affect the amount of subsequent revenue recognized by an acquirer for an acquired revenue contract. Task Force members decided that it would be inappropriate for two acquired

revenue contracts with identical performance obligations and different payment terms to result in different amounts of post-acquisition revenue for the acquirer. Prior to the expected issuance of a proposed Update, some Task Force members identified potential unintended consequences of including guidance about payment terms in the Codification. The Task Force decided that the implications of issuing guidance on payment terms should be further considered to determine whether the accounting results would be operable.

10. Most Task Force members agreed that on a conceptual basis, the subsequent amount of revenue recognized by an acquirer for contracts with identical performance obligations should be the same. However, some Task Force members indicated that guidance stating that payment terms of an acquired revenue contract should not affect the subsequent amount of revenue recognized by an acquirer could significantly change practice for some entities. For example, in order to have the same amount of revenue recognized after the business combination for a contract that requires payment over the contract term and for a contract that requires an upfront payment, an acquirer may need to recognize an identifiable asset for the contract that requires payment over the contract term for the fair value of future consideration expected to be received that is in excess of the fair value of the unsatisfied (or partially unsatisfied) performance obligation.

11. The staff developed simplified scenarios that were included in the ITC to illustrate the potential financial reporting effects of including guidance on payment terms in the Codification for arrangements with different payment terms. In those scenarios, an identifiable asset was recognized by the acquirer representing the amount of selling effort plus a reasonable profit on the selling effort that the acquiree incurred to enter into a contract with a customer before the business combination. In the scenarios, the identifiable asset is reduced as cash is collected in excess of the fair value of the performance obligation recognized on the date of business combination.

Overall Consideration of Whether Payment Terms Should Affect the Subsequent Amount of Revenue Recognized by an Acquirer

12. The ITC included the following question related to whether payment terms should affect the subsequent amount of revenue recognized by the acquirer:

    > **Question 1.1:** Should the timing of payments affect the subsequent amount of revenue recognized by the acquirer? Why or why not? Are there other accounting outcomes applied in practice for the different payment terms scenarios that are not illustrated?

13. All but one respondent to Question 1.1 conceptually agreed that the timing of payment should not affect the subsequent amount of revenue recognized by the acquirer. Several of those respondents noted that the timing of payments does not affect the revenue recognized under Topic 606, nor would it change the remaining performance obligation to be satisfied by the acquirer, which is what the amount of revenue recognized is intended to depict. One respondent (CL#13, an accounting firm) disagreed

with the principle that the timing of payment should not affect the subsequent amount of revenue recognized by the acquirer because of the nature of fair value measurements. However, that respondent indicated that it would not be opposed to an outcome in which the amount of revenue recognized by the acquirer is the same if the contracts acquired are identical.

14. Despite respondents generally agreeing with the principle that payment terms should not affect the subsequent amount of revenue recognized, a majority of respondents expressed concerns about the approach illustrated in the ITC, including concerns about operational challenges, the introduction of unnecessary costs and complexity, and whether the costs of the approach would justify the benefits. These concerns are discussed in more detail in paragraphs 15 through 28. Nine respondents provided or mentioned alternative approaches that they believe could achieve the same outcome as the approach illustrated in the ITC without the associated costs and complexity. Two accounting firms (CL#3 and CL#9) explained an approach that they believe is more consistent with the principles of Topic 805 and Topic 606, and the remaining seven respondents (which includes all types of respondents) explained or considered an approach that focused on providing an exception to the fair value measurement principle in Topic 805 for revenue contracts. These approaches are discussed in more detail in paragraphs 40 through 56. Two other respondents (CL#2, an accounting firm, and CL#12, a preparer) indicated that they would support continuing current practice for the accounting for acquired revenue contracts in a business combination.

Usefulness and Comparability of the Information

15. The ITC included the following question about how guidance on payment terms would affect the financial information provided to users:

> **Question 1.7:** Would guidance on payment terms improve the usefulness and comparability of financial information provided to users?

16. There was mixed feedback about whether guidance on payment terms would improve the usefulness and comparability of financial information provided to users. Four respondents (two accounting firms and two state societies) noted that the guidance on payment terms would improve the financial information provided to users and five respondents (which includes all types of respondents) indicated that they did not think that the guidance on payment terms would provide a meaningful improvement to the information provided to users.

17. The four respondents who believed that guidance on payment terms would improve financial information provided to users indicated that guidance on payment terms would reduce diversity in practice, which would lead to enhanced comparability and consistency of financial information across entities. One respondent (CL#8, a state society) noted that inconsistency in recording similar transactions in practice today could result in a user of the financial statements drawing different conclusions when the underlying terms of contracts are the same. A separate respondent (CL#4, a

state society) indicated that they believe the improvement to financial reporting would be modest because the approach in the ITC would require a fair value adjustment to revenue contracts acquired in an acquisition, which "results in the period immediately following the acquisition to not be representative of future results and not comparative to other financial statements where no acquisition has occurred." Additionally, that respondent noted that the period for which revenue is affected by payment terms is generally short-lived. However, the respondent indicated that guidance on payment terms would improve comparability between entities that complete acquisitions and diminish the opportunity for an acquirer to structure the acquisition.

18. Three of the five respondents (CL#12, a preparer, CL#15, a preparer, and CL #16, an accounting firm) who did not believe guidance on payment terms would improve the usefulness and comparability of financial information provided to users explained that companies often disclose a non-GAAP measure that reverses the effects of the fair value adjustments to deferred revenue (contract liability) as if the acquisition had not taken place to demonstrate comparative revenues. Those respondents reasoned that the existence of non-GAAP measures for these adjustments demonstrates that the adjustments have relatively low utility for users. One respondent (CL#12) noted that the prevalence of non-GAAP adjustments would likely increase if the approach in the ITC becomes guidance. Two of the five respondents (CL#15, a preparer and CL#6, an accounting firm) suggested that the additional benefit to users may be limited because the value of the identifiable asset (under the approach in the ITC) is likely captured as an intangible asset and amortized into income under current guidance, so the effect on the bottom line over time would be negligible. Another respondent (CL#5, a national society) also questioned the benefit to users of the approach in the ITC because "the accounting for revenue contracts assumed in a business combination is a temporary issue that should have limited impact beyond the near-term following an acquisition." One respondent (CL#15, a preparer) also questioned whether users would be able to understand what the new identifiable asset represents.

19. A number of respondents commented on the usefulness and comparability of financial information provided to users in the context of an alternative approach suggested in their comment letter. That feedback is described within the "Other Approaches Raised by Stakeholders" section of this Issue Summary Supplement.

Operational Complexity

20. The ITC included the following question about the operational complexity of recognizing an identifiable asset, which was illustrated in the ITC:

> **Question 1.3:** Would the recognition of an identifiable asset for each contract be operational? Are there alternative approaches that would make this more practical to apply?

