



April 29, 2019

Ms. Susan Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference Nos. 2019-200 and 2019-300

Dear Ms. Cospers:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Board's Proposed Accounting Standards Update, Business Combinations (Topic 805): *Revenue from Contracts with Customers-Recognizing an Assumed Liability* (the "Proposed ASU") and the Board's Invitation to Comment, *Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805* (the "ITC"). We acknowledge that some diversity exists in practice regarding an entity's accounting for a contract liability from a contract with a customer within the scope of ASC 606 that is acquired in a business combination. We support the FASB's ongoing efforts to address questions raised by stakeholders regarding how to apply ASC 805, *Business Combinations*, to a contract with a customer acquired in a business combination after the acquirer has adopted ASC 606.

While we support applying the concept of a performance obligation to determine whether a contract liability is recognized in a business combination, without providing additional guidance on the measurement of that obligation we believe it is preferable to retain current practice for several reasons. Consistent with current practice under ASC 605, we believe that in a business combination, the measurement of the revenue contract-related liability should reflect the estimated cash outflows for an obligation that an acquirer has assumed in connection with the arrangement. This approach is aligned with how market participants determine the purchase price. Acquirers do not ascribe value to assets and liabilities that do not have associated future cash flows. For example, in the case of a software license, the licensor typically assumes an obligation to incur cash outflows related to bug fixes and accordingly there would be a revenue contract-related liability for these cash outflows. Whereas in the case of an out-license of a brand, there may not be any cash outflows other than those related to patent defense and accordingly there would not be a revenue contract-related liability. Further, the measurement of liabilities related to acquired revenue arrangements should not change merely as a result of a change in the accounting model from ASC 605 to ASC 606 given that the cash flows associated with fulfilling performance obligations in a revenue contract have not changed.

We are also concerned with the unintended consequences of finalizing the Proposed ASU without addressing the recognition and measurement issues raised by the ITC. These issues would, in our view, require the Board to provide significant additional guidance, including valuation guidance beyond that currently found in ASC 805 and ASC 820. Furthermore, while the objective of recognizing the same amount of revenue regardless of whether the cash is collected before or after the business combination has a certain appeal, we do not believe that objective is achievable without significantly expanding the scope of the project beyond addressing the recognition and measurement of the assumed revenue contract-related liability.

While we believe that a revenue contract-related liability should be measured consistent with current practice, if the Board elects to move forward with the Proposed ASU as written, we believe the scope should be limited to revenue contract-related liabilities associated with symbolic IP because ASC 606 prescribes a specific model for symbolic IP. This would minimize the implementation issues and costs for most preparers. In addition, it would minimize divergence with IFRS on business combinations.



Please find our detailed comments on the ITC in the Appendix to this letter. We would be pleased to discuss our comments or to answer any questions that the FASB staff or the Board may have. Please do not hesitate to contact David Schmid (973-236-7247) or Andreas Ohl (646-229-9751) regarding our submission.

Sincerely,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP



Appendix

The discussion below includes our feedback on the ITC. It addresses many, but not all, of the Board's questions raised in the ITC while providing further considerations for the Board with respect to various approaches.

I. We support a continuation of current practice

ASC 805 does not provide guidance specific to the recognition and measurement of liabilities that arise from revenue contracts with customers in a business combination. However, based on our outreach, we believe that most companies are currently recording revenue contract-related liabilities based on the estimated cash outflows related to the obligation assumed.

In our view, there are several reasons to maintain current practice.

- In many industries, revenue contract-related liabilities do not exist or are not significant. Further, we see revenue contract-related liabilities most often in the technology industry, where we believe there is not significant diversity in practice. Based on our discussions with clients, for software license contracts, estimated cash outflows related to the revenue contract-related liability include those related to bug fixes and upgrades. For brand license contracts, estimated cash outflows are generally de minimis.
- The underlying economics related to revenue contract liabilities assumed in a business combination did not change as a result of ASC 606. Specifically, under current practice, the assets and liabilities recorded are consistent with what the acquirer paid for and the cash flows included in their deal model. These models are subject to the acquirer's internal controls and form the basis for the purchase price allocation.
- Cash flows are not impacted by the adoption of ASC 606. Accordingly, fair value should be the same before and after adoption.
- ASC 606 did not amend ASC 805.
- We believe there are a number of operational challenges with recording an amount related to a revenue contract-related liability based on the method described in the ITC. We address some of these in section IV.
- Any change to the standards have a cost to implement that should be weighed against the benefits of the change.
- Currently, ASC 805 is generally aligned with IFRS.

II. Limit the scope of the amendment to symbolic IP

If the Board determines that moving forward with the proposals in the Proposed ASU and ITC is appropriate, we believe the scope of the amendments should be limited to licenses of symbolic IP. We believe this is where diversity in practice may arise due to the new guidance in ASC 606 related to the recognition of these arrangements. Specifically, ASC 606 requires recognition of revenue over time for a license of symbolic IP even though there is typically no further cash outflows required by the licensor after the rights are transferred. There are also a number of issues that would need to be addressed in the guidance to avoid creating significant diversity in practice.

