FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: December 15, 2020
Comments Due: March 15, 2021

Business Combinations (Topic 805)

Accounting for Contract Assets and Contract Liabilities from Contracts with Customers

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 805 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2020-1000, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until March 15, 2021. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2020-1000
- Sending a letter to "Technical Director, File Reference No. 2020-1000, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The FASB is issuing this proposed Update to improve the accounting for acquired revenue contracts with customers in a business combination by addressing diversity and inconsistency related to the following:

1. Recognition of an acquired contract liability
2. Payment terms and their effect on subsequent revenue recognized by the acquirer.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* which provides a single comprehensive accounting model on revenue recognition for contracts with customers. In connection with the issuance of Topic 606, stakeholders raised questions about how to apply Topic 805, Business Combinations, to a contract with a customer acquired in a business combination after the acquirer has adopted Topic 606. Stakeholders indicated that there are differing views on whether the concept of a performance obligation introduced by Topic 606 should be used to determine whether a contract liability is recognized in a business combination from a revenue contract. Before the adoption date of Topic 606, a liability for deferred revenue was generally recognized in an acquirer's financial statements if it represented a legal obligation. The amendments in this proposed Update address how to determine whether a contract liability is recognized by the acquirer in a business combination.

Stakeholders also requested additional guidance on measuring revenue contracts with customers acquired in a business combination. Furthermore, it was identified that under current practice the timing of payment (payment terms) of a revenue contract may subsequently affect the postacquisition revenue recognized by the acquirer. For example, if two revenue contracts with identical performance obligations are acquired but one contract is paid upfront before the acquisition and the other contract is paid over the contract term after the acquisition, the revenue recognized by the acquirer after the business combination likely would differ between the two acquired contracts. The amendments in this proposed Update would resolve this inconsistency by providing specific guidance on how to recognize and measure acquired revenue contracts in a business combination.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities that enter into a business combination within the scope of Subtopic 805-10 after the adoption of Topic 606.

What Are the Main Provisions?

The amendments in this proposed Update would require that an entity (acquirer) recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with Topic 606. At the acquisition date, an acquirer would assess how the acquiree applied Topic 606 to determine what to record for the acquired revenue contracts. Generally, this would result in an acquirer recognizing and measuring the acquired contract assets and contract liabilities consistent with how they were recognized and measured in the acquiree's financial statements (if the acquiree prepared financial statements in accordance with generally accepted accounting principles [GAAP]). There may be circumstances in which the acquirer would have to apply the guidance in Topic 606 to the acquired contract, such as if the acquiree does not follow GAAP, if there were errors identified in the acquiree's accounting, or if there were changes identified to conform with the acquirer's accounting policies. For example, the acquirer may need to consider the terms of the acquired contract, such as timing of payment, identify each performance obligation in the contract, and allocate the contract transaction price to each identified performance obligation on a relative standalone selling price basis as of contract inception (that is, the date the acquiree entered into the contract) or contract modification to determine what should be recorded at the acquisition date.

The amendments in this proposed Update primarily address the accounting for revenue contracts from customers in a business combination. However, the proposed amendments also would apply to contract assets and contract liabilities from other contracts that apply the provisions of Topic 606, such as contract liabilities from the sale of nonfinancial assets within the scope of Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets.

The amendments in this proposed Update do not affect the accounting for other assets or liabilities that may arise from revenue contracts from customers in a business combination, such as customer-related intangible assets and contract-based intangible assets. For example, if an acquired revenue contract is considered to have terms that are unfavorable relative to market terms, the acquirer would recognize a liability for the off-market contract terms at the business combination date.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Current GAAP provides guidance on when to recognize (and how to measure) assets and liabilities in a business combination but does not provide guidance specific to contract assets and contract liabilities arising from revenue contracts with customers and other similar contracts that are accounted for in accordance with Topic 606. The amendments in this proposed Update would provide guidance on how to recognize and measure those contract assets and contract liabilities in a business combination.

The amendments in this proposed Update would improve comparability for both the recognition and measurement of acquired revenue contracts with customers at the date of and after a business combination. The amendments would improve comparability by specifying for all acquired revenue contracts regardless of their timing of payment (1) the circumstances in which the acquirer should recognize contract assets and contract liabilities that are acquired in a business combination and (2) how to measure those contract assets and liabilities. The proposed amendments would improve comparability after the business combination by providing consistent recognition and measurement guidance for revenue contracts with customers acquired in a business combination and revenue contracts with customers not acquired in a business combination.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied prospectively to business combinations occurring on or after the effective date of the proposed amendments. Early adoption of the proposed amendments would be permitted, including adoption in an interim period. An entity that early adopts in an interim period would need to apply the proposed amendments to all prior business combinations that have occurred since the beginning of the annual period that includes that interim period.

The effective date will be determined after the Board considers stakeholders' feedback on the proposed amendments.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Should an entity be required to recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with Topic 606? If not, please explain why and what alternative would be more appropriate.

Question 2: Is the recognition guidance in the proposed amendments understandable and operable? If not, please explain why.

Question 3: Is the measurement guidance in the proposed amendments understandable and operable? If not, please explain why.