21. Fourteen respondents provided feedback on Question 1.3 in the ITC. Ten out of 14 respondents indicated that the recognition of an identifiable asset for each contract would be either difficult or

extremely costly to operationalize. Concerns about the operationality of recognizing an identifiable asset for each contract were consistent with those raised by Task Force members (detailed in paragraphs 1.3, 1.4, and 1.29 of the ITC) about significant changes to current practice. Respondents noted that, generally, the evaluation of the identifiable asset (customer backlog) at the acquisition date is performed at a contract portfolio or entity level in current practice, and that, apart from contracts that have deferred revenue balances or long-term contracts, most individual contracts with customers are not reviewed in detail by the acquirer at the acquisition date for accounting purposes. Additionally, respondents noted that the intangible asset recognized from the portfolio or entity level review is usually subsequently amortized on a straight-line basis. All of the 10 respondents (including three preparers) described the significant incremental effort that would be required to recognize an identifiable asset for each contract.

22. Respondents explained that performing a detailed evaluation of the terms and status of all contracts, including executory contracts, would present a significant operational challenge to entities and described the potential efforts as difficult, burdensome, and impractical. Three respondents (CL#5, a national society, CL#16, an accounting firm, and CL#7, a preparer) highlighted that the acquisition process already requires a condensed timeframe to analyze and finalize the purchase price allocation after the acquisition. One accounting firm (CL #16) described that evaluating all of the acquiree's contracts would essentially be reperforming the acquiree's revenue accounting, which would likely require significant inputs from various personnel from across the entity. Two respondents (CL#2, an accounting firm and CL #7, a preparer) noted that significant data would be required to perform such an evaluation and that data may not be readily available. The preparer noted that there may be "practical, legal and regulatory barriers that limit the acquirer's access" to detailed contract information prior to the consummation of an acquisition. The accounting firm also noted that an acquiree may not have historically tracked the data necessary to complete the review at a contract level.

23. Three respondents (CL#2, an accounting firm, CL#15, a preparer, and CL#16, an accounting firm) explained that the scenarios in the ITC were highly simplified and that revenue arrangements may have more variables and may require significant estimates related to variable or non-cash consideration, long duration contracts, and amounts payable to the customer. Two respondents (CL#4, a state society, and CL#15, a preparer) also stated that there would be additional complexity in segregating the valuation of the identifiable assets from other intangible assets at the date of acquisition.

24. Three accounting firms (CL#2, CL#6, and CL#16) noted that the subsequent accounting for the identifiable asset may add further complexity to the accounting for acquired revenue contracts if an identifiable asset is recognized for each contract. Unlike today's practice where the aggregated backlog intangible asset is amortized on a straight-line basis, the recognition of an identifiable asset for each contract may necessitate the need for an acquirer to track and then recognize the reduction of the identifiable asset as the unsatisfied performance obligation is fulfilled. Those respondents noted that

the nature of the identifiable asset is unlike other assets recognized in Topic 606 (as evaluated in the ITC) and were concerned that the subsequent accounting guidance may prove to be complex and inconsistent with those revenue contracts not acquired in a business combination.

25. One preparer (CL#15) encouraged the Board to expand its outreach with preparers and auditors to further understand the operational impacts of the approach described in the ITC.

26. Four out of the 14 respondents (which includes of all types of respondents) indicated that the recognition guidance would be operational because Topic 805 currently requires acquirers to recognize a backlog intangible asset for in-place contracts, which represents the same value that would be theoretically attributable to the identifiable asset. One respondent (CL#10, a preparer) noted that the recognition of the identifiable asset would not significantly change practice other than the classification of the identifiable asset.

27. Two respondents (CL#3, an accounting firm, and CL#8, a state society) who indicated that the approach would be operational noted that acquirers could group contracts with similar payment terms to make the approach more practical to apply. One of those respondents (CL #3) noted that if an acquiree has a large number of revenue contracts, it believed that a "portfolio approach similar to that identified in paragraph 606-10-10-4 could enhance practicability." Four respondents (three accounting firms and one state society) who believed the approach would be difficult to operationalize also commented that, in practice, customer- or contract-related intangibles are measured at aggregated levels, such as on a portfolio basis. One of those respondents (CL #4, a state society) indicated that it expects that an entity would group contracts with similar characteristics. However, the three accounting firms (CL#2, CL#11, and CL#16) noted that a portfolio approach may not be operational or may be challenging to apply and still meet the principle that payment terms should not affect the subsequent amount of revenue recognized because payment terms and the fulfillment of performance obligations after the acquisition (which would affect the subsequent measurement of the identifiable asset) would vary for each individual contract.

Operational Concerns for Private Companies

28. Two respondents (CL#5, a national society, and CL#16, an accounting firm) indicated that adding guidance on payment terms could create additional implementation issues for private companies that have elected to apply the private company alternative under Accounting Standards Update No. 2014-08, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*.

Recognition of an Identifiable Asset

29. The ITC included the following questions related to the recognition of an identifiable asset:

> **Question 1.2:** If the timing of payments should not affect the subsequent amount of revenue recognized by the acquirer, would an acquirer need to recognize an identifiable asset separate from other contract-related assets and liabilities, as illustrated in the scenarios? Why or why not? Are there other approaches that should be considered (for example, measuring a contract liability on the basis of Topic 606 instead of Topic 805)?
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> **Question 1.4:** Would [the] identifiable asset meet the definition of an asset?
>
> a. If so, is the identifiable asset a financial asset, a customer-related intangible asset, or a contract asset? Please explain your view.
>
> b. Should the unit of account of the asset be each contract, each customer, or a group of contracts for similar customers?

Nature and Classification

30. Of the seven respondents who commented on Question 1.2, all respondents (which includes all types of respondents) indicated that an identifiable asset separate from other contract-related assets and liabilities would need to be recognized in situations in which full payment is not received upfront prior to the acquisition for payment terms not to affect the subsequent amount of revenue recognized. However, three of those respondents (CL#3, CL#9, and CL#11, all accounting firms) identified alternative approaches to those in the ITC that the Board should consider. Of the six respondents who answered Question 1.4, five respondents (which includes all types of respondents) indicated that they believe that the identifiable asset meets the definition of an asset, and one respondent (CL#9, an accounting firm) was unsure of what the separate identifiable asset would represent and whether it would meet the definition of an asset on its own. One respondent (CL#1, an accounting firm) explained that the identifiable asset meets the definition of an asset "based on the contractual-legal criterion included in the 'identifiable' definition" and further noted the value of this asset is already recognized today under GAAP.

