

Proposed Accounting Standards Update

Issued: February 14, 2019
Comments Due: April 30, 2019

Business Combinations (Topic 805)

**Revenue from Contracts with Customers—
Recognizing an Assumed Liability**

a consensus of the FASB Emerging Issues Task Force

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 805 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to “Technical Director, File Reference No. 2019-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until April 30, 2019. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at [Exposure Documents Open for Comment](#)
- Emailing comments to director@fasb.org, File Reference No. 2019-300
- Sending a letter to “Technical Director, File Reference No. 2019-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The FASB is issuing this proposed Update to address the diversity in views about the circumstances in which an entity should recognize a contract liability from a contract with a customer within the scope of Topic 606 (hereinafter referred to as a revenue contract) that is acquired in a business combination. In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (Update 2014-09 or Topic 606, including subsequent Updates), which provides a single comprehensive accounting model on revenue recognition for contracts with customers. After the issuance of Topic 606, stakeholders raised questions about how to apply Topic 805, Business Combinations, to a contract with a customer acquired in a business combination after the acquirer has adopted Topic 606.

Stakeholders have indicated that there are differing views on whether the new concept of a performance obligation defined in Topic 606 should be used to determine whether a contract liability is recognized in a business combination from a revenue contract. Before the adoption date of Topic 606, a liability for deferred revenue was generally recognized in an acquirer's financial statements if it represented a legal obligation. This proposed Update addresses how to determine whether a contract liability is recognized by the acquirer in a business combination from a revenue contract.

In addition, stakeholders have requested that the Board provide additional guidance on measuring contract liabilities from revenue contracts with customers acquired in a business combination. This proposed Update does not address the measurement of those liabilities or other topics related to the accounting for revenue contracts acquired in a business combination. Those topics are discussed in the FASB Invitation to Comment, *Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805*, issued concurrently with this proposed Update. Feedback from the Invitation to Comment could inform Task Force members on the amendments in this proposed Update.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities that enter into a business combination within the scope of Subtopic 805-10 after the adoption of Topic 606.

What Are the Main Provisions?

The amendments in this proposed Update would require that an entity (acquirer) recognize a liability assumed in a business combination from a contract with a customer if that liability represents an unsatisfied performance obligation under Topic 606 for which the acquiree has received consideration (or the amount is due) from the customer.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Currently, GAAP provides overall guidance on when to recognize and how to measure assets and liabilities in a business combination but does not provide guidance specific to liabilities from revenue contracts with customers. The amendments in this proposed Update would provide specific guidance for a business combination on how to apply the recognition principle in Topic 805 to revenue contracts with customers after the acquirer has adopted Topic 606.

The amendments in this proposed Update would improve comparability by specifying the circumstances in which the acquirer should recognize contract liabilities for revenue contracts with customers that are acquired in a business combination.

When Would the Amendments Be Effective?

The effective date and the ability to early adopt will be determined after the Task Force considers stakeholder feedback on this proposed Update. The amendments in this proposed Update would be applied prospectively to business combinations occurring on or after the effective date of the proposed amendments.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Should entities be required to recognize a contract liability from a revenue contract with a customer acquired in a business combination using the

definition of a performance obligation in Topic 606? If not, please explain why and what recognition criteria are more appropriate.

Question 2: Is the recognition that would be required by the amendments in the proposed Update operable? If not, please explain why.

Question 3: Would the proposed amendments result in financial reporting outcomes that are appropriate and meaningful to users of the financial statements? If not, please explain why.

Question 4: Should the proposed amendments be more broadly applied to similar transactions beyond contracts with customers, such as contracts within the scope of Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets? If yes, please provide examples of potentially affected transactions.

Question 5: The proposed amendments require no incremental disclosures. Should disclosures related to the proposed amendments or transition disclosures be required? If yes, please explain why and provide the additional disclosures that should be required.

Question 6: Do you agree with the proposed prospective transition requirement? If not, what transition method would be more appropriate and why? How much time would be needed to implement the proposed amendments? Should early adoption be permitted? Should entities other than public business entities be provided with an additional year to implement the proposed amendments? Why or why not?

Question 7: What would be the implications, if any, of finalizing the proposed amendments on the recognition of a contract liability from a revenue contract with a customer acquired in a business combination without finalizing amendments on measurement and other topics that may result from feedback received as part of the concurrently issued Invitation to Comment?

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–4. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Add the following Master Glossary terms to Subtopic 805-20 as follows:
[Note: The definitions of *Contract* and *Customer* are shown for convenience.]

Contract Liability

An entity's obligation to transfer goods or services to a **customer** for which the entity has received consideration (or the amount is due) from the customer.