Question 4: The proposed amendments would not amend the existing guidance for other assets or liabilities that may arise from revenue contracts from customers in a business combination, such as customer-related intangible assets and contract-based intangible assets. Is the existing guidance on customer-related intangible assets and contract-based intangible assets, such as contracts with off-market terms, understandable and operable under the proposed amendments? If not, please explain why and what additional guidance would be necessary to make it operable.

Question 5: If the recognition or measurement guidance in the proposed amendments is inoperable or is overly burdensome, are there any practical expedients that should be considered?

Question 6: Would the proposed amendments result in financial reporting outcomes that are appropriate and meaningful for users of financial statements? Please explain why or why not.

Question 7: The scope of the proposed amendments would include contract assets and contract liabilities from other contracts that apply the provisions of Topic 606, such as contract liabilities from the sale of nonfinancial assets within the scope of Subtopic 610-20. Should the proposed amendments be applied to contracts beyond contracts with customers that also are accounted for in accordance with Topic 606? If not, please explain why.

Question 8: The proposed amendments would require no incremental disclosures. Should other disclosures be required; for example, are additional disclosures needed that would provide investors with the information necessary to distinguish between acquired revenue contracts and originated revenue contracts? If yes, please explain why and provide the additional disclosures that should be required.

Question 9: Should the proposed amendments be applied on a prospective basis? If not, what transition method would be more appropriate and why?

Question 10: How much time would be needed to implement the proposed amendments? Should entities other than public business entities be provided with an additional year to implement the proposed amendments? Please explain why or why not.

Question 11: Is the early application requirement appropriate as proposed, or should an entity not be required to apply the proposed amendments to all prior business combinations that occurred since the beginning of the annual period if the proposed amendments are applied in an interim period? Please explain why or why not.

Question 12: IFRS Standards on business combinations contain guidance similar to what is currently in Topic 805. The proposed amendments would create a difference between IFRS Standards and Topic 805 for measuring contract assets and contract liabilities acquired in a business combination. Would differences in that area of the guidance create additional costs or complexity for entities or users of financial statements? Please explain why or why not.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–5. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Add the following Master Glossary term *Contract Liability* to Subtopic 805-20 as follows: **[Note: The definitions of *Contract, Contract Asset,* and *Customer* are shown for convenience.]**

Contract Liability

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1.

An entity's obligation to transfer goods or services to a **customer** for which the entity has received consideration (or the amount is due) from the customer.

Contract

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1.

An agreement between two or more parties that creates enforceable rights and obligations.

Contract Asset

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1.

An entity's right to consideration in exchange for goods or services that the entity has transferred to a **customer** when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

Customer

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1.

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Amendments to Subtopic 805-20

3. Amend paragraphs 805-20-25-16 through 25-17 and add paragraphs 805-20-25-28C through 25-28D and their related heading, with a link to transition paragraph 805-20-65-3, as follows:

Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest

Recognition

General

> Exceptions to the Recognition Principle

805-20-25-16 This Topic provides limited exceptions to the recognition and measurement principles applicable to business combinations. Paragraphs 805-20-25-17 through 25-28D ~~25-28B~~ specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the recognition principle in paragraph 805-20-25-1. The acquirer shall apply the specified GAAP or the specified requirements rather than that recognition principle to determine when to recognize the assets or liabilities identified in paragraphs 805-20-25-17 through 25-28D ~~25-28B~~. That will result in some items being recognized either by applying recognition conditions in addition to those in paragraphs 805-20-25-2 through 25-3 or by applying the requirements of other GAAP, with results that differ from applying the recognition principle and conditions in paragraphs 805-20-25-1 through 25-3.

805-20-25-17 Guidance is presented on all of the following exceptions to the recognition principle:

a. Assets and liabilities arising from contingencies
b. Income taxes
c. Employee benefits
d. Indemnification assets
e. Leases.
f. **Contract assets** and **contract liabilities.**

> > Contract Assets and Contract Liabilities

805-20-25-28C The acquirer shall recognize a contract asset or contract liability in accordance with Topic 606 on revenue from contracts with customers. This includes a contract asset or contract liability from the following:

a. **Contracts** with **customers**
b. Other contracts that apply the provisions of Topic 606.

805-20-25-28D The acquirer shall recognize other intangible assets or liabilities related to acquired contracts in accordance with the overall recognition principle in paragraph 805-20-25-1 (see paragraphs 805-20-55-20 and 805-20-55-31).

4. Amend paragraphs 805-20-30-10 through 30-12 and add paragraph 805-20-30-27 and its related heading, with a link to transition paragraph 805-20-65-3, as follows:

Initial Measurement

> Exceptions to the Measurement Principle

805-20-30-10 Paragraph 805-20-25-16 notes that the Business Combinations Topic provides limited exceptions to the recognition and measurement principles applicable to business combinations. Paragraphs 805-20-30-12 through 30-27 ~~30-26~~ specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the paragraph 805-20-30-1 measurement principle. The acquirer shall apply the specified GAAP or the specified requirements rather than that measurement principle to determine how to measure the assets or liabilities identified in paragraphs 805-20-30-12 through 30-27 ~~30-26~~. That will result in some items being measured at an amount other than their acquisition-date fair values.

805-20-30-11 As noted in paragraph 805-20-25-17, income taxes, employee benefits, indemnification assets, ~~and~~ leases, and **contract assets** and **contract liabilities** are also exceptions to the recognition principle in paragraph 805-20-25-1.