31. All five respondents who commented on how to classify the identifiable asset indicated that the identifiable asset should be classified as a contract asset. Three respondents (CL#9, an accounting firm, CL#11, an accounting firm, and CL#10, a preparer) explained that the identifiable asset is best classified as a contract asset because of the current derecognition model for contract assets. Those respondents noted that applying the derecognition model of a contract asset (that is, subsequently derecognizing the asset as the cash flows are received) to the identifiable asset recognized would achieve the principle that the acquirer should recognize the same amount of revenue regardless of the payment terms of the contract. Although it indicated that the identifiable asset is best classified as a contract asset, one accounting firm (CL#9) acknowledged that the identifiable asset may not meet the definition of a contract asset in the Master Glossary as of the acquisition date. That respondent indicated that it considered whether the identifiable asset should be classified as an intangible asset

but did not believe that the identifiable asset should be derecognized like an intangible asset. That accounting firm was concerned that the identifiable asset could be recognized as part of a larger intangible asset, which would be amortized over a period disconnected from the contract term.

32. Three other respondents (CL#2, an accounting firm, CL#6, an accounting firm, and CL#15, a preparer) who did not provide feedback on how to classify the identifiable asset commented that it would be necessary to include additional guidance on how the identifiable asset should be classified because it is unclear what the asset represents. One respondent (CL#2, an accounting firm) indicated that the identifiable asset did not appear to meet the definition of a contract asset, a financial asset, or an intangible asset.

33. Three respondents (CL#4, a state society, CL#8, a state society, and CL#11, an accounting firm) who answered Question 1.4(b) stated that the unit of account should be each contract but indicated that a portfolio approach could be utilized for similar contracts. One accounting firm (CL#11) noted that the "portfolio approach may be acceptable if the facts and circumstances of the contracts acquired are consistent with the portfolio guidance in Topic 606."

Interaction with Other Assets

34. The ITC included the following question about how the recognition of an identifiable asset would affect other assets recognized in a business combination:

> **Question 1.5:** Would an entity still need to consider whether to recognize an order or production backlog if guidance requires the recognition of an identifiable asset that results in the same amount of revenue recognized by the acquirer after acquisition for contracts with different payment terms? Why or why not?

35. Six respondents responded to Question 1.5 on whether an entity would still need to consider whether to recognize an order or production backlog if guidance requires the recognition of an identifiable asset as illustrated by the ITC. Four of the respondents did not believe an entity would still need to consider whether to recognize an order or production backlog. Those four respondents (which includes all types of respondents) explained that the identifiable asset captures the value associated with acquiring a committed order or contract and, therefore, recognizing backlog would be unnecessary or could result in double-counting the associated value. One accounting firm (CL#3) noted that the backlog asset generally would be subsumed into the identifiable asset; however, if the scope of the new guidance on accounting for revenue contracts in business combinations is limited to arrangements that meet the definition of a contract in Topic 606, an acquiree may have some arrangements with customers that are outside the scope of Topic 606 for which it would continue to be appropriate to recognize a backlog asset. One example provided by the accounting firm included a wholly unperformed contract for which each party has a unilateral right to terminate without compensation under paragraph 606-10-25-4. One accounting firm (CL#11) indicated that it believes that an entity would continue to recognize a backlog

asset in most acquisitions because "only a portion of orders or production would meet the fact pattern of recognizing contract liabilities and assets at the acquisition date. That is a customer order may be in hand, but fulfillment has not commenced, and no cash been received or is due. In that case, we would expect a small contract asset if the fair value of the performance obligation is reduced from the contract amount because of selling effort as discussed in the scenarios." That accounting firm viewed the identifiable asset as a carved-out portion of backlog, not the entire amount of backlog that is recognized today.

36. Two of the respondents (CL#2, an accounting firm, and CL#15, a preparer) did not directly respond to Question 1.5 but observed that the identifiable asset that would be separately recognized may not result in an equal reduction in customer-related intangible assets because its value could be included in the fair value of other assets today, such as inventory (when the obligation is to deliver goods) or another type of intangible asset (for example, a brand or technology asset).

Subsequent Measurement

37. The ITC included the following question about subsequent measurement:

> **Question 1.6:** Would additional guidance on subsequent measurement be needed for the identifiable asset?

38. Ten respondents provided feedback on Question 1.6. Seven respondents (accounting firms and state societies) indicated that additional guidance on subsequent measurement would be needed so that the principle that payment terms should not affect the subsequent amount of revenue recognized by the acquirer is achieved. Three of the seven respondents (all accounting firms) explained that guidance would be necessary because the unique nature of the identifiable asset would likely result in diversity in how entities subsequently recognize and measure it without further guidance. One of those respondents (CL#6) explained that without further guidance, Topic 805 would require that an entity subsequently account for the identifiable asset in accordance with other relevant GAAP. However, other relevant GAAP (such as Topic 606) would not explicitly address how to account for the identifiable asset acquired. Two other accounting firms (CL#1 and CL#3) indicated that guidance would be needed on how the identifiable asset should be amortized in a manner that is consistent with the fulfillment of the performance obligation. Those respondents also indicated that guidance would be needed on the classification of the related amortization. Other comment letter respondents noted that guidance would be needed to address impairment of the identifiable asset, accounting for the asset when a contract modification occurs, and differences between the amount of post-acquisition consideration ultimately received and the acquisition-date fair value of the identifiable asset.

39. Three respondents indicated that additional guidance would not be necessary if the identifiable asset is classified appropriately. However, one of those respondents (CL#11, an accounting firm) indicated that additional guidance should be added if contingent consideration is included in the fair value

measurement of the asset. Two of those respondents (CL#10, a preparer, and CL#11) noted that if the identifiable asset is classified as a contract asset, the existing guidance for contract assets in Topic 606 could be followed for subsequent recognition and measurement.

Other Approaches Raised by Stakeholders

40. Question 1.2 asked whether approaches other than the recognition of an identifiable asset should be considered by the Board to achieve the principle that the timing of payment and payment terms should not affect the amount of revenue recognized by the acquirer. Several respondents suggested or considered alternative approaches to achieve that principle and discussed the operationality of their approaches and the resulting usefulness of the financial information to users.

41. Two accounting firms (CL#3 and CL#9) suggested an approach that would focus on measuring the net fair value of the rights and the obligations in an acquired revenue contract. One respondent (CL#17, a preparer association) expressed concerns about this approach to measuring the fair value of the acquired contract in a business combination. Five respondents (which includes all types of respondents) supported an approach that would provide a scope exception to the general fair value measurement principle in Topic 805 for contract assets and contract liabilities arising from an acquired revenue contract. In addition to those five respondents, two other respondents (CL#11, an accounting firm, and CL#15, a preparer) noted that the scope exception approach should be considered or explored. Two respondents (CL#2 and CL#3, accounting firms) expressed concerns about providing an exception to the scope of the measurement principle in Topic 805.

Net Fair Value of the Revenue Contract Approach (Net Fair Value Approach)

42. This approach, suggested by two accounting firms, would measure the fair value of an acquired revenue contract at the acquisition date as the difference between:

    a) The fair value of the expected remaining net contractual payments; and

    b) The fair value of the remaining unsatisfied or partially satisfied performance obligation(s).

