Committee on Corporate Reporting

March 15, 2021

Ms. Hillary Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2020-1000

Dear Ms. Salo,

This letter is submitted by Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) in response to the Financial Accounting Standards Board's ("FASB" or "Board") Proposed Accounting Standards Update, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers* ("proposed amendments" or "Exposure Draft").

FEI is a leading international organization comprised of members who hold positions as Chief Financial Officers, Chief Accounting Officers, Controllers, Treasurers, and Tax Executives at companies in every major industry. CCR is FEI's technical committee of approximately 50 Chief Accounting Officers and Corporate Controllers from Fortune 100 and other large public companies, representing more than $13 trillion in market capitalization. CCR reviews and responds to pronouncements, proposed rules and regulations, pending legislation, and other documents issued by domestic and international regulators and organizations such as the U.S. SEC, PCAOB, FASB, and IASB.

This letter represents the views of CCR and not necessarily the views of FEI or its members individually.

Executive Summary

We commend the Board's responsiveness to stakeholder feedback and appreciate the Board's objective to improve the accounting for acquired revenue contracts with customers in a business combination. We support the Exposure Draft, including the outcome of applying the proposed amendments to both contract assets and contract liabilities, and we agree that the proposed amendments will reduce diversity and inconsistency in practice. We believe that applying Topic 606 to revenue contracts acquired in a business combination will result in more decision-useful information for users and will reduce complexity and costs for preparers. In our letter, we expand upon these points, focusing specifically on contract liabilities (i.e., deferred revenue), and offer suggestions for improving the operability of the proposed amendments and clarifying the proposed transition guidance. Finally, we suggest that the Board also consider addressing the accounting for inventory acquired in a business combination, as it generates many of the same challenges for users and preparers addressed by this Exposure Draft.

More Decision-Useful Information

We agree with the proposed amendments to recognize contract assets and contract liabilities in accordance with Topic 606, as we believe that the timing of payment generally should not affect the amount of revenue recognized by an acquirer of a revenue contract in a business combination.[1] We also believe that the proposed amendments will reduce complexity and confusion. For example, under current business combination guidance in Topic 805, measuring the fair value of an acquiree's deferred revenue balance often results in a downward adjustment when a revenue contract has been paid upfront. Explaining to users the reasons for and implications of the fair value adjustment can be challenging and unproductive, and additional complexity, confusion, and divergence in analysis may arise when entities try to provide information necessary to reverse the effects of the adjustment in response to questions from users.[2] Our investors have noted that the current approach does not provide decision-useful information and may result in an incorrect view of revenue growth. Our investors have also emphasized that by contrast, the Topic 606 approach would offer more consistent and comparable results that are more useful for predicting future revenues. We note that the majority of members on the FASB's Investor Advisory Committee agreed with these views.[3]

The proposed amendments largely resolve issues with current guidance because the acquiree's pre-acquisition deferred revenue balance would provide the basis for recognition and measurement of those balances in the post-acquisition financial statements of an acquirer, and future revenue would be recognized on a basis consistent with Topic 606. Even if an acquiree's deferred revenue balance requires some adjustments to correct errors or to adjust for differences in accounting policies or estimates, we anticipate that questions about these adjustments will occur less frequently and be answered more easily than questions received under the current requirements. We acknowledge that the expected increase in deferred revenue balances from implementing the proposed amendments would result in a corresponding increase to goodwill balances and an increase in the subsequent revenue recognized by acquirers. However, we believe that providing investors with comparable revenues is more important than maintaining consistency in the fair value model. Furthermore, we agree with the Board's majority view that the comprehensive guidance in Topic 606 limits the number of arrangements that would allow acquirers to "buy revenue," and acquirers would still need to satisfy remaining performance obligations before revenue could be recognized.

Operability of the Proposed Amendments

Overall, we believe that the proposed amendments are operable and will reduce costs and complexity compared to current practice. Determining the fair value of deferred revenue in a business combination often requires significant time and judgment, whereas we expect the application of Topic 606 to be relatively more straightforward.