805-20-30-12 Guidance is presented on all of the following exceptions to the measurement principle:

a. Income taxes
b. Employee benefits
c. Indemnification assets
d. Reacquired rights
e. Share-based payment awards

f. Assets held for sale
g. Certain assets and liabilities arising from contingencies
h. Leases
i. **Purchased financial assets with credit deterioration**.
j. Contract assets and contract liabilities.

> > Contract Assets and Contract Liabilities

805-20-30-27 The acquirer shall measure a contract asset or contract liability in accordance with Topic 606 on revenue from contracts with customers. This includes a contract asset or contract liability from the following:

a. **Contracts** with **customers**
b. Other contracts that apply the provisions of Topic 606.

5. Add paragraph 805-20-65-3 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2021-XX, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*

805-20-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2021-XX, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*:

a. For **public business entities**, the pending content that links to this paragraph shall be effective for annual periods, including interim periods within those annual periods, beginning after [date to be inserted after exposure].
b. For all other entities, the pending content that links to this paragraph shall be effective for annual periods, including interim periods within those annual periods, beginning after [date to be inserted after exposure].
c. Early application of the pending content that links to this paragraph is permitted, including in any interim period, for:
    1. Public business entities for periods for which financial statements have not yet been issued
    2. All other entities for periods for which financial statements have not yet been made available for issuance.

    An entity that elects early application of the pending content that links to this paragraph in an interim period shall apply the pending content to all prior business combinations that have occurred since the beginning of the annual period that includes that interim period.

d. An entity shall apply the pending content that links to this paragraph prospectively to business combinations that occur after the effective date.

The amendments in this proposed Update were approved for publication by five members of the Financial Accounting Standards Board. Ms. Botosan and Mr. Schroeder voted against publication of the amendments. Their alternative views are set out at the end of the basis for conclusions.

Members of the Financial Accounting Standards Board:

Richard R. Jones, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Susan M. Cosper
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The Board decided to undertake this project to improve the accounting for acquired revenue contracts with customers in a business combination by addressing diversity and inconsistency related to the following:

a. Recognition of an acquired contract liability
b. Payment terms and their effect on subsequent revenue recognized by the acquirer.

Background Information

BC3. Topic 805 provides guidance on the accounting for business combinations. In applying the acquisition method in Topic 805, an acquirer recognizes identifiable assets acquired and liabilities assumed in a business combination and generally measures those assets and liabilities at fair value. Paragraph 805-20-25-2 provides additional guidance on the recognition criteria. It states that for an identifiable asset acquired or liability assumed to be recognized in a business combination, it must meet the definition of an asset or liability in FASB Concepts Statement No. 6, *Elements of Financial Statements.* Concepts Statement 6 defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events" (footnote references omitted). The definition in Concepts Statement 6 also clarifies that a present obligation is broader than a legal obligation.

BC4. Emerging Issues Task Force Issue No. 01-3, "Accounting in a Business Combination for Deferred Revenue of an Acquiree," provided specific guidance on the accounting for deferred revenue in a business combination. Issue 01-3 required that an acquiring entity recognize a liability related to the deferred revenue of an acquired entity only if that deferred revenue represented a legal obligation assumed by the acquiring entity (a legal performance obligation as described in Issue 01-3) and the amount assigned to that liability was its acquisition date fair value. Issue 01-3 was superseded by FASB Statement No. 141 (revised 2007), *Business Combinations,* which did not include specific guidance on the recognition of a liability for deferred revenue in a business combination. Rather, Statement

141(R) referenced the definition of a liability in Concepts Statement 6 (that guidance is now codified in paragraph 805-20-25-2) for all liabilities recognized in a business combination.

BC5. Although Statement 141(R) superseded the guidance in Issue 01-3, stakeholders indicated that practice generally continued to apply the concepts in Issue 01-3, including use of the legal obligation concept, to determine whether an entity should recognize a liability assumed related to deferred revenue of an acquired entity accounted for under Topic 605, Revenue Recognition.

BC6. In May 2014, the Board issued Update 2014-09, which provides a single comprehensive accounting model on revenue recognition for contracts with customers. Among other things, Topic 606 introduced the term *performance obligation*, which is defined in the Codification Master Glossary as follows:

> A promise in a contract with a customer to transfer to the customer either:
>
> a. A good or service (or a bundle of goods or services) that is distinct
> b. A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

BC7. In addition, paragraph 606-10-25-16 states:

> A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the promised goods and services identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer also may include promises that are implied by an entity's customary business practices, published policies, or specific statements if, at the time of entering into the contract, those promises create a reasonable expectation of the customer that the entity will transfer a good or service to the customer.

The discussion in paragraphs BC32 and BC87 of the basis for conclusions of Update 2014-09 further explains that customary business practices or other implied promises in a contract with a customer do not need to be legally enforceable.

BC8. Stakeholders indicated that it is unclear how an acquirer should evaluate whether to recognize a contract liability from a revenue contract with a customer assumed in a business combination after Topic 606 is adopted. Some stakeholders stated that an entity should use the definition of *performance obligation* introduced by Topic 606 to determine whether a contract liability from a revenue contract with a customer is a liability assumed that is recognized in the business combination. Other stakeholders indicated that Topic 606 did not amend the guidance in Topic 805 and stated that an entity should continue to use the legal obligation concept from Issue 01-3 when applying the guidance in Topic 805. For example, an entity will recognize revenue over time for what is now referred to as a license to symbolic intellectual property under Topic 606. Therefore, when an acquirer is evaluating whether to recognize a liability assumed related to a license to symbolic intellectual property, the acquiree's balance sheet may have a contract liability (a remaining performance obligation) under Topic 606 at the acquisition date. However, the entity may have no legal obligation other than to allow for the continued use of its intellectual property because the remaining activities to support and maintain the underlying intellectual property are not legal obligations.

