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April 29, 2019

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2019-200

Dear Ms. Cosper:

RSM US LLP appreciates the opportunity to comment on the Invitation to Comment, *Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805* (the "ITC"). Overall, we support the FASB's efforts to address measurement issues that may arise if the definition of a performance obligation under Topic 606 is used in determining whether a contract liability should be recorded for customer contracts acquired in a business combination under Topic 805. Provided below for your consideration are our responses to the "Questions for Respondents" on which specific comment was requested.

Responses to Questions for Respondents

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?*

> We do not believe that the timing of payments in a customer contract acquired in a business combination should generally have an impact on the subsequent revenues recognized by the acquirer. From a conceptual standpoint, the obligation of the acquirer to fulfill a customer contract is not impacted by whether some or all of the payments have been made prior to the acquisition. As a result, the revenues recognized should not be impacted by payment timing.

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)?*

> We believe an identifiable asset separate from other contract-related assets and liabilities would need to be recognized. This identifiable asset would need to be recognized in situations in which full payment is not received upfront prior to the acquisition. In the ITC, Scenarios 2, 3 and 4 (and Outcomes 2B, 3B and 4B) illustrate the scenarios in which we believe it is appropriate to recognize a separate identifiable asset. These scenarios illustrate situations in which the fair value of the remaining payments to be received under the contract are in excess of the fair value of the unsatisfied performance obligations. Under current practice, we believe this asset should be recorded as contract backlog (or as part of a customer-relationship intangible asset) and amortized (as either contra-revenue or expense) as performance occurs. If the amortization were classified as contra-

revenue, the accounting treatment and the related total revenue recognized under current GAAP would be consistent with Outcomes 2B, 3B and 4B 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?*

We believe that the recognition of an identifiable asset for customer contracts in the accounting for business combinations is already required under current GAAP as noted in our response to Question 1.2. Our understanding is that under current practice this asset is typically valued and recorded as either contract backlog or as part of a customer relationship intangible asset, which includes value beyond that of the currently outstanding contracts with customers.

Question 1.4: *Would that 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?

We believe this identifiable asset meets the definition of an asset based on the contractual-legal criterion included in the “identifiable” definition in the Glossary in Subtopic 805-20-20. Further, the value of this asset is already recognized under current GAAP as noted in our response to Question 1.3 above.

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?*

We believe the identifiable asset referenced in the prior questions would essentially be contract backlog or part of a customer relationship intangible asset. As a result, we do not believe an entity would need to consider order or production backlog separately if this identifiable asset is recorded.

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

We believe it would be helpful to provide subsequent measurement guidance to make clear that the identifiable asset should be amortized in a pattern consistent with the fulfillment of the performance obligation in the customer contract to which the asset relates. We also believe that subsequent measurement guidance should address the classification of the related amortization.

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

Guidance on payment terms definitely would help improve the usefulness and comparability of financial information. Given the potential diversity in practice in the absence of this guidance, we recommend moving forward and issuing an Exposure Draft that addresses this issue.

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?*

We do not believe that contingencies related to the amount of consideration to be received should affect the subsequent amount of revenue recognized by the acquirer. We understand the Board included guidance in Topic 606 limiting the estimate of variable consideration and related revenue recognition in certain scenarios (including those with sales or usage-based royalties relating to intellectual property licenses) partially from a practicality standpoint. However, we would be concerned with a similar limitation to an acquired revenue contract in a business combination as this could result in revenues being recognized by an acquirer on contracts in which they did not perform at all post-acquisition (e.g., all performance under the revenue contract occurred prior to the acquisition, and a royalty payment was received post-acquisition). We do not believe it would be appropriate for revenue to be recognized by an acquirer in this scenario.

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?*

We do not believe an acquirer should apply the sales and usage-based royalties constraint or variable consideration constraint guidance in the accounting for a business combination. See our response to preceding Question 1.8.

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?*

For the contingencies to not impact the amount of revenue subsequently recognized, any changes in the amount expected to be received (or actually received) compared to the original amount recorded in the business combination would have to be included in a line item other than revenue recognized from customers. Perhaps if material, these amounts could be included in a non-customer revenue line item or in Other Income/Expense. From a subsequent measurement standpoint, it seems that an approach of updating based on fair value each period would be reasonable although this would be more time-consuming. Alternatively, a simpler approach for subsequent measurement would be to periodically test for impairment along with derecognizing the asset as payments are received relating to the contingency.

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?*

We do not believe 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.

The direct costs to fulfill a contract liability are captured through cash expenses (e.g., cost of goods sold, salary expenses, etc.). The use of “wasting” tangible assets, such as fixed assets, is not typically captured by direct expenses. Rather, the use of fixed assets is captured through depreciation based on the economic useful life of the asset. This depreciation expense related to a “wasting” asset also would be considered in the costs to fulfill a contract liability when measuring its fair value. Incorporation of a contributory charge for use of a related fixed asset would double count its economic cost in fulfilling the contract liability.

