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April 30, 2019

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

Via Email to [director@fasb.org](mailto:director@fasb.org)

**Re: File reference No. 2019-200**

Dear Ms. Cospers:

Grant Thornton LLP appreciates the opportunity to respond to the Invitation to Comment, *Measurement and Other Topics Related to Revenue Contracts with Customer under Topic 805* (ITC).

We are wholly sympathetic to the difficulties that were identified during the EITF's deliberations surrounding Issue No. 18-A and support the Board and staff efforts to resolve how to measure acquiree deferred revenue in light of the advent of Topic 606. This is not an easy task.

Topic 805 focuses on the assets acquired and obligations assumed. One might say that the balance sheet has a primary position in the accounting, while the acquirer's subsequent accounting is secondary. A shift in direction toward the perspective of the acquirer's revenue would seem to elevate 'day two' accounting, at least with regard to revenue.

Our comments in this letter are predicated on the presumption that the Board most likely will amend Topic 805 to embrace a Topic 606 performance obligation perspective in accounting for customer contracts acquired. We believe, however, that the current guidance based on legal obligations assumed is operational and we would support not amending Topic 805 if the Board ultimately decides not to amend it. Current guidance works well, even though entities in some industries or sectors wherein cash from customers is front- or back-ended might believe their post-acquisition results do not reflect their efforts. The current guidance has been used for over fifteen years and need not be replaced.

One subject not raised in the ITC is whether an acquirer should also recognize assets related to the acquiree's costs to obtain a contract and deferred fulfillment costs. We have had this question in practice and suggest that the Board consider whether some of these assets should be recognized in purchase accounting.

Our responses to select Questions for Respondents follow. We did not address Question 1.7 that is directed to users of financial statements.

**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 should affect the subsequent amount of revenue recognized by the acquirer. In particular, we believe the timing of cash flows does not affect the level of effort that the acquirer must render in order to satisfy a performance obligation. We did not identify accounting outcomes applied in practice for different payment term scenarios that are not illustrated. We recognize that removing the timing of payments from the amount of revenue the acquirer recognizes will represent a change in practice, but we would be comfortable with the change because of the principle-based guidance in Topic 606.

**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 that an acquirer would need to recognize separate identifiable assets in order for the mechanics of the accounting to work that remove the impact of payment timing from revenue after acquisition. The scenarios appropriately illustrate those mechanics when that timing occurs as laid out in the four scenarios. We note that the issues in Questions 1.8 through 1.10 concerning contingencies and sales- and usage-based royalties are very important because Topic 606 did not contemplate how the constraint and royalties exception would operate in a business combination if the acquisition occurred part way through fulfillment. Another approach might be carrying over the acquiree's contract assets and liabilities, after the acquirer validates the accounting, but that accounting would not eliminate the post-acquisition impact of variable consideration and the royalties exception.

**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?**

Under Topic 606, entities must identify and track the fulfillment of individual performance obligations. Therefore, if Topic 805 amendments were to require a performance obligation approach to customer contracts acquired, then acquirers would need to evaluate and establish contract assets as of the acquisition date by reference to individual performance obligations. Although this might require more effort when compared with current guidance, we believe the recognition guidance would be operational, although the incremental effort could be significant when there are many customer contracts. We do not believe that an alternative, such as making a broad estimate of identifiable assets as a whole or by groups of contracts without specific contract identification, would be operational because the assets subsequently need to be tracked along with the specific related performance obligations fulfilled post-acquisition.

**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 that the best characterization of the asset would be a contract asset. This is because the asset is simply a means to achieve the desired post-combination revenue amounts when cash flow timing does not equate to the deferred revenue at the acquisition date.

As we noted in our response to Question 1.3, we believe the unit of account should be based on the individual contract so that the derecognition of the asset can follow the related revenue recognition for the assumed contract liability. A portfolio approach may be acceptable if the facts and circumstances of the contracts acquired are consistent with the portfolio guidance in Topic 606.

**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 for most acquisitions that there would continue to be a recognized backlog because only a portion of orders or production would meet the fact pattern of recognizing contract liabilities and assets at the acquisition date. That is, a customer order may be in hand, but fulfillment has not commenced and no cash has been received or is due. In that case, we would expect a small contract asset if the fair value of the performance obligation is reduced from the contract amount because of selling effort as discussed in the scenarios. In other words, what is not captured and recognized in the contract asset as of acquisition would be considered in valuing an order or production backlog. In a way, the contract asset is a carved-out portion of the backlog.

