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April 30, 2019

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

File Reference No. 2019-200
Re: Invitation to Comment, *Measurement and Other Topics Related to Revenue Contracts With Customers Under Topic 805*

Dear Ms. Cosper:

Deloitte & Touche LLP appreciates the opportunity to provide feedback on the FASB's Invitation to Comment (ITC), *Measurement and Other Topics Related to Revenue Contracts With Customers Under Topic 805.*

We support the FASB's efforts to address questions related to the measurement of revenue contracts under ASC 805 that are acquired as part of a business combination. We believe that if the Board finalizes its proposed Accounting Standards Update (ASU) *Business Combinations (Topic 805), Revenue From Contracts With Customers — Recognizing an Assumed Liability* without also providing measurement guidance for revenue contracts, there is likely to be diversity in practice.

We have considered the alternatives presented in the ITC and, conceptually, we agree that the amount of revenue the acquirer recognizes related to an acquired revenue contract generally should not be affected by the timing of the payments in a contract. However, we recommend that the Board describe the objective differently. The objective should be to measure the fair value of the contractual rights and obligations in an acquired revenue contract combined as a single unit of account, either as an asset or a liability. We believe that this alternative would be simpler and more consistent with the principles in ASC 606.

The appendix contains our responses to the ITC's questions for respondents.

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Deloitte & Touche LLP appreciates the opportunity to comment on the ITC. If you have any questions, please contact Michael Morrissey at (203) 761-3630.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

Appendix A
Deloitte & Touche LLP
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 believe that the amount of revenue the acquirer recognizes from an acquired revenue contract after an acquisition should equal the fair value of the assumed performance obligation. Conceptually, we agree that that amount generally should not be affected by the timing of the payments in a contract. However, we believe that the amount of revenue recognized could be affected by the time value of money.

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)?

If the objective is for the acquirer to recognize the same amount of revenue regardless of payment terms, outcome B in each of the scenarios presented in the ITC achieves that objective. However, as described in our response to question 1.4, we are unsure of what that separate identifiable asset would represent and whether it would meet the definition of an asset on its own.

We recommend that the Board consider describing the objective differently. We believe that the objective should be to measure the fair value of the contractual rights and obligations in an acquired revenue contract. That fair value should incorporate both the fair value of the remaining performance obligations associated with the contract and the fair value of the right to receive consideration in the future. We believe that this alternative would be simpler and more consistent with the principles in ASC 606.

ASC 606-10-45-1 states that "[w]hen either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable." Paragraph BC317 of the Basis for Conclusions of ASU 2014-09 provides the Board's rationale for this conclusion:

> The Boards decided that the remaining rights and performance obligations in a contract should be accounted for and presented on a net basis, as either a contract asset or a contract liability. The Boards noted that the rights and obligations in a contract with a customer are interdependent—the right to receive consideration from a customer depends on the entity's performance and, similarly, the entity performs only as long as the customer continues to pay. The Boards decided that those interdependencies are best reflected by accounting and presenting on a net basis the remaining rights and obligations in the statement of financial position.

We believe that the fair value of an acquired revenue contract should be presented as a single unit of account (either as an asset or a liability) that contemplates both the contractual rights and obligations in the contract, in a manner consistent with the presentation requirement under ASC 606. For example, we assumed the same facts as described in scenario 2 in the ITC. (The examples in the ITC (1) do not include considerations about other intangible assets, (2) assume all contracts are priced at market, and (3) ignore income taxes, credit, and discounting for simplicity. We have done the same to illustrate our view; however, we believe that the Board should address those considerations to ensure consistent application.)

We believe that the amount recognized in scenario 2 for the contract in the acquirer's acquisition accounting should be a $400 contract liability, because if the acquirer were to transfer that contract to a third party in an orderly transaction, the counterparty would require $400 to assume the contract (i.e., the fair value of the performance obligation of $900 is offset by the $500 in consideration Company A/B expects to receive in the future). Accordingly, A/B would recognize a $400 contract liability in its acquisition accounting.

During year 1, A/B would recognize $450 in revenue (assuming ratable recognition of the $900 performance obligation over the two-year contract period). Recognizing $450 in revenue would result in the acquired contract's being in a net $50 contract asset position at the end of year 1.

At the beginning of year 2, A/B's receipt of $500 in consideration would result in the acquired contract's then being in a net $450 contract liability position. Then, throughout year 2, A/B would recognize $450 in revenue, and there would be no contract asset or liability remaining at the end of year 2.