    Under this approach, an acquirer would recognize and present either a contract asset (when the fair value of the remaining contractual payments exceeds the fair value of the remaining performance obligations) or a contract liability (when the fair value of the remaining unsatisfied performance obligations exceeds the fair value of the remaining contractual payments) for each acquired revenue contract. Both respondents noted that using the contract as the unit of account is consistent with the unit of account for presenting contract assets and liabilities in Topic 606. One respondent (CL#3) explained that the contract asset or liability recognized under the net fair value approach reflects "what a market participant would pay to acquire a contract (when the fair value of the remaining contractual payments exceeds its fulfillment costs plus a reasonable margin) or what an entity would need to pay a market participant to assume the remaining obligation(s) (when the fair value of the remaining net contractual payments is less than its fulfillment costs plus a reasonable margin).” Therefore, the respondents noted that the principles of the approach are consistent with those of Topic 805 and Topic 820, Fair Value Measurement.

43. Both respondents noted that the contract asset or contract liability recognized under the net fair value approach would replace the identifiable asset that was recognized under the approach illustrated in the ITC. The contract asset or contract liability also would remove the need to consider whether an order or production backlog intangible asset should be recognized for the acquired contract. Additionally, one of the respondents (CL#3) noted that the acquirer would not need to recognize a favorable (unfavorable) asset (liability) because the suggested approach would subsume the value attributable to this intangible asset (liability) into the contract asset (liability) recognized for each contract. That respondent also noted that the contract asset (liability) recognized as part of the accounting for the business combination would be separate from a customer relationship intangible asset.

44. Both respondents addressed how the contract asset (liability) recognized as part of the business combination should be subsequently accounted for under the net fair value approach. One respondent (CL#3) noted that the subsequent accounting of the contract asset (liability) would need to be addressed and indicated that the asset (liability) recognized as part of the business combination should be recognized in the income statement as a reduction of (increase to) revenue of the acquirer. The other respondent (CL#9) indicated that the subsequent accounting for the contract asset (liability) recognized as part of the business combination would be consistent with the accounting for contract assets and liabilities that are accounted for under Topic 606.

45. One respondent (CL#3) noted that the subsequent accounting guidance also would need to address the differences between the amount of consideration to which the entity is ultimately entitled and the fair value of the expected net contractual payments at the acquisition date. That respondent noted that differences would arise because cash flows used in the fair value measurement would be discounted and the credit risk of those cash flows could change. Additionally, subsequent accounting guidance would be needed for differences in the assumptions used to determine the fair value of variable consideration at the acquisition date and the ultimate results of that variability. That respondent described two approaches that it believes are appropriate, which are detailed in the Contingent Payment Terms Considerations section of this Issue Summary Supplement.

46. Each of the respondents noted that the alternative approach would be consistent with principles of Topic 805 and Topic 606 and indicated that they believe the approach would be operational. One respondent (CL#9) noted that the alternative would be “simpler than identifying and separately tracking a separate asset that relates to the assumed contract,” which would be required to apply the approach illustrated in the ITC. The other respondent (CL#3) indicated that the proposed approach would not require significantly more effort than the approach used to account for business combinations today.

That respondent noted that preparers currently use the same contractual net cash flows to value an acquiree's contracts but include the value within customer-related intangible assets. The net fair value approach would reclassify those intangible assets and the favorable (unfavorable) asset (liability) into a separate identifiable contract asset (liability).

47. One respondent (CL#17, a preparer association) did not support the alternative approach in which an entity would measure the fair value of each revenue contract. That respondent acknowledged that using the contract as a single unit of account for balance sheet purposes is consistent with the approach in Topic 606 but noted that this alternative approach would result in significant changes to existing practice. The preparer association noted that it believes that the net fair value approach would not produce meaningful information for users, in addition to being cumbersome for both preparers and auditors.

Exception to the Measurement Principle in Topic 805 (Exception Approach)

48. Two respondents (CL#16, an accounting firm, and CL#17, a preparer association) highlighted the difficulty in attempting to provide a solution for the accounting for acquired revenue contracts in a business combination that complies with both Topic 805 and Topic 606. The respondents noted that there are inherent conceptual differences between the two standards, primarily that Topic 805 is based on fair value and Topic 606 is largely based upon inputs that are not fair value, such as a transaction price negotiated with a customer. Those respondents noted that attempting to resolve these differences by compromising between the two standards, such as through the approach illustrated in the ITC, would only create further complications and complexities or areas where practical approaches would need to be reached. For example, one respondent highlighted the complications that would arise when accounting for variable consideration and sales-based royalties under a mixed model that uses fair value on the acquisition date and the revenue recognition sales-based royalty constraint after the business combination. Both respondents reasoned that an approach to accounting for acquired revenue contracts that is based solely on one framework would be more appropriate. Those respondents supported applying Topic 606 because it is a comprehensive and detailed framework designed to address all aspects of revenue transactions. Therefore, providing a scope exception to Topic 805 so that acquired revenue contracts are accounted for consistent with Topic 606 would be the most appropriate approach.

49. Five respondents (which includes all types of respondents), including those mentioned in paragraph 48, recommended or preferred an approach that would add an exception to the fair value measurement principle in Topic 805 so that any assets or liabilities arising from contracts with customers (for example, contract assets and liabilities) would be accounted for in accordance with Topic 606 (both at the acquisition date and subsequent to the acquisition date) instead of the general measurement guidance in Topic 805 (that is, fair value). This would result in an acquirer recognizing contract assets and liabilities that would be the same (or similar) to the contract assets and liabilities recognized by the

acquiree. One respondent (CL#16, an accounting firm) noted that acquirers would still need to evaluate the accounting under Topic 606 instead of relying entirely on the acquiree's accounting.

50. All five respondents noted that the exception approach would be a simple, cost-efficient alternative that would achieve the principle described in the ITC that the timing of payment should not affect the subsequent amount of revenue recognized by the acquirer. Two respondents (CL#13, an accounting firm, and CL#14, a preparer) noted that stakeholders are familiar with the core principles in Topic 606, and therefore, the exception approach would be relatively simple to operationalize compared with the approach illustrated in the ITC. One preparer (CL#14) noted that the complexity of and resulting diversity from applying the fair value measurement principle in Topic 805 to contract liabilities would be eliminated under the exception approach. This respondent and two accounting firms (CL#6 and CL#16) also indicated that applying the exception approach would address the issue of what costs should be included in the fair value measurement of a contract liability considered in Chapter 2 of the ITC.

51. Two respondents (CL#6, an accounting firm and CL#17, a preparer association) noted that the exception approach also would eliminate the need for potentially complex subsequent measurement guidance for contingent payment terms (for example, changes in estimates of variable consideration or sales- or usage-based royalties) that are considered when measuring the fair value of contract assets at the acquisition date. See the Contingent Payment Terms Considerations section for further details on the potentially complex subsequent measurement guidance for contingent payment terms.