On the other hand, there are limited direct expenses associated with common intangible assets. For example, the costs to maintain intellectual property (e.g., trademarks, patents, or even unpatented technology or trade secrets), and correspondingly to fulfill a contract liability, are typically insignificant. However, a contributory charge is not required to capture the use of this type of related asset. Trademarks and other intangible assets, such as technology platforms (e.g., SaaS), an assembled workforce, and others, are not considered wasting assets. In other words, the value of this type of asset does not diminish with each use. This is proven through "real life" scenarios in which several parties use these assets simultaneously without affecting their underlying values. For example, a SaaS platform can be licensed to several customers at the same time. There is no impact on the SaaS platform's value regardless of the number of users or uses. The same is true of a trademark, which can be licensed to and used by multiple parties at the same time. If anything, greater use of intangible assets increases their perceived value to the market. Therefore, incorporation of a contributory charge for these types of assets is a mismatch with their actual utility.

Based on the framework outlined above, we believe consideration of a contributory charge for a related asset, which increases the fair value of the liability, is misleading to users of the financial statements since there is no increase in the actual economic cost of fulfilling the contract liability. Further, the inclusion of a contributory charge in the fair value measurement would require use of additional subjective and unobservable inputs, which would increase the cost and complexity of the related fair value analysis. Even if we believed the inclusion of a contributory charge was appropriate from a conceptual standpoint, the additional subjectivity, expense and complexity of the fair value analysis would outweigh the benefits gained by the users of the financial statements. Our perspective is that current best practice fully considers the costs that a market participant would incur to assume the contract liability, which in this case would be settled through the regular operations of the business as opposed to a cash payment or refinancing.

Further, with respect to subjectivity, we note that the Mandatory Performance Framework (MPF) for the Certified in Entity and Intangible Valuations Credential requires the valuation professional to document the following, among other matters, for the valuation of a contract liability:

> *A3.11.4.b. When using the bottom-up approach, clear indication of all the costs necessary to fulfill the contract liability and how the normal profit margin was estimated*
>
> *A3.11.4.c. When using the top-down approach, provision of market data sources and support for each assumption for related selling costs and profits thereon*

Given the introduction of additional unobservable and subjective inputs, we believe financial statement preparers would incur significant additional expenses in meeting the MPF documentation requirements. While compliance with the MPF certainly will help provide visibility to the assumptions regarding the assumed costs and associated profitability on those costs, this also potentially will highlight an additional layer of exposure to unobservable inputs that may not result in a fair value measurement that is more meaningful to the users of the information.

Lastly, it seems a top-down approach to valuing a contract liability would be problematic unless future disclosures provide sufficient visibility to support these currently unobservable inputs.

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?*

There are clear best practices regarding the valuation of a contract liability using the top-down and bottom-up approaches. If the guidance provided notes that contributory charges are not required to be considered in measuring the fair value of a contract liability acquired in a business combination, then we do not believe additional guidance would be required on measuring the fair value of the related assets, as we would expect no change to current practice.

However, if the guidance instead required the inclusion of a contributory charge in valuing a contract liability, significant further guidance regarding the purpose of the contributory charge, the measurement of the contributory charge, and the measurement of the profit on the contributory charge would be needed. Further, this approach also may have implications for the valuation of other assets in a business combination, which also should be considered. Finally, the AICPA currently is developing an audit and valuation guide on business combinations, and we believe it is critical that any significant change to best practices be included in that guide prior to release of the exposure draft.

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?*

We believe the unit of valuation in a business combination should be the remaining activities required to be undertaken by the acquirer within the overall performance obligation, rather than the entire performance obligation. The determination of performance obligations per Topic 606 is based on whether the goods and/or services being provided are both capable of being distinct and distinct within the context of the contract. Part of the purpose of these performance obligation criteria is to ensure that the ultimate timing of revenue recognition is consistent with the transfer of control of the goods and/or services based on the customer's understanding of the intent of the arrangement.

This purpose is different from the purpose of the accounting for a business combination, which is the determination of the fair value of acquired assets and assumed liabilities. As a result, we believe the amount recorded for a contract liability assumed in a business combination should be based on the fair value of only the remaining activities required to be undertaken by the acquirer. If this is the conclusion reached, we believe it should be made clear in any guidance issued.

We think the starting point for determining the fair value of the liability for an assumed revenue contract would be the performance obligation itself. An entity should evaluate the performance obligation to determine whether it is comprised of multiple different goods and/or services. If so, the performance obligations within the revenue contract should be valued based on the remaining activities required to be performed to fulfill each performance obligation. We believe this would appropriately represent the fair value of the acquirer's post-acquisition obligations under the contract.

If instead the unit of valuation is considered to be the entire performance obligation per Topic 606, we do not believe the resulting revenue recognized would be consistent with the acquirer's obligation to perform in the future (e.g., in a symbolic intellectual property license scenario, the amount recorded would consider the granting of the right to use and benefit from symbolic intellectual property that was transferred prior to the acquisition). As a result, we do not believe the performance obligation unit of account used in Topic 606 should be used as the unit of valuation in a business combination under Topic 805.

We appreciate this opportunity to provide feedback on the proposed ITC. We would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Rick Day at 563.888.4017 or Brian H. Marshall at 203.905.5014.

Sincerely,

RSM US LLP

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