Performance Obligation

A promise in a **contract** with a **customer** to transfer to the customer either:

- a. A good or service (or a bundle of goods or services) that is distinct
- b. A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Customer

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Amendments to Subtopic 805-20

3. Add paragraph 805-20-25-15B and its related heading, with a link to transition paragraph 805-20-65-3, as follows:

Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest

Recognition

> Recognizing Particular Assets Acquired and Liabilities Assumed

> > Revenue from Contracts with Customers

805-20-25-15B An acquirer shall recognize a liability assumed in a business combination from a **contract** with a **customer** if that liability represents an unsatisfied **performance obligation** under Topic 606 for which the acquiree has received consideration (or the amount is due) from the customer (that is, a **contract liability**).

4. Add paragraph 805-20-65-3 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 201X-XX, Business Combinations (Topic 805): Revenue from Contracts with Customers—Recognizing an Assumed Liability

805-20-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 201X-XX, *Business Combinations (Topic 805): Revenue from Contracts with Customers—Recognizing an Assumed Liability*:

- a. For **public business entities**, the pending content that links to this paragraph shall be effective for annual periods, including interim periods within those annual periods, beginning after [date to be inserted after exposure].
- b. For all other entities, the pending content that links to this paragraph shall be effective for annual periods, including interim periods within those annual periods, beginning after [date to be inserted after exposure].
- c. Early application of the pending content that links to this paragraph is [to be inserted after exposure].
- d. An entity shall apply the pending content that links to this paragraph prospectively to business combinations that occur after the effective date.

The amendments in this proposed Update were approved for publication by the unanimous vote of the six members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this proposed Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Topic 805 provides guidance on the accounting for business combinations. In applying the acquisition method in Topic 805, an acquirer recognizes identifiable assets acquired and liabilities assumed in a business combination and generally measures those assets and liabilities at fair value. Paragraph 805-20-25-2 provides further guidance on the recognition criteria. It states that for an identifiable asset acquired or liability assumed to be recognized in a business combination, it must meet the definition of an asset or liability in FASB Concepts Statement No. 6, *Elements of Financial Statements*. Concepts Statement 6 defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events" (footnote references omitted). The definition in Concepts Statement 6 also clarifies that a present obligation is broader than a legal obligation.

BC3. EITF Issue No. 01-3, "Accounting in a Business Combination for Deferred Revenue of an Acquiree," provided specific guidance on the accounting for deferred revenue in a business combination. Issue 01-3 required that an acquiring entity recognize a liability related to the deferred revenue of an acquired entity only if that deferred revenue represented a legal obligation assumed by the acquiring entity (a legal performance obligation as described in Issue 01-3) and the amount assigned to that liability was its acquisition date fair value. Issue 01-3 was superseded by FASB Statement No. 141 (revised 2007), *Business Combinations*, which did not include specific guidance on the recognition of a liability for deferred revenue in a business combination. Rather, Statement 141(R) referenced the definition of a liability in Concepts Statement 6 (that guidance is now codified in paragraph 805-20-25-2) for all liabilities recognized in a business combination.

BC4. Although Statement 141(R) superseded the guidance in Issue 01-3, stakeholders indicated that practice generally continued to apply the concepts in

Issue 01-3, including use of the legal obligation concept, to determine whether an entity should recognize a liability assumed related to deferred revenue of an acquired entity accounted for under Topic 605, Revenue Recognition.

BC5. In May 2014, the FASB issued Update 2014-09, which provides a single comprehensive accounting model on revenue recognition for contracts with customers. Among other things, Topic 606 defined a performance obligation as “a promise in a contract with a customer to transfer to the customer either: (a) a good or service (or a bundle of goods or services) that is distinct or (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.” In addition, paragraph 606-10-25-16 states:

A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the promised goods and services identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer also may include promises that are implied by an entity’s customary business practices, published policies, or specific statements if, at the time of entering into the contract, those promises create a reasonable expectation of the customer that the entity will transfer a good or service to the customer.

The discussion in the basis for conclusions of Update 2014-09 in paragraphs BC32 and BC87 further explains that customary business practices or other implied promises in a contract with a customer do not need to be legally enforceable.

BC6. For example, an entity will record revenue over time for what is now referred to as a license to symbolic intellectual property under Topic 606. Therefore, when an acquirer is evaluating whether to recognize a liability assumed related to a license to symbolic intellectual property, the balance sheet of the acquiree may have a contract liability under Topic 606 at the acquisition date. However, there may be no legal obligation of the entity other than to allow for the continued use of the entity’s intellectual property because the remaining activities to support and maintain the underlying intellectual property are not legal obligations. Before Topic 606 was created, the acquirer would not have been able to consider the definition of performance obligation in Topic 606 when evaluating whether a liability assumed should be recognized.

BC7. Stakeholders have indicated that it is unclear how an acquirer should evaluate whether to recognize a contract liability as a liability assumed in a business combination for a contract with a customer within the scope of Topic 606 (a revenue contract) after Topic 606 is adopted. Some stakeholders stated that an entity should use the Topic 606 performance obligation definition to determine whether a contract liability from a revenue contract with a customer is a liability assumed that is recognized in the business combination. Other stakeholders

stated that an entity should continue to use the legal obligation concept when applying the guidance in Topic 805.