However, we note that in applying the proposed amendments, entities will still need to consider whether the terms of an acquired contract require recognition of an additional intangible asset or liability for off-

[1] We note that this position is also supported by the majority of EITF members (see paragraph BC11 of the Exposure Draft).
[2] Preparers may also be hesitant to disclose adjustments that reverse the fair value impacts on deferred revenue because providing a measure that uses individually tailored recognition and measurement methods for financial statement line items could violate Rule 100(b) of Regulation G.
[3] Paragraph BC18 of the Exposure Draft

market terms. Although perhaps outside the scope of this proposal, we recommend providing a practical expedient[4] that allows entities to evaluate contracts with similar off-market terms at a portfolio level, and we recommend allowing the policy election to be made on a transaction-by-transaction basis. While some acquisitions may involve a small number of large, heterogeneous contracts that lend themselves to evaluation at a contract-by-contract level, other acquisitions may include a high volume of similar contracts that would result in an overly burdensome evaluation process. We are concerned that the absence of a practical expedient may generate additional costs for entities when evaluating contracts for off-market terms. If the Board decides not to provide a practical expedient, an acknowledgment by the Board that entities may use reasonable judgment in assessing contracts for off-market terms would also be helpful in reducing these costs.

Transition Guidance

We agree that the proposed amendments should be adopted prospectively with the opportunity to early adopt as of the beginning of the annual period that includes the interim period of adoption. However, we request that the Board clarify how the proposed amendments should be applied when early adopted in an interim period.

We understand that the Board does not intend to make the proposed early adoption guidance so onerous that it would deter entities from early adopting,[5] yet we agree with the Board's observation in BC45 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. Therefore, the Board could consider providing two transition options for early adoption in an interim period. That is, for entities that wish to retain comparability despite the potential challenges of retroactively applying the proposed amendments, the Board could provide for retrospective application. For entities that would otherwise be deterred from adopting the proposed amendments retrospectively, the Board could provide an option to early adopt in an interim period by following the guidance for measurement period adjustments for provisional amounts found in Topic 805.[6] In this case, we would support requiring the same disclosures required for measurement period adjustments, such as those found in ASC 805-20-50-4A(c), to help users assess revenue trends and understand the impact and timing of adopting the proposed amendments.[7]

Inventory Acquired in a Business Combination

The proposed amendments specifically address the accounting for revenue contracts acquired in a business combination; however, we note that the application of existing guidance related to accounting for inventory acquired in a business combination often yields similar challenges for users and preparers.

[4] A similar practical expedient is used in ASC 606-10-10-4 that allows entities to apply Topic 606 to a portfolio of contracts (or performance obligations) with similar characteristics if the results would not differ materially from applying the guidance to individual contracts.
[5] The Board acknowledged its desire to avoid making early adoption guidance so onerous that it would deter entities from early adopting the proposed amendments in paragraph BC45 of the Exposure Draft.
[6] See ASC 805-10-25-17
[7] The Board likewise observed in BC8 of ASU 2015-16 that the disclosure requirements in ASC 805-20-50-4A(c) would benefit users without incurring the costs of retrospective application.

Specifically, measuring the fair value of an acquiree's inventory balances upon acquisition typically results in an upward adjustment, which may temporarily reduce margins and distort short-term trends. As with deferred revenue, our investors have indicated that this approach does not provide decision-useful information, leading them to request information to reverse the effects of the adjustment, increasing costs and complexity for preparers. We suggest that the Board consider providing a similar exception to Topic 805 whereby inventory acquired in a business combination is measured in accordance with Topic 330 to help resolve some of these issues.

Conclusion

We appreciate the Board's effort to obtain input from stakeholders on these proposed amendments and stand ready to assist the Board in this endeavor.

Sincerely,

Rudolf Bless

Rudolf Bless
Chair, Committee on Corporate Reporting
Financial Executives International