52. Most of the five respondents indicated that the exception approach would improve the usefulness and comparability of financial information provided to users. Three respondents noted that the approach would provide better overall alignment with the revenue accounting model, which enhances the understandability of financial information to users. One of those respondents (CL#16, an accounting firm) also noted that if the exception approach is adopted, consistent revenue and margins would be achieved for contracts with the same economics but different payment terms and for contracts that are executed before and after an acquisition. Another respondent (CL#6) explained that under the exception approach, revenue trends would be better preserved and users would be able to compare the results of the pre-combination period with the post-combination period. Two accounting firms (CL#6 and CL#16) added that the exception approach could reduce the prevalence of certain non-GAAP adjustments that reverse the effects of fair value adjustments on deferred revenue. Lastly, one respondent (CL#17, a preparer association) asserted that users are better informed by entities reporting post-acquisition revenue that is also indicative of future performance (that is, it has not been reduced by the value of the pre-acquisition selling effort).

53. Three respondents noted that the recommendation to provide an exception to the fair value measurement principle in Topic 805 is consistent with previous decisions made by the FASB on other topics. One respondent (CL#17) explained that "transactions and balances that tend to cross multiple accounting periods and are in scope of other accounting pronouncements that establish a

comprehensive accounting framework are often granted scope exceptions from the fair value provisions of Topic 805." Respondents provided examples of those decisions including income taxes, employee benefits, and leases.

54. Two respondents who supported the exception approach acknowledged that the acquirer likely would recognize revenue and profit for the portion of the liability attributable to the acquiree's performance before the business combination (for example, its selling effort). One respondent (CL#6, an accounting firm) noted that it would expect this revenue and profit to be minor relative to the total cost to fulfill the remaining performance obligations and only have a short-term affect. The other respondent (CL#17, a preparer association) noted that an acquirer also likely would recognize revenue and profit attributable to the acquiree's performance before the business combination under the approach illustrated in the ITC in some circumstances (for example, when the contract includes variable consideration or when extensive efforts have been performed by the acquiree to acquire a contract and the contract is not finalized by the date of the acquisition). One of those respondents also acknowledged that the exception approach could have an effect on the goodwill recorded for the acquisition.

55. Three respondents commented on the scope of the proposed exception approach and indicated that certain assets acquired and liabilities assumed (other than contract assets and liabilities arising from contracts with customers) should be included within the scope of the exception to the fair value measurement principle. One respondent (CL#17, a preparer association) noted that "any assets and liabilities arising from contracts with customers would be excluded from the general…measurement guidance in Topic 805 unless they are in the scope of other accounting literature or are not separable from other assets and liabilities recognized in the business combination." That respondent also noted that the exception should be extended to (a) contracts that do not meet the criteria in Topic 606 to be accounted for under the model in Topic 606 as of the acquisition date but are expected to meet those criteria at a later date, (b) contracts that are required to be accounted for using recognition and measurement provisions of Topic 606, such as contracts in the scope of Subtopic 610-20, and (c) contracts for which an entity elects to account for the contract under an analogy to Topic 606. That respondent also indicated that that the exception should apply to assets recognized in accordance with Topic 340-30, Other Assets and Deferred Costs—Contracts with Customers. Conversely, one respondent (CL#13, an accounting firm) noted that the final guidance should specify that the exception does not apply to the valuation of customer relationship assets arising under Subtopic 340-40. Another respondent (CL#6, an accounting firm) explained that an acquirer should continue to measure any intangible assets or labilities related to the revenue contract at fair value, including a liability associated with contract terms that are unfavorable when compared to market terms.

56. Two accounting firms (CL#2 and CL#3) expressed concerns with the exception approach because it would be inconsistent with the principles underlying Topic 805 and would not reflect the amount a market participant would pay (or receive) to acquire a contract in a stand-alone transaction. One of

those respondents (CL#2) also indicated that it believes the exception approach would introduce other challenges and potentially unintended consequences because “revenue is a key input into the cash flow models used to value most other assets.”

Contingent Payment Terms Considerations

Issue Background

57. Some Task Force members expressed concerns about the effect of including guidance on payment terms in the Codification on transactions in which payment is contingent on future events, such as arrangements with sales-based or usage-based royalties. Task Force members indicated that the interaction between the general constraint for estimates of variable consideration and the sales- and usage-based royalty exceptions in Topic 606 and the fair value measurement principle in Topic 805 would need to be considered in conjunction with the issues related to the timing of payment for revenue contracts with customers. Including guidance in the Codification that states that payment terms should not affect the subsequent amount of revenue recognized by an acquirer raises questions about how an entity would apply existing guidance in Topic 606 to contingent payment terms in a business combination and whether additional guidance would be needed. One view is that any guidance on payment terms would not apply to arrangements with variable consideration or sales-based or usage-based royalties because there is specific guidance in Topic 606 on the timing of revenue recognition for such arrangements. Another view is that any payment terms guidance would apply to contingent payments, so an entity would need to estimate the fair value of the future consideration to be received and recognize that amount as an identifiable asset on the date of the business combination. The second view may raise additional questions about how to update the estimate of the identifiable asset for actual variable consideration or sales-based royalties received and how to derecognize the asset so that payment terms do not affect the subsequent amount of revenue recognized by the acquirer of a sales-based royalty arrangement.
58. The ITC included the following questions related to contingencies:

> **Question 1.8:** Should contingencies related to the amount of consideration to be received affect the subsequent amount of revenue recognized by the acquirer? Are there other variable payment arrangements that should result in a different conclusion?
>
> **Question 1.9:** Should an acquirer continue to apply the sales and usage-based royalty constraint or variable consideration constraint guidance in Topic 606 as part of a business combination to an acquired revenue contract in which one or more performance obligations have been satisfied before the acquisition?

Question 1.10: How should an entity subsequently measure and derecognize the asset that would result if contingencies related to the amount of consideration to be received do not affect the subsequent amount of revenue recognized by the acquirer?

Feedback

59. Eleven respondents addressed the potential implications of including guidance on payment terms in the Codification on arrangements that include consideration that is contingent on future events. Several respondents indicated that additional guidance would be necessary on how to account for contracts with contingent payment arrangements in a business combination because of the complex nature of such arrangements. Those respondents noted that the need for guidance would become more pronounced if guidance on payment terms existed. Two of those respondents noted that there would be increased diversity in practice if payment terms guidance is added to the Codification without additional guidance addressing contingent consideration. One of those respondents (CL#2, an accounting firm) noted that it is unclear how the approach in the ITC would or should be applied to contracts with variable consideration because of the different objectives and guidance in Topic 805 and Topic 606.

