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April 30, 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

Re: ITC Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805

Dear Ms. Cosper:

Connor Group, Inc. is pleased to provide our comments on the FASB's Invitation to Comment (ITC) – *Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805.* Connor Group was founded in 2005 and is a technical accounting advisory firm built of Big 4 alumni and industry executives. We currently have over 250 accounting professionals and over 600 clients and specialize in helping our clients solve complex technical accounting issues under both U.S. GAAP and IFRS. Our clients represent industries such as technology, software, internet, cloud services, life sciences and manufacturing, amongst others. Many of our clients are emerging growth mid-cap or small-cap public entities, companies aspiring to become public in the near future, or high-growth private companies.

We agree with the Board's view that payment terms should not affect the subsequent amount of revenue recognized by the acquirer. However, to achieve this outcome, the most practical approach in our mind is to include a scope exception under Topic 805 which allows entities to account for certain assets and liabilities arising from revenue contracts (e.g. contract asset, contract liabilities, etc.) in accordance with Topic 606.

Alternatively, if the Board decides against our proposed scope exception approach, then with respect to *Chapter 1 – Payment Terms and Their Effect on the Subsequent Revenue Recognized*, we do not support the addition of guidance to state that payment terms should not affect the subsequent amount of revenue recognized by the acquirer. We do not believe the costs associated with the proposal could be justified by the benefits. With respect to *Chapter 2 – Costs to Fulfill a Performance Obligation in Measuring the Fair Value of a Contract Liability for a Revenue Contract under Topic 805,* we believe a contributory charge should be included in all

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circumstances where an asset is used in satisfying an assumed contract liability regardless of whether such asset is owned by the acquiring entity after the business combination.

Following are our considerations underlying the above recommendations.

Chapter 1 – Payment Terms and Their Effect on the Subsequent Revenue Recognized

We will first discuss why we do not support the Board's proposed addition of guidance to achieve that payment terms not affect the subsequent amount of revenue recognized by the acquirer. We will then provide the rationale of our proposed scope exception approach.

As discussed above, we agree with the view that payment terms should not affect the subsequent revenue amount by the acquirer on a conceptual level; however, we believe the costs of implementing this proposal are not justified by the benefits. We have identified several potential issues that the proposal might bring about, as follows:

- Acquisition timeline: Based on our experience, entities usually have a tight timeline to complete purchase price allocation. In many cases, acquirors would need to re-do acquiree's revenue accounting during that process. To manage the timeline, accounting teams often focus on ensuring the balance sheet amounts to be accurate by reviewing deferred revenue details and long-term revenue contracts for the purpose of acquisition accounting and leave the review of each revenue contract for subsequent monthly or quarterly closing. Following the proposal in ITC, those entities will have to complete the review of all revenue contracts in order to complete the accounting within a short period of time after the acquisition date. In addition to the shortened timeline, the ITC proposal would likely require preparers to perform a more in-depth assessment of each revenue contract than what is required at present. This is because an asset will be recognized for most executory contracts where there is no contract liability, and a portfolio approach could be challenging to apply as payment terms might vary for each contract.

- Estimation beyond what is required under Topic 606: The proposed approach in the ITC will require entities to make certain significant estimates on the acquisition date that are not required under Topic 606, e.g. (a) amount of sales-based or usage-based royalties entities expect to receive, for which Topic 606 provides specific royalty exceptions; (b) amount to be received for contracts that are eligible for application of as-invoiced practical expedient, etc. Most of such estimates are highly judgmental by nature and might require significant inputs from various business teams. In the context of an acquisition, this estimation and input gathering process could be particularly challenging.

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- Recognition of newly created asset proposed in ITC: To follow on the previous point, once the significant estimates, e.g. future royalty payments, are made, another question then arises as to how to subsequently recognize the assets recorded as a result. This issue is not covered under Topic 606 as sales-based or usage-based royalties in many cases are recognized as the underlying sale or usage occurs. In today's acquisition accounting, a similar asset, e.g. customer contract intangible, is recognized; however, the recognition for that is generally on a straight-line basis. This straight-line recognition would not be appropriate for the newly created asset proposed in ITC because by doing so, subsequent offset to revenue will not match the timing of satisfaction of performance obligations, and as a result, payment terms would still affect the subsequent revenue amount in a way. Therefore, a new framework would need to be established to address the recognition issues for the newly created asset, which further complicates the application of the guidance.