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

We believe that additional guidance would be needed, specifically if contingent consideration were included in the purchase price as raised in Questions 1.8 through 1.10. Otherwise, it seems that the identifiable asset would unwind as the related performance obligation is recognized and cash inflows are received post-acquisition.

**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?**

This is a challenging issue in light of the idea of removing the impact of cash flow timing on an acquirer's revenue. That is, should an acquirer recognize the impact of contingencies in its post-acquisition revenue or should the acquirer seek to anticipate



or otherwise estimate the impact and establish contract assets and liabilities in purchase accounting?

We believe that other than for variable consideration and sales- or usage-based royalties, as discussed in Question 1.9, an acquirer consistently should account for all acquired contingencies in the same manner by applying Topic 450. If an acquirer identifies a contingency other than variable consideration or royalties that nonetheless relates to customer contracts and meets the recognition criteria, that amount should be recognized. Subsequent adjustments of that contingency could impact revenue. We were unable to identify an example of such a contingency, but note that this is similar to the accounting for estimated sales returns. For example, a returns liability would be recognized at the acquisition date. If, in the future, there is an adjustment related to pre-acquisition products sold by the acquiree that is not a measurement period adjustment, the adjustment would flow through post-acquisition revenue.

**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?**

Yes, an acquirer should continue to apply the constraints. An acquirer continuing to apply the constraints on royalties and variable consideration would seem to contradict the notion that timing of payment should not impact revenue recognition. But this approach may be the best way forward: Topic 606 prescribes the accounting for these constraints and we do not see justification for an acquirer to handle them any differently. That is, the acquirer would recognize the revenue impact as royalties are received and variable consideration estimates are adjusted, even though it might recognize amounts for performance obligations which have been satisfied before the acquisition. We do not believe that Topic 805 should require recognizing variable consideration and royalties differently than Topic 606 would require them to be recognized absent a business combination.

We would support Topic 805 addressing the estimated transaction price as of the acquisition date (constrained and not anticipating royalties subject to the royalties exception). This would capture the necessary contract accounts in business combination accounting to neutralize some of the impact of payment timing, but not violating the constraints. As such, the resolution of the variable consideration and royalties (and related cash flows) would be reflected in the post-acquisition income statement, without the need to attribute amounts to the acquiree's activities prior to acquisition. This might not achieve the conceptual goal set out to neutralize the impact of payment timing in all cases, but we believe it would be better than seeking to anticipate future variable consideration and royalties in purchase accounting.

**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?**



We stated in our response to Question 1.9 that we believe an acquirer should continue to apply the constraints; that is, an asset should not be recognized for either variable consideration or sales- or usage-based royalties. Should, however, the Board require recognition of an asset(s) for contingencies, we struggle with where to charge subsequent adjustments for reasons other than cash collections, if not adjusted to revenue. Say, for instance, that the predicted sales-based royalties fall short of the estimated amounts that underlie the asset recognized at the acquisition date and the asset later is impaired. Because the asset is not a receivable, there is no bad debt charge. Similarly, there does not seem to be a basis to characterize the impairment charge as an operating expense or cost of sales. This seems to point to creating a new line item in the income statement—likely below gross margin, but maybe not—so as to preserve the importance of the acquirer’s revenue or margin. Perhaps it could be a form of amortization charge, or at least classified in the same way as amortization or impairment of intangible assets. That might not be the best means of derecognition, but it might be acceptable for this unusual asset being considered.

Perhaps a better alternative would be to have an exception to the thought that derecognition should not impact the acquirer’s subsequent revenue. This alternative hinges somewhat on the theory that if contingent cash inflows that exceed the amount estimated and recognized as an asset at acquisition increase the acquirer’s revenue, then shortfalls in those cash inflows should be charged to revenue. This might be a way forward.

At worst, the asset in essence is somewhat of an orphan if the intent is to capture the contingent amounts of revenue at acquisition, but not charge revenue for its derecognition under any circumstances. We believe the Board should consider the most practical way forward, and that well could be derecognizing these assets against revenue, even though that is inconsistent with the notion in the ITC to give priority to the acquirer’s revenue post-acquisition. We say this in light of the variable consideration constraint and the sales- and usage-based royalties exception guidance that does not necessarily track with the transfer of goods or services.