We believe that the Proposed ASU should explicitly scope in both exclusive and non-exclusive symbolic IP licenses and address whether the treatment of the two should be the same. For example, many symbolic IP licenses include restrictions of time, geographical region, or use. This distinction will typically have a significant impact on cash flows an acquirer expects to receive from the acquired IP, the price paid and the measurement of the related intangible assets. Accordingly, the fair value of the revenue contract-related liability may not be the same for an exclusive and non-exclusive out-license executed by the acquiree prior to the acquisition. Further, this will likely mean that additional guidance is needed regarding the measurement of the related IP asset.



We also believe the ITC should address perpetual licenses (i.e., in substance sales). For example, we do not believe that an entity should recognize a revenue contract-related liability for an exclusive perpetual royalty free arrangement that has been out-licensed prior to a business combination. In this case, the acquirer's deal models typically do not contemplate any future cash flows associated with the licensing arrangement and therefore the economics (or lack thereof) of that arrangement in the business combination are not reflected in the fair value of the net assets acquired. Enabling an acquirer to record a revenue contract-related liability as a result of its business combination in this scenario in effect allows the entity to "buy" revenue. There would also be cost benefit considerations as these licenses may have been entered into decades before the business combination. Identifying and valuing these dated transactions would likely be time consuming and of limited relevance to users of financial statements.

Symbolic IP often appreciates in value over time. Accordingly, the value of the IP could be meaningfully higher at the date of the business combination than at the date the contract was entered into. The ITC should address if the revenue contract-related liability can be recorded at a higher current value, in line with higher asset values, thus resulting in revenue in excess of the amount provided for in the original contract.

Finally, we believe that the ITC should address revenue agreements that include variable consideration and financing components. The measurement of purchase price and the fair value of inventory and intangible assets will be based on expected cash flows and thus include expected variable consideration. Due to the limitations on recognizing variable consideration upfront in ASC 606, there may be differences in how much variable consideration is reflected in the assets and revenue contract-related liability acquired. It is unclear how these differences would impact the mechanics of the examples in the ITC.

III. Considerations around scoping deferred revenue out of the fair value measurement requirements of ASC 805

We understand that some preparers support scoping revenue contract-related liabilities out of the fair value measurement requirements of ASC 805 if the driving principle is to not have the timing and amount of revenue recognized be impacted by an acquisition. The acquirer would carry over the contract liability amounts recorded by the acquiree (assuming these amounts were correct under ASC 606). While this approach would appear simpler, we do not think this is an optimal solution as this would be inconsistent with the principles underlying ASC 805. In addition, we believe there would be challenges and potentially unintended consequences because revenue is a key input into the cash flow models used to value most other assets.

IV. Specific comments on the ITC

We have identified a number of operational issues with the proposals in the ITC. The scenarios included in the ITC are simplified for illustrative purposes and reflect a fixed amount of consideration in exchange for a fixed number of services with a relatively short period of performance. However, in practice, revenue arrangements have many more variables and are inherently more complex. For example, contract consideration may include variable consideration, a significant financing component, noncash consideration, or amounts payable to the customer. In the absence of guidance that addresses a number of the more complex considerations, as discussed further below, we reasonably expect that issuing this guidance could result in significantly more diversity in practice than exists today.

Nature of identifiable asset

The examples in the ITC describe an identifiable asset that would be recorded by the acquirer in order to recognize a consistent amount of revenue regardless of the payment terms. We believe that the unique nature of the asset would result in significant diversity in practice absent further guidance. We considered the measurement principle described in ASC 805 and whether the asset



described in the ITC meets the definition of an identifiable asset acquired in a business combination. We considered whether the asset most closely reflects contract costs, a contract asset, a financial asset or an intangible asset. Costs to obtain or fulfill a contract that meet certain criteria are an asset under ASC 606 and are amortized on a systematic basis consistent with the pattern of the transfer of the goods or services to which the asset relates. Contract assets, as defined in ASC 606, are an entity's right to future consideration in exchange for goods or services that have been transferred. Financial assets, as defined in ASC 860, include cash, or generally provide an entity with the right to receive cash or exchange other financial instruments, or evidence of ownership in an entity. Intangible assets are those that lack physical substance. In determining whether an identifiable intangible asset should be recognized separate from goodwill under ASC 805, the acquirer should evaluate whether the asset meets either the contractual-legal or separability criteria. If the asset represents costs to obtain or fulfill a contract, the ITC does not contemplate the amortization of such amounts on a systematic basis in accordance with ASC 606; rather, the amount is relieved upon receipt of cash. This asset does not appear to meet the definition of a contract asset as no goods or services have been transferred. It does not appear to be a financial asset as there is no right to receive cash or another financial asset. It also does not appear to meet the requirements in ASC 805 to qualify as a separable intangible asset. Without clarity on what this asset represents, questions arise, including the proper classification in the balance sheet, which impairment model to use and which presentation and disclosure standard to apply.