60. Five of the 17 respondents discussed whether contingencies related to the amount of consideration to be received should affect the subsequent amount of revenue to be recognized (Question 1.8). Some respondents did not address Question 1.8 but provided a view indirectly by providing a conclusion for Question 1.9 (see paragraphs 62 through 64). Of the five respondents, one respondent (CL#1, an accounting firm) indicated that contingencies should not affect the subsequent amount of revenue recognized by the acquirer. Another respondent (CL #11, an accounting firm) indicated that contingencies other than those that are addressed by the variable consideration constraint or sales-based royalty constraint in Topic 606 should not affect subsequent revenue. However, that respondent indicated that variable consideration and sales- and usage-based royalties should still be subject to constraints under Topic 606 in a business combination. Another respondent (CL#4, a state society) also supported continuing to apply the variable consideration constraint and sales-based royalty exceptions, which would affect the subsequent amount of revenue recognized.

61. Two other respondents (CL#3, an accounting firm, and CL#9, an accounting firm) who addressed Question 1.8 described their considerations of whether contingencies should affect the subsequent amount of revenue recognized within the context of their alternative approach to the approach illustrated in the ITC on payment terms guidance (that is, the net fair value approach, as described in paragraphs 42 through 46). One of those respondents (CL#9) indicated that contingencies should affect the overall fair value of an acquired revenue contract. The other respondent (CL#3) noted that contingencies should not affect the subsequent amount of revenue recognized by the acquirer to achieve the principle that payment terms should not affect the amount of subsequent revenue

recognized by the acquirer. However, that respondent acknowledged that achieving the principle may be more challenging operationally when there is variable consideration in a contract, so additional guidance on the subject would be necessary.

62. Eight respondents (which includes all types of respondents) addressed whether an acquirer should continue to apply the sales- and usage-based royalty constraint or variable consideration constraint guidance in Topic 606 as part of a business combination to an acquired revenue contract in which one or more performance obligations have been satisfied before the acquisition (Question 1.9). Of the eight respondents, six (which includes all types of respondents) indicated that an entity should continue to apply the constraints that exist in Topic 606, and two respondents (both accounting firms) noted that entities should no longer apply the constraint guidance in Topic 606 as part of a business combination.

63. Of the six respondents who supported applying the constraints in Topic 606 as part of a business combination, five supported applying both the variable consideration constraint and the sales- and usage-based royalty constraint as part of a business combination. One respondent (CL#9, an accounting firm) supported applying the sales- and usage-based royalty constraint because determining the fair value of such contingencies would be particularly challenging. However, that respondent did not support a similar exception for variable consideration. All six respondents generally indicated that entities should not be required to estimate the fair value of contingencies typically subject to the constraint guidance in Topic 606 because it would be overly complex. One respondent (CL#10, a preparer) noted that the rationale for including the constraint guidance in Topic 606 continues to apply to those contracts in a business combination and that estimating the fair value on the date of the business combination would ultimately require significant adjustments to that estimate. Another respondent (CL#11, an accounting firm) acknowledged that continuing to apply the constraints would affect the subsequent amount of revenue recognized by an acquirer, which would contradict the principle of any payment terms guidance, but noted that continuing to apply the constraints in Topic 606 would be the best way forward. That respondent explained that it does not believe that the guidance in Topic 805 for accounting for an acquired revenue contract should require different treatment for variable consideration and royalties than Topic 606. That respondent indicated that it would support including guidance in Topic 805 to address how an acquirer should estimate the transaction price as defined and accounted for in Topic 606 as of the date of a business combination.

64. Two respondents (CL#1 and CL#3, accounting firms) indicated that the constraint guidance in Topic 606 should not continue to be applied in a business combination. Both respondents stated that it would be inappropriate for an acquirer to recognize revenue after an acquisition if that revenue was derived from the performance of the acquiree before the business combination (for example, if an acquiree fully satisfied a performance obligation before the acquisition but did not recognize revenue under the sales-based royalty constraint). One respondent (CL#3) explained that the constraints should be disregarded

for purposes of accounting for a business combination because a market participant would consider assumptions about the variable consideration and royalties that will be received by the acquirer.

Subsequent Measurement

65. Three respondents (all accounting firms) addressed the subsequent measurement and derecognition of the asset that would result if contingencies related to the amount of consideration to be received do not affect the subsequent amount of revenue recognized by the acquirer (Question 1.10). One respondent (CL#3) described two approaches that would be appropriate to address contingencies. Under one approach, the amount of revenue recognized after the business combination for each contract would be fixed at the acquisition-date fair value of the unsatisfied performance obligations and any difference between the consideration received after the acquisition date and the acquisition-date fair value of the unsatisfied performance obligations would be recorded as other operating income or expense. That respondent indicated that this approach would ensure that the acquirer recognizes the same amount of revenue after the business combination regardless of payment terms. Under a second approach, adjustments to variable consideration after the business combination could be presented as an adjustment to revenue, which the respondent indicated is the general approach used in practice today. That respondent indicated that there is merit to both approaches but that making adjustments through revenue for the variable consideration received may be more practical to apply.

66. Another respondent (CL#1) indicated that the difference between the amount expected to be received and the amount of the asset recorded in the business combination should be recorded in a line item other than revenue recognized from customers (for example, a non-customer revenue line item or in other income/expense). That respondent explained that requiring an entity to update its estimate of the fair value of the contingencies each period would be reasonable, although a simpler approach would be to require a periodic impairment test along with derecognizing the asset as payments related to the contingency are received.

67. The other respondent (CL#11) described multiple possible approaches to account for differences between the amount expected to be received and the amount of the asset recorded in the business combination and indicated that it struggled with including the adjustment in any line item but revenue. That respondent noted that because the asset is unique in nature, there does not seem to be an appropriate basis for (a) treating it like a receivable, (b) characterizing an impairment charge on it as an operating expense or a cost of sales, or (c) amortizing and impairing it similar to an intangible asset. That respondent noted that a potential solution would be to create a new line item below gross margin, which would preserve the importance of the acquirer's revenue and margin. However, that respondent acknowledged that the most practical alternative would be to allow the subsequent changes in these assets to be recognized in revenue.

Question for the Task Force
1. Do Task Force members have any additional feedback or recommendations for the Board as it considers the feedback on the issues in Chapter 1?

Chapter 2—Costs to Fulfill a Performance Obligation in Measuring the Fair Value of a Contract Liability for a Revenue Contract under Topic 805

Issue Background

68. When Issue 18-A was added to the EITF agenda, the Board acknowledged that there may be questions about how to measure a liability for revenue contracts after Topic 606 has been adopted that could require the EITF to provide educational guidance. The primary question raised by stakeholders focused on *what* costs should be included in the fair value measurement of a contract liability and not *how* an entity would determine the fair value of those costs. At the June and September 2018 EITF meetings, the Task Force discussed how to measure the fair value of a contract liability for an in-process arrangement for a license to symbolic intellectual property that was acquired in a business combination after the adoption of Topic 606. That is because Topic 606 provides specific guidance on how to recognize revenue for licenses and the agenda request that led to Issue 18-A used that fact pattern. The Task Force observed that any decision made on the measurement of the contract liability in that fact pattern could affect other arrangements that require the use of an underlying asset to fulfill a performance obligation in a revenue contract.