BC9. On March 28, 2018, the Board added a narrow scope project to the EITF's agenda to reduce the diversity that might arise when evaluating whether to recognize a contract liability from a contract with a customer that is acquired in a business combination after an entity has adopted Topic 606. In addition, stakeholders indicated that questions may arise under Topic 606 about measurement of contract liabilities from revenue contracts with customers in a business combination. The Board also asked the EITF to consider those measurement issues.

BC10. Under Topic 805, the general measurement principle in paragraph 805-20-30-1 explains that an acquirer must initially measure all assets acquired and liabilities assumed, with limited exceptions, at their acquisition date fair values in accordance with Topic 820, Fair Value Measurement. There is no specific guidance or exception related to the measurement of revenue contracts with customers, and, thus, the contract assets and contract liabilities that arise from them follow the overall measurement principle. Topic 805 generally requires that an acquirer subsequently measure and account for assets acquired and liabilities assumed in a business combination in accordance with other applicable GAAP; therefore, acquired contract assets and contract liabilities would subsequently be accounted for under Topic 606.

BC11. During the deliberations of EITF Issue No. 18-A "Recognition under Topic 805 for an Assumed Liability in a Revenue Contract," Task Force members considered whether two acquired revenue contracts with identical performance obligations but with different payment terms would result in different amounts of postacquisition revenue for the acquirer. Most Task Force members indicated that, theoretically, the timing of payment should not affect the amount of revenue recognized by the acquirer after the acquisition for the acquired contract (other than perhaps because of a significant financing component). However, in current practice, a revenue contract that is paid upfront before the acquisition likely will result in different postacquisition revenue compared with an identical revenue contract that is paid over time after the acquisition.

BC12. When a revenue contract is paid upfront, an acquirer recognizes an assumed contract liability at fair value when the acquiree has received consideration from the customer and there is still a remaining unsatisfied, or partially unsatisfied, obligation as of the acquisition date. The resulting fair value measurement will often be lower than the contract liability balance that is recorded by the acquiree. Under fair value measurement techniques, the costs or activities to enter into the contract are considered to have already been performed by the acquiree before the acquisition and, therefore, are not included in the measurement of the remaining obligation for the related contract liability. However, under Topic 606, the costs to enter into the contract are not considered for purposes of revenue recognition, and contract liabilities are derecognized as the corresponding performance obligation is satisfied by transferring either a good or service to the customer. Alternatively, when a contract is paid over time as performance occurs, an acquirer likely would not analyze the specific revenue contract at the acquisition date because there would be no identifiable assets or liabilities assumed to measure at fair value for that contract (absent assumed intangible assets). Therefore, there is no contract-specific fair value adjustment, and an acquirer likely would subsequently recognize the same amount of revenue that the acquiree would have recognized if no business combination took place.

BC13. At the October 10, 2018 Board meeting, the Board authorized the staff to prepare an Invitation to Comment, *Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805,* as part of a research project to address the measurement and payment terms issues. On February 14, 2019, the Board issued proposed Accounting Standards Update, *Business Combinations (Topic 805): Revenue from Contracts with Customers—Recognizing an Assumed Liability,* as part of Issue 18-A to address the recognition issue and the related Invitation to Comment concurrently.

BC14. At the June 13, 2019 EITF meeting, the Task Force considered the feedback received from the Invitation to Comment and the proposed Accounting Standards Update and decided not to affirm its consensus-for-exposure on Issue 18-A. On the basis of stakeholders' feedback, the Task Force recommended to the Board that the issues related to recognition and measurement be addressed holistically. At the July 31, 2019 Board meeting, the Board decided to subsume Issue 18-A on recognition into the Board's research project, Recognition and Measurement of Revenue Contracts with Customers under Topic 805. On September 23, 2020, the Board added the project to its technical agenda.

Benefits and Costs

BC15. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC16. The Board does not anticipate that entities will incur additional costs as a result of the amendments in this proposed Update when compared with the current costs incurred for accounting for acquired revenue contracts with customers in a business combination. The Board acknowledged that the proposed amendments may not be as simple as recording the same contract assets and contract liabilities that were recorded by the acquiree before the acquisition and that there may be additional effort required to evaluate how the acquiree applied Topic 606. Additionally, the Board clarified that in accordance with the existing requirements in Topic 805, acquirers would still need to consider whether the terms of the contract require recognizing an additional intangible asset or liability for off-market terms (for example, if there were changes to the prevailing standalone selling price since that contract was entered into). However, the Board believes that the level of effort required to account for the acquired revenue contracts in accordance with Topic 606 will be similar to or less than the level of effort required when applying current guidance.