Subsequent recognition and measurement

Once the Board determines the nature of the identifiable asset that has been proposed, we believe the Board would have to include guidance on the subsequent recognition and measurement of such assets. Initial recognition without an explicit impairment or amortization model could lead to significant diversity in practice. In addition, many contracts include provisions that could trigger measurement changes to revenue in the future. The Board would need to include guidance on the treatment of changes in estimates and how contract modifications impact the identifiable asset.

Impact to other identifiable assets

The ITC assumes that when the identifiable asset is recorded, there is a dollar-for-dollar reduction in a customer-related intangible asset. However, this may not be the case in practice, as some of the contract value may be captured in inventory, through the step up in value in situations when the obligation is in part to deliver goods, and in tangible or intangible assets such as a brand or technology asset. Adjusting the model to fair value inventory to take into account the revenue contract-related liability could be challenging in practice. In the case of a brand, it may have an indefinite life and thus will not be amortized over the period that the liability is recognized as revenue. This is especially likely to be true for licenses of symbolic IP.

In the case of symbolic IP that the acquiree previously out-licensed on a royalty free basis, additional value must be attributed to the IP intangible asset in the amount of the foregone royalty income (otherwise goodwill would change). This would be similar to the initial recognition of a liability for an asset retirement obligation. If this is not the Board's intent, then the standard should be clear on this point. Assuming the intangible would be presented on a gross basis, this incremental value is essentially the cost of not being able to license the IP to others (or perhaps use it internally). For example, assume the target in a business combination owned Brand X and five years earlier out-licensed the rights to Brand X in Europe on a royalty free basis. One approach that the acquirer could take in the opening balance sheet would be to record the fair value of Brand X as the sum of a valuation based on the cash flows outside of Europe and the fair value of the deferred revenue related to the European rights.

It should be noted that the fair value of the revenue contract-related liability would reflect the value at the acquisition date, which would likely be different than the amount recorded in target's books due to changes in market conditions in the intervening five years (i.e., fair value could be substantially higher). Another consideration is that if Brand X is indefinite lived, then on an



ongoing basis, the current value of this liability would need to be factored into the fair value of the IP in applying the impairment test in ASC 350. Since indefinite lived intangibles are not amortized, there would be no amortization expense related to the revenue contract-related liability as it is recognized as revenue. This would essentially allow for the buying of profits by acquiring a business.

Measuring the consideration

The ITC examples assume a fixed amount of consideration. We are unclear how the model would work in the event that the contract included variable consideration. Specifically, the fair value of intangible assets such as customer relationships and IP include the amounts of variable consideration that a market participant would expect to receive in the future. On the other hand, ASC 606 provides two methods for estimating variable consideration and the guidance directs entities to use the method that better predicts the amount of cash that they expect to be entitled to.

Measurement of tangible vs. intangible assets

There is currently a difference in practice as it relates to the valuation of real estate and intangibles. Acquired tangible assets such as buildings that have in-place leases are typically recorded on an unencumbered basis (i.e., in-place leases do not impact the value of the asset). Any unfavorable lease agreement (e.g., leases prepaid prior to the acquisition) is recorded as a liability. Intangible assets are typically recorded on a net basis (i.e., only the economic interest acquired is recorded). One of the reasons for this is that buildings are typically valued on the basis of sales of comparable assets or on a replacement cost approach. This means that the asset value is derived independent of the actual cash flows generated by the in-place leases. As a result, obtaining a gross value is a part of the valuation process. Intangible assets, on the other hand, are typically valued using a discounted cash flow model. The cash flow forecast typically comes from the deal model used to price the acquisition. This model will only include cash flows related to the economic interest acquired. While gross value can certainly be derived, it would require extra cost and effort and would be a change in practice for valuing intangible assets.

Determining contributory charges

In our discussions with clients, some raised the question of whether the view that the fair value of a performance obligation involving symbolic IP does not include the cost of acquiring the IP implies that the fair value of performing a service would exclude the cost of using tangible assets. For example, in valuing a revenue contract-related liability for a contract to construct an asset, would the bottoms up approach include the cost of renting (or a depreciation charge for owned) construction equipment? In our experience, such charges have rightfully been included. We see nothing in ASC 606 that would change this practice. If it is clear that a market participant would use similar assets to fulfill the obligation, then the related cost should be considered in determining the fair value of the obligation. This is different than in the case of symbolic IP, in which the target would not have incurred additional cash outflows once the IP was made available.

Contract by contract evaluation

Applying the model in the ITC would seem to require a contract by contract calculation in acquisition accounting and does not appear to offer entities the ability to apply a portfolio approach. In practice, customer intangibles and revenue contract-related liabilities are measured at an aggregated level. Applying the mechanics of the model described in the ITC at the contract level could present challenges for entities that have not separately identified and tracked such amounts historically and would require significant effort to do so even if this model was only applied prospectively. Entities applying the proposed model would need to identify and implement individual control activities to address the risk of material misstatement associated with this proposed guidance. We believe this could result in considerable additional cost and would conflict with the simplification efforts the Board continues to undertake.