In this example, we believe that part of the consideration A/B expects to collect in year 2 affects the fair value of the assumed contract but should not affect the revenue recognized for performance completed in year 1. That is, from the acquisition date through the end of year 2, the total revenue to be recognized in the contract is $900. Because the contract contains a single performance obligation satisfied ratably over time, the acquisition-date fair value of the assumed performance obligation (i.e., $900) should be allocated equally to years 1 and 2. Because the example assumes that the $500 is not billable until the beginning of year 2, at the end of year 1, $50 represents A/B's unbilled right to consideration in exchange for services provided in year 1. That $50 would meet the definition of a contract asset and would be recognized as A/B performs under the assumed contract rather than as of the acquisition date.

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 to measure the fair value of a revenue contract, an acquirer must measure both the fair value of the remaining performance obligations and the fair value of the consideration to be received in the future. The alternative we propose would be simpler than identifying and separately tracking a separate asset that relates to the assumed contract.

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?

If the Board decides that an acquirer should recognize a separate identifiable asset, we believe that the identifiable asset should be classified as a contract asset because we believe that the asset should be derecognized as a contract asset rather than as an intangible asset. However, the separate identifiable asset may not meet the definition of a contract asset at the acquisition date. The ASC master glossary defines a contract asset as "[a]n 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)." As of the acquisition date, the acquirer has not yet transferred any goods or services to the customer. Therefore, the identifiable asset does not by itself seem to be a contract asset to the acquirer.

We also considered whether the separate identifiable asset should be classified as an intangible asset; for example, a customer-related or a contract-based intangible asset. However, we do not believe that the identifiable asset should be derecognized like an intangible asset. ASC 350-30-35-6 states that intangible assets are derecognized through an amortization method that reflects "the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up." Often, intangible assets are amortized ratably over the period of benefit. There is also diversity in the classification of amortization expense. We believe that to achieve the objective of recognizing the same amount of revenue regardless of payment terms, an entity would not amortize the intangible asset ratably and would present the amortization as contra revenue. For example, consider scenario 2 in the ITC. To recognize $450 in revenue in year 2, an entity would not amortize the intangible asset in year 1 but would only derecognize it in year 2 as contra revenue. This is not the typical derecognition pattern for an intangible asset. Further, if the identifiable asset is not recognized separately but as part of a larger intangible asset, the intangible asset could be amortized over a period that is different from the contract term.

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?

Regardless of whether an acquirer recognizes a separate identifiable asset, as proposed in outcome B in each of the scenarios in the ITC, or a net contract asset or liability, as we recommend, we believe that recognition of a revenue contract at fair value would capture order or production backlog intangible assets.

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

We believe that regardless of the approach, practitioners would benefit from subsequent measurement guidance to reduce the diversity in practice that might otherwise occur.

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

As described in our response to question 1.2, we suggest that the Board should describe the objective as the measurement of the fair value of an acquired revenue contract, which would incorporate the measurement of both the fair value of the rights and remaining performance obligations embodied in the contract. We believe that the Board should develop examples that would improve the usefulness and comparability of the information provided to users. In addition, we believe that the examples should include fact patterns such as when a revenue contract is for the sale of a functional versus symbolic license or contains a significant financing component, variable consideration, and sales and usage-based royalties. The examples should also illustrate situations in which other assets or liabilities related to an acquired contract might be recognized (e.g., an asset for a noncontractual customer relationship).

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 believe that contingencies related to the amount of consideration to be received will affect the overall fair value of an acquired revenue contract.

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?

Determining the fair value of a right to receive consideration related to sales and usage-based royalties can be particularly challenging, especially when the right is for a long period or perpetual. As a result, we would support the Board's allowing an exception for sales and usage-based royalties.

Although we believe that the determination of the fair value of variable consideration may also pose challenges, we do not believe that the Board should provide an exception under ASC 805.

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?

As described in our response to question 1.2, we do not believe that an acquirer should recognize a separate identifiable asset.

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 believe that it is appropriate for entities to include a contributory charge in measuring the fair value of the performance obligation in an acquired revenue contract. We understand that this may be a change to practice, particularly when the related asset is an intangible asset (e.g., intellectual property) rather than a tangible asset. However, we could not determine the conceptual basis for treating tangible versus intangible assets differently in the assessment of whether a contributory asset charge should be included in the measurement of the fair value of an assumed performance obligation.

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?

We believe that the Board should provide guidance on how to measure the fair value of related assets to reduce the diversity in practice that might otherwise occur. Specifically, we suggest that the Board include an example of how a contributory asset charge may be used to develop a cost-based measure of fair value for an assumed performance obligation related to a symbolic license.

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 that the unit of account should be an individual contract with a customer under ASC 805, noting that in practice entities may value pools of similar contracts in aggregate rather than individually. We also believe that because of the fair value measurement requirement under ASC 805, an acquirer might recognize additional assets or liabilities associated with a revenue contract under ASC 805 than it might under ASC 606 (e.g., noncontractual customer relationships).