BC17. The Board believes that initial fair value measurement for acquired revenue contracts in a business combination is complex and requires significant judgment, and the Board notes that diversity exists in current practice for determining the fair value of contract liabilities for certain revenue arrangements. Additionally, even for those arrangements for which the fair value measurement is not overly complex, preparers explained that they often receive questions from users of financial statements about the fair value adjustments. To address those questions, preparers incur additional costs and complexity to maintain records that adjust revenue by reversing out the effects of the fair value adjustments in order to report and explain those adjustments to users. Stakeholders explained that these adjustments are often difficult for users to understand and, in most cases, the effects of the fair value adjustments to the contract liability balance are short lived because of the contract terms of the acquired contracts. The Board indicated that the proposed amendments would provide information consistent with what users are seeking for acquired revenue contracts, which would address questions received by preparers and the need for preparers to track and disclose non-GAAP or supplemental financial information. The Board also indicated that the proposed amendments would result in less complexity when subsequently accounting for the acquired revenue contracts.

BC18. The amendments in this proposed Update would provide specific guidance on recognition and measurement, resulting in consistent application of GAAP for acquired revenue contracts with customers in a business combination. The proposed amendments also would eliminate differences in the subsequent amount of revenue recognized by an entity (acquirer) after a business combination based on the timing of payment, which the Board indicated results in counterintuitive outcomes and does not provide users of financial statements with decision-useful information. Additionally, based on outreach, the Board believes that the proposed amendments would provide investors with more decision-useful information. The Board met with members of its Investor Advisory Committee (IAC), and the majority of its members supported the Topic 606 approach because it would provide more decision-useful information for projecting future cash flows and revenues of the acquirer after the acquisition. Those members explained that the current requirement to measure the deferred revenue (contract liability) balance at fair value (a) does not provide useful information, (b) is often challenging to understand, and (c) reduces comparability between the preacquisition and postacquisition period, disrupting the ability to predict future cash flows and revenue.

BC19. IAC members also explained that the resulting fair value adjustments are often reversed to analyze an entity after the acquisition. This analysis requires investors to search for information, such as non-GAAP disclosures or supplemental financial information, when business combinations occur to attempt to identify the acquired deferred revenue balance and the period over which that deferred revenue will be recognized. A number of the IAC members further explained that the supplemental information is sometimes unavailable or lacks the necessary information to enable investors to perform this analysis with any precision.

BC20. Overall, the Board concluded that the amendments in this proposed Update would maintain or reduce the costs for preparers of financial statements, reduce investor costs of analyzing and interpreting the reported information, and provide investors with more decision-useful information.

Basis for Conclusions

Recognition of an Acquired Contract Liability in a Business Combination

BC21. The Board decided that an entity should use the definition of performance obligation as defined in Topic 606 to determine whether to recognize a contract liability from a revenue contract with a customer that is acquired in a business combination at the acquisition date.

BC22. An entity should evaluate whether it has a contract liability from a revenue contract that is assumed in a business combination if the acquiree has been paid (or consideration is due) for goods or services promised in the contract for which control has not been transferred to the customer (that is, an unfulfilled performance obligation). The acquirer would not need to perform this evaluation if the acquiree has not received payment or there is no consideration due (that is, a contract liability would not have been recognized under Topic 606).

BC23. In reaching this decision, the Board believes that using the definition of *performance obligation* better aligns with the current overall recognition principle in Topic 805 and by utilizing the guidance in Topic 606, the identification of an obligation for a revenue contract will be consistent for all revenue contracts (that is, whether it is acquired in a business combination or originated by an entity). In addition, the Board observed that the Topic 606 performance obligation concept may be less complex to apply than current guidance.

BC24. The Board indicated that in most situations in which an acquired revenue contract has been paid upfront before the business combination, the recognition conclusion under a Topic 606 performance obligation would be the same as current practice, which uses legal obligation as the recognition criteria. However, the Board acknowledged that there may be circumstances in which the recognition conclusion could be different, such as for licenses of symbolic intellectual property or goods or services that are provided as a customary business practice because an entity is not legally obligated to perform in those situations (see paragraph BC8).

BC25. Several respondents to the February 2019 proposed Update identified implications of providing recognition guidance for acquired revenue contracts in a business combination without providing corresponding measurement guidance. For example, some respondents suggested that determining the fair value of performance obligations as defined in Topic 606 may be complex and could lead to diversity in practice. To address those implications, the Board also decided how to measure acquired revenue contracts in a business combination when deliberating the issue of payment terms and their effect on subsequent revenue recognized by the acquirer.

Payment Terms and Their Effect on Subsequent Revenue Recognized by the Acquirer

BC26. To address the issue that the timing of payment for an acquired revenue contract affects the subsequent amount of revenue recognized by the acquirer after the business combination, the Board decided that acquired contract assets and contract liabilities arising from revenue contracts with customers in a business combination would be measured in accordance with Topic 606 at the acquisition date. Therefore, the acquirer will no longer measure the remaining obligations of the acquired revenue contract at fair value but, instead, utilize the contract transaction price for the remaining performance obligations in accordance with the principles of Topic 606.

BC27. The overall result of the Board's decisions on recognition of contract assets and contract liabilities and on payment terms would result in an entity (acquirer) accounting for contract assets and contract liabilities arising from revenue contracts with customers acquired in a business combination in accordance with Topic 606 at the acquisition date. For example, if a revenue contract was paid fully upfront before the acquisition, the acquiree would have recognized a contract liability for the remaining, unsatisfied performance obligations in accordance with Topic 606. At the acquisition date, an acquirer would assess the acquiree's accounting under Topic 606 to determine what to record for the acquired contract. There may be circumstances in which the acquirer would have to determine the accounting for the contract in accordance with Topic 606, such as if the acquiree does not follow GAAP or there were errors identified in the acquiree's accounting. Generally, either of those efforts would result in the acquirer recording a contract liability that is the same as, or similar to, the contract liability that would have been recorded by the acquiree before the acquisition (if the acquiree had prepared financial statements in accordance with GAAP).