**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 a contributory charge should be included in the measurement of the fair value of a contract liability in any circumstance in which a market participant would need to rent (as with the backhoe), license (as with IP, even if the license period were short and akin to a short-term rental), or otherwise have access to an asset in order to fulfill the performance obligation. With some hesitation primarily because of the significant judgments and estimates that entities would need to make and also the risk of abuse, we believe that the spirit of a market participant approach is that a participant would include the cost of access to the asset needed to fulfill the obligation. This would be a significant change to current practice, and we expressed our view in the opening of this letter that we would support not changing the current guidance on recognizing legal obligations.



We considered the nature of the asset and whether there should be a different approach to valuing a service contract (that is, one requiring the backhoe) versus symbolic IP, hosting arrangements, and indefeasible right-of-use arrangements as noted in ITC paragraph 2.15. We struggled with the fact that there are known future activities requiring the use of an asset such as the backhoe in some contracts, but few, if any, substantive future activities for those contracts in which the customer already took delivery of the asset prior to the business combination (for example, symbolic IP).

We theorized about a market participant's reaction if it were required to remediate a situation in which licensed symbolic IP previously delivered to a customer somehow became corrupted or something happened such that the customer needed a new copy of the IP. We do not believe the current legal obligation approach to deferred revenue contemplates this type of contingency; however, a market participant approach perhaps would. That is, if a market participant understood that it assumed that kind of contingency, it would place a higher value on the obligation, thus supporting a contributory charge. Under the alternative view that excludes a contributory charge, the substance would be as if the market participant has assumed the part of the obligation related to direct support of the IP, but not the contingency described. In other words, there would be an inconsistent treatment of a market participant needing to have access to the asset, depending on its nature. We landed on the view that there instead should be consistency, and the contributory charge is a reasonable approach to achieving that outcome.

The value attributed to the contributory charge, however, in the context of a contingent need for the market participant to access the IP, as described above, may be much less than the value of what might be called a full license of the asset. That is, a market participant might approach valuation based on a probability assessment of whether the contingency will occur. See our response to Question 2.2 below.

**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 existing guidance in Topic 820, *Fair Value Measurement*, is sufficient, but we suggest that the Board consider whether additional guidance is warranted to address valuation when a contingency exists, such as the contingency we noted in our response to Question 2.1. That is, some might approach the valuation with the presumption that a broad (and costly) license of IP is necessary, resulting in a large contributory charge, while others might value the obligation in a manner (less costly) that reflects the contingent nature of part of the obligation.

For example, assume that the fair value of an unrestricted license of symbolic IP is \$1 million and a limited-use license is \$10,000. The limitations specified in the limited-use license are that the market participant will have access to the IP only if enumerated parties (customers) that already have possession of the IP for some reason need a replacement copy. The market participant may not utilize the license in any other manner. The question is whether the fair value of the assumed contract liability would be based on \$1 million or \$10,000. In a way, this is analogous to the market



participant buying a backhoe versus renting one, and the lower \$10,000 amount reasonably could be an input to the fair value of the contract liability, just as the backhoe rental cost would be.

**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?**

Yes. We support the second view expressed in ITC paragraph 2.38 that the unit of account to establish customer contract assets and liabilities should be the performance obligations to which they relate. We hold that view because the direction being taken in the proposed amendments on recognizing assumed liabilities from customer contracts appears to be acquirer-revenue centric. That is, if the objective is to establish accounts that facilitate an acquirer's 'day two' and ongoing revenue recognition (and the derecognition of contract assets and liabilities), the amounts recognized at the acquisition date should properly align with the various performance obligations themselves.

We observe, however, that Question 2.3 is broadly worded and asks if the performance obligation should be the unit of valuation under Topic 805. We do not believe the performance obligation should be the unit of account for assets and liabilities beyond those involved with contract assets and liabilities that are under discussion. Customer-related intangible assets, for example, broadly look at projected cash flows and not the revenue recognition pattern of revenue per se, although, ultimately, there is a correlation between cash flows and revenue over the course of time.

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We would be pleased to discuss our comments with you. If you have any questions, please feel free to contact Douglas J. Reynolds, Partner, at 617.848.4877 or [doug.reynolds@us.gt.com](mailto:doug.reynolds@us.gt.com).

Sincerely,

/s/ Grant Thornton LLP