- Impact on intangible assets: Based on the proposal in the ITC, entities will no longer record customer contract ("backlog") intangible assets. This significantly changes today's practices. Customer contract and customer relationship intangible assets are often valued on a combined basis in practice, and private companies can elect not to separate either of them from goodwill. Accordingly, in those situations, the proposal would require significant incremental efforts to evaluate customer contract and customer relationship intangible assets separately.

Separately, we note that the description of the accounting approach proposed in the ITC, "if GAAP were to state that payment terms should not affect the subsequent amount of revenue recognized by the acquirer", in our mind, is difficult to understand and ambiguous. Under the current accounting practices, different revenue amounts would result depending on whether the customer pays the contract consideration all upfront, or all in arrears. From the above description it is not clear whether the "benchmark" revenue amount is determined under the assumption that all consideration is paid up front (prior to delivery of goods and services) or in arrears. From the examples in the ITC, it is clear that payment up front is the "benchmark". However, it is not clear why this should be the "benchmark". A better description for the approach in the ITC may be "if GAAP were to state that revenue recognized by the acquirer should exclude the value of the pre-acquisition selling efforts by the acquired entity", as this appears to be the key driving factor for the adjustments to revenue the ITC approach would bring.

Proposed scope exception approach

While discussing the implications of applying the proposed guidance in ITC, a few team members suggested that inclusion of a scope exception for certain assets and liabilities arising from revenue contracts under Topic 805 would be a more practical solution to achieve the same

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outcome. That is, acquirors will record contract assets and contract liabilities as if the contracts were originated by the acquirors and the acquirors were to apply Topic 606 to such contracts beginning from the acquisition date.

The ITC is seeking for an accounting solution for acquired revenue contracts that comply with both Topic 805 and 606. This is particularly challenging due to the inherent difference in conceptual basis between the two standards. That is, Topic 805 is based on fair value on acquisition date while Topic 606 builds largely upon inputs that are not fair value based, e.g. transaction price negotiated at the contract inception, determination of variable consideration, allocation basis, measure of progress, etc. As a result, the Board's proposed approach of creating an artificial asset in order to marry the two framework brings about both conceptual and practical issues.

In our mind, the solution should be based on which framework between the two would be more appropriate for assessing acquired revenue contracts rather than getting to a middle ground, as conceptual differences will persist with a middle-ground approach. Topic 606 is a comprehensive and complicated framework designed to address all aspects of revenue transactions, e.g. various allocation approaches, change in estimate, modification, exercise of customers' options, etc. If acquisition balances are recorded under Topic 805, which does not align with Topic 606 concepts as discussed above, it is inevitable that complications will arise, and practical application areas will be discovered which are not addressed by either Topic 805 or Topic 606.

Because of those reasons, we believe Topic 606 should be applied to the acquired revenue transactions instead of standard fair-value based acquisition accounting.

If the Board adopts the scope exception, consistent revenue and margins will be achieved for both (a) contracts with the same economics except for payment terms, and (b) contracts executed pre- and post-acquisition. We believe this approach would also significantly reduce implementation time and efforts compared to what is proposed in the ITC, as all entities have to apply Topic 606 after the acquisition regardless.

Additionally, many companies today disclose non-GAAP measures where they reverse the effects of "haircut" on acquired contract liabilities in order to demonstrate "true" margin and operating performance during the short period after the acquisition when the "haircut" is reversed. From this perspective, we anticipate the scope exception approach would result in entities presenting information that are most useful to the users.

Chapter 2 – Costs to Fulfill a Performance Obligation in Measuring the Fair Value of a Contract Liability for a Revenue Contract under Topic 805

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Under our recommended scope exception approach, contract liability is recorded based on the amount determined under Topic 606. However, if the Board decides to retain the proposed approach in the ITC, we believe a contributory charge should be included in measuring the contract liability fair value where an asset, whether owned or leased, is used in satisfying an assumed contract liability. This is because the asset and the contract liability are separate units of account; accordingly, fair value should be determined based on that premise, independent for each unit of account, and derived from a third-party market participant perspective.

We would be pleased to respond to any questions the Board might have regarding our comments.

Sincerely,

Connor Group, Inc.

Accounting Standards and Professional Practice Group