BC28. The Board indicated that differences between contract assets and contract liabilities recorded by an acquirer and those recorded by the acquiree before the acquisition generally would result from (a) differences in the acquirer's and acquiree's revenue recognition accounting policies and the resulting change to the acquiree's policies, (b) differences in estimates between the acquirer and acquiree, or (c) errors in the Topic 606 accounting of the acquiree. Therefore, the Board acknowledged that the amendments in this proposed Update may not be as simple as carrying over the acquiree's recorded contract assets or contract liabilities for some arrangements. On the basis of the outreach performed, the Board believes that the information necessary to assess the acquiree's recorded balance in accordance with Topic 606 would be available and that the assessment would be relatively straightforward for most revenue contracts acquired. The Board also explained that practical expedients and policy elections are not pervasive in Topic 606; therefore, confirming accounting policies and elections should not be overly burdensome. The Board acknowledges that certain areas in Topic 606 require the use of judgment, such as estimates of variable consideration or determining the method of measuring progress for longer term contracts. However, the Board believes that evaluating those areas of judgment should not be overly burdensome when compared with current practice and indicated that, in certain situations, acquirers are currently required to perform these assessments at the acquisition date and that acquirers subsequently account for those contracts in accordance with Topic 606 and their own accounting policies.

BC29. The proposed amendments in this Update relate only to contract assets and contract liabilities as defined in Topic 606. Therefore, the proposed amendments would not affect the accounting for associated customer-related intangible assets (paragraph 805-20-55-20) or contract-based intangible assets (paragraph 805-20-55-31) that also may arise from revenue contracts with customers in a business combination under current guidance. Therefore, the

Board clarified that, consistent with current practice, contracts with customers should continue to be evaluated for related intangible assets and liabilities, such as customer relationships and contracts with off-market terms. However, on the basis of outreach performed, the Board believes that assets and liabilities related to off-market contract terms in acquired revenue contracts are not currently prevalent in business combinations.

BC30. The Board acknowledges that there may be circumstances where the revenue recognized by an acquirer after the acquisition may be different from what would have been recognized by an acquiree if there was no acquisition. For example, a contract liability balance may be higher or lower due to differences in accounting policies or an additional asset or liability may be recognized in the business combination for off-market contract terms (that is, if the amortization of that asset or liability is presented in revenue). While this may cause users of financial statements some difficulty in analyzing revenue trends, the Board believes that the subsequent revenue reported would provide decision-useful information because it would better reflect future revenue of the acquirer. In situations in which there are adjustments recorded because of differences in accounting policies between the acquirer and acquiree, the resulting subsequent revenue would better indicate future revenue because it would reflect how the acquirer will account for similar contracts in the future. In situations in which contracts have off-market terms that are recorded and the amortization of the asset or liability is presented as revenue, the resulting subsequent revenue would better indicate future revenue because it would reflect either the current market terms or current standalone selling prices for those performance obligations identified in the acquired contract.

BC31. Under the amendments in this proposed Update, future expected variable consideration that is constrained under the general constraint on estimates of variable consideration (paragraphs 606-10-32-11 through 32-14) or the constraint for sales-based and usage-based royalties (paragraph 606-10-55-65) in Topic 606 would be precluded from being recognized in the acquired contract asset balance until the variable consideration becomes unconstrained. While the future expected variable consideration that is constrained under Topic 606 would be precluded from being measured and recognized in the contract asset balance, the fair value of that expected variable consideration could still be captured as part of the valuation of customer-related intangible assets. The Board understands that this is similar to how revenue contracts with variable consideration are generally valued and accounted for in current practice.

BC32. The Board believes that the amendments in this proposed Update would simplify an area of business combination accounting that is complex and costly to apply. During outreach, stakeholders explained that the proposed amendments did not have significant implications on how other identifiable assets and liabilities that arise from revenue contracts are recognized and measured in a business combination in current practice. For acquired revenue contracts that do not have an associated contract liability at the acquisition date, the Board understands from outreach participants that the proposed amendments would generally be consistent with current practice. That is, the acquiree's revenue accounting would likely be retained, and the fair value of those acquired revenue contracts would be captured within other identifiable assets or liabilities recognized in the business combination, such as customer-related intangible assets and contract-based intangible assets (for example, contracts with favorable or unfavorable terms compared with market terms).