BC8. On March 28, 2018, the Board added a narrow scope project to the EITF agenda to reduce the diversity that might arise when evaluating whether to recognize a contract liability from a contract with a customer that is acquired in a business combination after an entity has adopted Topic 606. In addition, stakeholders have indicated that questions may arise under Topic 606 about measurement of contract liabilities from revenue contracts with customers in a business combination. The Board asked the EITF to also consider those measurement issues.

Basis for Conclusions

Scope

BC9. The amendments in this proposed Update would apply to business combinations within the scope of Topic 805 that occur after the effective date that include revenue contracts with customers. The proposed amendments would result in consistent application of the guidance in paragraphs 805-20-25-1 through 25-2 for the recognition of assumed contract liabilities from revenue contracts with customers. The scope does not include contract liabilities other than those from revenue contracts with customers, even if those liabilities are accounted for using guidance in Topic 606 (for example, contract liabilities from the sale of nonfinancial assets within the scope of Subtopic 610-20). The scope also does not include liabilities other than contract liabilities that could arise in a business combination from revenue contracts with customers.

Recognition of an Assumed Liability from Revenue Contracts with Customers

BC10. The Task Force reached a consensus-for-exposure that would require an entity to use the Topic 606 performance obligation definition to determine whether to recognize a contract liability from a revenue contract with a customer that is acquired in a business combination at the acquisition date. An entity would evaluate whether it has a contract liability from a revenue contract that is assumed in a business combination because the acquiree has been paid (or consideration is due) for goods or services for which control has not been transferred to the customer. The acquirer would not need to perform this evaluation if the acquiree has not received payment or there is no consideration due (that is, a contract liability would not have been recognized under Topic 606).

BC11. In reaching this consensus-for-exposure, the Task Force considered both the Topic 606 performance obligation concept and the superseded legal obligation concept as potential alternatives. The Task Force discussed the use of the legal obligation concept alternative in current practice before the adoption of Topic 606

and observed that Topic 606 did not consequentially amend Topic 805, which requires that a liability recognized in a business combination meet the definition of a liability in Concepts Statement 6. The Task Force rejected that alternative because it believes that the use of the definition of performance obligation better aligns with current guidance already included in the Codification and by using that definition, the guidance under Topic 606 and the guidance under Topic 805 would be consistent (that is, for the identification of an obligation for a revenue contract). In addition, the Task Force also observed that the Topic 606 performance obligation concept may be less complex to apply and is more consistent with the definition of a liability in Concepts Statement 6.

BC12. The Task Force indicated that in most situations the recognition conclusion under either a Topic 606 performance obligation alternative or a legal obligation alternative would be the same. However, the Task Force acknowledged that there may be circumstances in which the recognition conclusion could be different, such as for licenses of symbolic intellectual property or goods or services that are provided as a customary business practice because the entity is not legally obligated to perform in those situations (see paragraph BC5).

Invitation to Comment—Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805

BC13. In discussing whether to recognize an assumed contract liability from an acquired revenue contract with a customer, the Task Force also considered the measurement of the assumed contract liability and the effects of payment terms on the subsequent revenue recognition of the acquired revenue contract. The Task Force decided not to address those issues at this time. A separate Invitation to Comment has been issued concurrently with this proposed Update to solicit input on those issues.

Effective Date and Transition

BC14. The Task Force did not propose an effective date for the amendments in this proposed Update. Consequently, the Task Force will take into consideration the comments received on the proposed amendments before determining when this proposed Update would be effective.

BC15. The Task Force reached a consensus-for-exposure that would require that an entity apply the amendments in this proposed Update prospectively to all business combinations that occur after those amendments are effective. In reaching this consensus-for-exposure, the Task Force considered previous amendments to Topic 805, which generally followed a prospective transition method. The Task Force also indicated that allowing a choice between prospective transition or modified retrospective transition could result in unnecessary costs and complexity for preparers (for example, restating the subsequent accounting for the assets and liabilities recognized in the business combination), particularly because

the Task Force noted that the financial reporting outcome resulting from the proposed amendments may not be materially different from current practice.

BC16. The Task Force also reached a consensus-for-exposure not to require any disclosures in the period of adoption because the Task Force believes that the disclosures would not provide incremental information that would be useful to users of financial statements and therefore would result in unnecessary costs for preparers.

Benefits and Costs

BC17. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC18. The Task Force does not anticipate that entities will incur significant costs as a result of applying the amendments in this proposed Update. The Task Force agreed that guidance on the recognition of an assumed contract liability from revenue contracts with customers in a business combination would benefit users by reducing diversity in practice. Thus, on balance, the Task Force concluded that those expected benefits would justify the expected costs that entities would incur as a result of applying the proposed amendments.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed improvements to the Taxonomy through [Proposed Taxonomy Improvements](#) provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the Taxonomy will be finalized as part of the annual release process.