69. At the September 2018 EITF meeting, the Task Force recommended that the Board solicit broad feedback about the measurement of contract liabilities assumed in a business combination, the effect of the fair value measurement of contract liabilities on the fair value measurement of underlying assets used to fulfill obligations, and the appropriate unit of account for recognizing such obligations.

Overview of Chapter 2 Feedback

Question 2.1 – Costs to Fulfill a Performance Obligation

Background

70. Throughout the Task Force’s consideration of Issue 18-A, stakeholders expressed different views on what costs should be included in the fair value measurement of a performance obligation assumed in a business combination. Some stakeholders supported a view that an entity should include only the remaining costs of activities required to fulfill the performance obligation that an acquirer must perform after the date of the business combination when measuring the fair value of the contract liability. For example, under that view, the fair value of a contract liability for a license to symbolic intellectual

property would not include the cost of the use of the underlying intellectual property because those stakeholders note that the intellectual property is delivered to the customer by the acquiree before the business combination.

71. Conversely, other stakeholders supported a view in which an entity should include a contributory charge for the use of the underlying asset (for example, intellectual property) as well as the costs that an acquirer must perform after the date of the business combination in measuring the fair value of a contract liability. Those stakeholders noted that a market participant would consider the cost of the use of the underlying asset in measuring the fair value of the obligation because the use of an asset generally diminishes the value of that asset.

72. The ITC included the following question related to the costs to fulfill a performance obligation:

> **Question 2.1:** In what circumstances, if any, do you think an entity should include a contributory charge for the use of a related asset in measuring the fair value of a contract liability acquired in a business combination?

Feedback

73. Eleven of the 17 respondents provided a view on the circumstances in which contributory charges for the use of a related asset should be included in measuring the fair value of a contract liability assumed in a business combination. Of the 11 respondents, 5 respondents (which includes all types of respondents) indicated that a contributory charge should be considered whenever a related asset is utilized to fulfill a performance obligation. Three respondents (two accounting firms and one preparer association) indicated that they preferred a scope exception to the fair value measurement principle in Topic 805 for contract liabilities assumed in a business combination, which would make this question no longer applicable. However, those respondents noted that if the Board determines that fair value is the appropriate method for measuring contract liabilities assumed in a business combination, contributory charges generally should be included in the fair value measurement. Three accounting firms supported a continuation of current practice in which they observed that no contributory charge is included in measuring the fair value of a contract liability assumed in a business combination.

74. The reasoning provided by the five respondents who supported the inclusion of a contributory charge for all types of assets used to fulfill performance obligations was generally consistent with the view of stakeholders described in paragraph 2.13 in the ITC. That is, market participants would consider the cost of the use of an underlying asset in measuring the fair value of the obligation because the use of the asset generally diminishes the value of that asset. One respondent (CL#3, an accounting firm) noted that “a market participant would include all relevant contributory asset charges when determining the price that it would be willing to pay (or would demand to receive) when acquiring a revenue contract in a stand-alone transaction,” so the inclusion of a contributory charge is consistent with the fair value principles in Topic 820.

75. Three of the five respondents who supported including a contributory charge in the fair value of a contract liability whenever an underlying asset is used to fulfill an obligation commented on the considerations they made to reach such a conclusion for both tangible and intangible assets. All three respondents (CL#3, CL#9, and CL#11, all accounting firms) acknowledged that current practice widely accepts the inclusion of contributory charges for tangible assets but excludes an equivalent charge when intangible assets are used to fulfill a contract. Two of those respondents indicated that they believe that there is no conceptual basis for including a contributory charge for the use of a tangible asset and excluding such a charge for the use of an intangible asset because of the similarities between the economics of arrangements to use either type of asset. For example, one respondent (CL#3, an accounting firm) noted that if a market participant acquired a license revenue contract in a business combination, the acquirer must either acquire or rent the underlying intellectual property to fulfill the contract. Therefore, a contributory charge should be included in the fair value of the contract liability. That respondent illustrated the similarities between arrangements to use tangible assets and arrangements to use intangible assets through two examples. The first example is that an exclusive license of intellectual property is similar to a contract that requires the use of a dedicated tangible asset, and the second example is that a non-exclusive license of intellectual property is similar to a contract that requires a tangible asset that can fulfill multiple customer contracts simultaneously (for example, a fiber-optic cable). In contrast to those two respondents, the other respondent (CL#11, an accounting firm) indicated that a contributory charge should be included in the measurement of the liability, even if the charge is less than the value of a similar license, because a market participant likely would consider the potential costs to provide a new copy of the intellectual property if it becomes corrupted or for other reasons, even though the acquiree provided the customer with the intellectual property at the beginning of the license period. That respondent noted that determining the value of the contributory charge would require significant judgment.

76. In contrast, three respondents (CL#6, an accounting firm, CL#16, an accounting firm, and CL#17, a preparer association) preferred an exception to the fair value measurement principle in Topic 805 for contract liabilities assumed in a business combination. Their reasoning (as well as similar respondents who did not specifically address Chapter 2) is included in paragraphs 48 through 55 of this Issue Summary Supplement. However, those respondents noted that if the Board concludes that a measurement exception is not appropriate, the fair value of a contract liability assumed in a business combination should generally consider the cost to use a related asset. One of those respondents (CL#16, an accounting firm) noted that "because the asset and the contract liability are separate units of account…the fair value should be determined based on that premise, independent for each unit of account, and derived from a third-party market participant perspective."

77. The remaining three other respondents (CL#1, CL#2, and CL#13, all accounting firms) supported what they indicated is the current practice of including contributory charges for the use of tangible assets in fulfilling a performance obligation and not including contributory charges for the use of intangible assets,

such as symbolic intellectual property. Those three respondents noted that the cost to maintain the intangible asset would not be significant nor would incremental cash outflows, in some cases, be incurred by the acquirer to maintain the intangible asset, which should be considered when determining the fair value of the assumed contract liability. One respondent (CL#2, an accounting firm) provided an example of an entity that licenses a brand to a customer. In that case, the respondent indicated that the entity would not be required to incur future cash outflows for the license other than those related to defending the patent for the brand. Therefore, that respondent indicated that a liability for that revenue contract should not be recognized in a business combination. Another respondent (CL#1, an accounting firm) indicated that depreciation expense for a "wasting" asset should be considered in the costs to fulfill a contract liability but noted that a contributory charge would be inappropriate for the intangible asset because it is not a wasting asset. That respondent indicated that the value of many intangible assets does not decrease with use over time (for example, a software as a service platform can be licensed to several customers at the same time without affecting its underlying value). Therefore, that respondent noted that the inclusion of a contributory charge would be "misleading to users of the financial statements since there is no increase in the actual economic cost of fulfilling the contract liability." That respondent also noted that the valuation of such a contributory charge would create cost and complexity because the measurement would require the use of "additional subjective and unobservable inputs."