BC33. The amendments in this proposed Update would generally align the accounting for acquired revenue contracts that were paid upfront before the acquisition and have an associated contract liability at the acquisition date with the current accounting for acquired revenue contracts that do not have an associated contract liability at the acquisition date. That is, the proposed amendments would likely retain the acquiree's revenue accounting under Topic 606 and if there are other identifiable assets or liabilities associated with the contract, they would be recognized in the business combination. For example, if an acquired contract with an associated contract liability is considered to have off-market terms, an asset or liability would be recognized and measured consistent with how they are currently recognized and measured for acquired contracts that do not have an associated contract liability (see paragraph BC29). The Board acknowledged that there is likely to be an increase in the acquired contract liabilities balance because of the amendments in this proposed Update. The Board indicated that this is because the preacquisition balance under Topic 606 would not be subject to the downward adjustments that usually result from fair value measurement of those liabilities related to the selling and marketing efforts to enter into the related contracts (see paragraph BC12). The Board believes that the corresponding increase to the acquired contract liabilities balance for those adjustments would be recognized in goodwill. The Board also believes that the resulting effects to the contract liabilities balance from these proposed amendments would not affect how entities consider which underlying assets contribute to fulfilling contract liability obligations.

BC34. The Board acknowledged that the expected increase in contract liabilities in a business combination will result in an increase in the subsequent revenue recognized by an acquirer, which a few stakeholders equated to creating an opportunity to "buy revenue." That is, the acquirer may be able to recognize revenue for activities performed by an acquiree before the acquisition (for example, selling and marketing efforts to enter into the contracts). This concern was included in the basis for conclusions of Statement 141(R) as support for why previous business combination accounting was inappropriate. However, the Board believes that the comprehensive guidance in Topic 606, which was issued after Statement 141(R), limited the number of arrangements that present this opportunity. Additionally, the Board believes that the model in Topic 606, which requires an entity to recognize revenue as the entity satisfies performance obligations, represents a faithful representation of performance and the revenue recognized for that performance. Accordingly, satisfying a performance obligation postacquisition will result in a consistent approach to recognizing revenue that is generally not affected by the timing of payment or by whether it was originated by the acquiree or the acquirer. The Board also indicated that stakeholders understand the Topic 606 guidance and its resulting outcomes and that the amendments in this proposed Update provide subsequent revenue information that users seek when an entity performs a business combination. Additionally, the Board explained that certain intangible assets and liabilities (favorable or unfavorable contracts) would be recognized if the acquired revenue contract contains off-market terms or conditions, which would limit the ability for an entity to acquire revenue contracts with favorable conditions and not depict those conditions in the financial statements.

BC35. As described in paragraphs BC17 through BC19, users of the financial statements explained that they currently seek additional information in order to reverse the effects of the fair value measurement of acquired revenue contracts with associated contract liabilities at the acquisition date. The Board indicated that the amendments in this proposed Update would provide the decision-useful information sought by users in the financial statements, which should further enhance the consistency and availability of this information.

Alternatives Approaches Considered but Dismissed by the Board

BC36. The Board also considered an alternative approach that would have retained the fair value measurement principle in Topic 805. The net fair value approach would require that an entity (acquirer) measure the fair value of an acquired revenue contract at the acquisition date as the difference between the fair value of the expected remaining net contractual payments and the fair value of the remaining unsatisfied or partially unsatisfied 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 acquired revenue contracts.

BC37. The approach theoretically would utilize the same contractual net cash flows to value an acquiree's revenue contracts that are currently recognized and measured within customer-related intangible assets. The net fair value approach would have effectively reclassified those cash flows from intangible assets into a separate identifiable contract asset or liability for each acquired revenue contract or aggregated group of revenue contracts.

BC38. The Board ultimately rejected this approach because it concluded that the benefits may not justify the costs after all issues were considered. The Board agreed with stakeholders' operability concerns both at the acquisition date when measuring the fair value of the acquired revenue contracts and after the acquisition date when accounting for the acquired revenue contracts under Topic 606. The

Board indicated that the costs and complexity of this approach would be exacerbated by the existence of any acquired revenue contract that contained variable consideration. Additionally, the Board explained that the net fair value approach would likely have amplified the effect of fair value measurement on acquired revenue contracts and the subsequent amount of revenue recognized from those contracts. Therefore, financial statement users would have continued to request non-GAAP disclosures or supplemental information from preparers about the fair value adjustments and their effect on the revenue recognized subsequently by the entity.

Scope

BC39. The amendments in this proposed Update would apply to entities that enter into a business combination within the scope of Subtopic 805-10 after the effective date that includes contract assets and contract liabilities as defined by Topic 606. The Board decided that the scope should be broader than revenue contracts with customers and include all contracts that contain contract assets and contract liabilities, such as contract liabilities from the sale of nonfinancial assets within the scope of Subtopic 610-20, that are recognized and measured using the guidance in Topic 606. In reaching this decision, the Board agreed with outreach participants that the proposed amendments should apply to all contracts that are required to apply the principles of Topic 606 because it would result in applying consistent principles in the Codification to similar assets and liabilities. The Board does not expect that the expanded scope of the guidance will cause uncertainty about which acquired contracts would be within the scope of the proposed amendments.

Disclosures

BC40. The Board decided not to require additional general disclosures or transition disclosures because it believes that the disclosures would not provide incremental information that would be useful for users of financial statements and, therefore, would result in unnecessary costs for preparers. The Board indicated that the amendments in this proposed Update would affect only the recognition and measurement of acquired revenue contracts under Topic 805 and that entities would still need to adhere to the disclosure requirements in Topic 805.

BC41. The Board agreed with outreach participants that the current disclosures required under Topic 805 and Topic 606 would provide sufficient information for users of financial statements both during and after the period of the business combination. Specifically, the Board considered the requirements in paragraphs 805-10-50-2(h) and 606-10-50-13. Paragraph 805-10-50-2(h) requires that public entities disclose the amounts of revenue and earnings of the acquiree included in the consolidated income statement for the annual period of the acquisition and supplemental pro forma information about revenues and earnings of the combined entity. Paragraph 606-10-50-13 requires that entities provide information on the transaction price allocated to the remaining performance obligations (that is, revenue that will be recognized in a future period when [or as] the performance obligation is satisfied).

BC42. The Board considered requiring additional disclosures as part of the amendments in this proposed Update, including disclosing (a) the fair value of the acquired contract liability balance and (b) information that would distinguish between the revenues of acquired contracts and the revenues of originated contracts. However, the Board decided that it did not want to require preparers to prepare disclosures for information that was unnecessary to perform the accounting for acquired revenue contracts in a business combination. It also was unclear to the Board whether those disclosures would provide users of financial statements with decision-useful information.

Effective Date and Transition

BC43. The Board decided that the amendments in this proposed Update should be adopted prospectively and that early application would be permitted. The effective date will be determined after the Board considers stakeholders' feedback on the proposed amendments.

BC44. The Board indicated that retrospective application of the proposed amendments could result in unnecessary costs and complexity for preparers and that the information provided from retrospective application would be limited. The Board indicated that some complexities that may arise as a result of requiring retrospective application include that recognizing additional performance obligations and remeasuring all acquired contract liabilities in accordance with Topic 606 (that is, reversing the fair value adjustments) could affect (a) the measurement of goodwill in the business combination, which could raise questions about whether retrospective impairment assessments need to be made, and (b) previous amounts of revenue recognized by the acquirer after the business combination, which could raise additional issues for income taxes and other projections.

BC45. With its decision to allow entities to early adopt the amendments in this proposed Update, the Board clarified that an entity that elects to early adopt the amendments in an interim period should apply the amendments to all business combinations that have occurred since the beginning of the annual period that includes that interim period. The Board reached this decision because if the proposed amendments were not adopted as of the beginning of the year, it could result in inconsistent revenue recognition policies if a business combination was completed earlier in the annual period and provide users of financial statements with noncomparable information. The Board acknowledged that there could be difficulties in retroactively applying the proposed amendments as of the beginning of the annual period for previously completed business combinations within that period and it did not intend to make the proposed early adoption guidance so onerous that it would deter entities from early adopting the proposed amendments.

Alternative Views

BC46. Ms. Botosan and Mr. Schroeder do not support the proposed Update's change in measurement basis for contract assets and contract liabilities (as defined in Topic 606) that are acquired in a business combination. Such a change would create both an exception to the fair value measurement required by Topic 805 and an additional difference between GAAP and International Financial Reporting Standards related to accounting for business combinations. As more fully explained in the following paragraphs, they note that the proposed Update would not improve the accounting for business combinations and it would not meet the objective of financial reporting of providing more decision-useful information. They also believe that the expected benefits would not justify the expected costs.

BC47. As proposed, an acquiree's preacquisition measurement of contract assets and liabilities would in most situations carry over to the postacquisition financial statements of an acquirer. Ms. Botosan and Mr. Schroeder believe that simply carrying over the same basis would not faithfully represent the economics of a business acquisition transaction and could result in an overstatement of postacquisition revenues and income. This concern is not new; it was discussed in the basis for conclusions in Statement 141(R), which stated in part that "by recording assets and liabilities at the carrying amounts of predecessor entities, postcombination revenues may be overstated (and expenses understated) as the result of embedded gains that were generated by predecessor entities but not recognized by them" (paragraph B38).

BC48. Ms. Botosan and Mr. Schroeder are concerned that any potential overstatement of postacquisition revenues and income by the acquirer resulting from carrying over the acquiree's basis may create perverse incentives for entities to "buy revenues." Exacerbating this concern is that an increase in contract liabilities (related to the application of carryover-basis measurement) would produce an offsetting increase in goodwill, which generally is not subject to systematic amortization. Moreover, they believe that these resulting effects on postacquisition revenues and income will not be transparent to investors and other users of the financial statements.

BC49. Ms. Botosan and Mr. Schroeder understand that investors and other users of financial statements often seek information outside the financial statements (for example, non-GAAP disclosures) to distinguish and separately evaluate acquired and originated revenues. They acknowledge the relevance of such information and would support enhanced disclosures to help users assess the longer term implications of a business combination on revenue, revenue growth, and margins.

BC50. Ms. Botosan and Mr. Schroeder recognize that the proposed application of carryover-basis measurement would incorporate certain information that is useful in assessing the longer term implications of a business combination into the face of the financial statements. However, its application also would result in the loss of fair value information that is useful in evaluating the soundness of the business acquisition decision. They note that the objective of financial reporting is to provide information useful in assessing an entity's prospects for future net cash inflows and the efficiency and effectiveness with which "the entity's management and governing board have discharged their responsibilities to use the entity's resources" (paragraph OB4 of Concepts Statement 8, *Conceptual Framework for Financial Reporting—Chapter 1, The Objective of General Purpose Financial Reporting;* footnote reference omitted). Accordingly, they believe that the proposed Update's change in measurement basis for contract assets and contract liabilities acquired in a business combination, combined with a loss of decision-useful information, would fail to achieve the objective of financial reporting.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed improvements to the Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the Taxonomy will be finalized as part of the annual release process.