Question 2.2 – Effect on the Underlying Asset

Background

78. As the Task Force considered the costs to fulfill a performance obligation, Task Force members also considered whether the conclusion reached on measurement would have an effect on the fair value of the underlying asset. Stakeholders indicated two views regarding the value of the underlying asset with respect to the symbolic intellectual property example provided in the agenda request. Under the first view, the fair value of the underlying intellectual property would be lower because the acquirer determines that the realizable value of the intellectual property is reduced each time it is licensed. That is, the value of the intellectual property would be encumbered because a market participant would consider that part of the overall value of the intellectual property has already been realized. Under the second view, the value of the underlying intellectual property would be estimated on an unencumbered basis, and a market participant would consider all cash flows attributable to the asset irrespective of the fact that part of the cash flows already has been realized because of the contractual commitment.

79. The ITC included the following question related to the need to provide additional guidance on how to measure the fair value of related assets:

Question 2.2: If guidance is provided on how to measure the fair value of a contract liability assumed in a business combination, would additional guidance be needed on how to measure the fair value of related assets?

Feedback

80. Eight of the 17 respondents addressed Question 2.2 in the ITC. Seven respondents (six accounting firms and one state society) generally agreed that additional guidance would be necessary on how to measure the fair value of related assets if guidance is provided on the fair value measurement of contract liabilities assumed in a business combination. One respondent (CL#8, a state society) indicated that guidance on related assets is unnecessary.

81. The seven respondents who generally supported the inclusion of measurement guidance for the underlying asset raised various considerations for the Board's consideration with respect to the asset valuation. One of the seven respondents (CL#3, an accounting firm) indicated that regardless of the conclusion reached by the Board on whether a contributory asset charge should be included in the valuation of the contract liability, measurement guidance should be included in the Codification for the related asset. That respondent noted that if the Board concludes that contributory charges should be excluded from the valuation of the contract liability, the resulting valuation would be inconsistent with the market participant view under Topic 820. Therefore, the respondent noted that explicit guidance would need to be provided on how entities should determine the fair value of underlying assets considering the associated revenue contracts. That respondent indicated that if the Board concludes that a contributory charge should be included in the fair value of contract liabilities, measurement guidance would need to be provided to specify that the related asset should be valued on an unencumbered basis. Another respondent (CL#1, an accounting firm) noted that the measurement guidance related to assets would need to be extensive if the Board concludes that contributory charges should be included in the valuation of contract liabilities and noted that any measurement guidance related to assets used to satisfy a contract liability may have implications for the valuation of other assets in a business combination.

82. Several of the respondents who supported including additional guidance related to the underlying asset also suggested that the Board include examples illustrating how entities should determine the fair value of the underlying assets. One respondent (CL#11, an accounting firm) indicated that the guidance in Topic 820 is generally sufficient to measure the assets but guidance about inputs to the fair value measurement of the contract liability should be included in the Codification because an entity's assumptions could differ significantly from another entity's assumptions, which could subsequently affect the valuation of related assets.

83. In addition to addressing whether guidance would be necessary on how to measure the fair value of assets used to fulfill performance obligations, some respondents provided a view on how to measure those assets. One respondent (CL#17, a preparer association) supported the view that the value of

intangible assets should be estimated on an unencumbered basis, indicating that that view is more consistent with the Board's concept of control as described in Topic 606. Another respondent (CL#3, an accounting firm) indicated that they believe measuring the related asset on an unencumbered basis is more consistent with the market participant view required under Topic 820 because estimating the fair value of the underlying asset on an encumbered basis would be dependent on in-place revenue contracts and, therefore, would be an entity-specific valuation. Another respondent (CL#13, an accounting firm) indicated that the value of a contract asset should include all expenses required to maintain the contractual cash flows. One respondent (CL#2, an accounting firm) noted that buildings (and other tangible assets) are generally valued on the basis of the sale of comparable assets while intangible assets are generally valued using a discounted cash flow model. That respondent explained that the model for intangible assets only includes cash flows related to the economic interest acquired. Therefore, determining the gross value of intangibles would be a costly change in practice for preparers.

Question 2.3 – Unit of Account

Background

84. While discussing Issue 18-A, Task Force members expressed mixed views on whether the unit of account in Topic 606 should be used as the unit of valuation under Topic 805, specifically for licenses to symbolic intellectual property. Some Task Force members indicated that the unit of account in Topic 606 does not need to be consistent with Topic 805 because an entity is required to measure the fair value of the contract liability, which is the fair value of the remaining performance obligation. Therefore, the unit of account under Topic 805 would be only a portion of the original performance obligation under Topic 606 (for example, only uncompleted activities even if the activities are not considered separate performance obligations) under this view. Conversely, other Task Force members indicated that the unit of valuation under Topic 805 for revenue contracts should be consistent with the original unit of account under Topic 606. That is, the performance obligation.

85. The ITC included the following question related to the appropriate unit of valuation for revenue contracts assumed in a business combination:

> **Question 2.3:** Should the performance obligation unit of account used in Topic 606 for revenue recognition (for example, the unit of account for a license to symbolic intellectual property) be used as the unit of valuation in a business combination under Topic 805?

Feedback

86. Four respondents (which includes all types of respondents) indicated that the performance obligation unit of account used in Topic 606 for revenue recognition should be used as the unit of valuation under Topic 805. Two of those respondents (CL#8, a state society, and CL#11, an accounting firm) indicated that requiring the unit of valuation under Topic 805 to be the performance obligation unit of account in

Topic 606 would provide consistency for the basis of revenue recognition before and after a business combination. Another respondent (CL#7, a preparer) noted that retaining the performance obligation unit of account in a business combination would reduce the complexity of applying Topic 606 after a business combination and align the guidance with how operating leases are treated in a business combination (that is, the unit of valuation for an operating lease is the same as the unit of account for Topic 842).

87. Two respondents (CL#1 and CL#13, both accounting firms) indicated that the performance obligation unit of account should not be used as the unit of valuation under Topic 805. One of those respondents (CL#13) indicated that Topic 606 and Topic 805 each contain a different concept and the unit of account in Topic 606 should be considered separately from valuation methodology generally used under Topic 805. The other respondent (CL#1) noted that the unit of valuation should be the remaining activities to be performed by the acquirer. That respondent indicated that this unit of valuation, which is more granular than the original performance obligation of the acquiree, is more representative of the acquirer's obligation.

88. Two other respondents (CL#3 and CL #9, both accounting firms) indicated that the individual contract with a customer should be the appropriate unit of valuation under Topic 805, which was part of their recommended approach for the issues in Chapter 1. Both respondents noted that using the contract as the unit of account would be consistent with the unit of account for presentation of contract assets and contract liabilities under Topic 606. The unit of account recommended by those respondents is described in more detail as part of their suggested approach described in paragraphs 42 through 46.

Question for the Task Force
2. Do Task Force members have any additional feedback or recommendations for the Board as it considers the feedback on the issues in Chapter 2?