FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2021-08
October 2021

Business Combinations (Topic 805)

Accounting for Contract Assets and Contract Liabilities from Contracts with Customers

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

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

The FASB is issuing this Update to improve the accounting for acquired revenue contracts with customers in a business combination by addressing diversity in practice and inconsistency related to the following:

1. Recognition of an acquired contract liability
2. Payment terms and their effect on subsequent revenue recognized by the acquirer.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* which provides a single comprehensive accounting model on revenue recognition for contracts with customers. In connection with the issuance of Topic 606, stakeholders raised questions about how to apply Topic 805, Business Combinations, to contracts with a customer acquired in a business combination after the acquirer has adopted Topic 606. Stakeholders indicated that there are differing views on whether the concept of a performance obligation introduced by Topic 606 should be used to determine whether a contract liability is recognized in a business combination from revenue contracts. 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. The amendments in this Update address how to determine whether a contract liability is recognized by the acquirer in a business combination.

Stakeholders also requested additional guidance on measuring revenue contracts with customers acquired in a business combination. Furthermore, it was identified that under current practice the timing of payment (payment terms) of a revenue contract may subsequently affect the amount of postacquisition revenue recognized by the acquirer. For example, if two revenue contracts with identical performance obligations are acquired but one contract is paid upfront before the acquisition and the other contract is paid over the contract term after the acquisition, the amount of revenue recognized by the acquirer after the business combination likely would differ between the two acquired contracts. The amendments in this Update resolve this inconsistency by providing specific guidance on how to recognize and measure acquired contract assets and contract liabilities from revenue contracts in a business combination.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to all entities that enter into a business combination within the scope of Subtopic 805-10, Business Combinations—Overall.

What Are the Main Provisions?

The amendments in this Update require that an entity (acquirer) recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with Topic 606. At the acquisition date, an acquirer should account for the related revenue contracts in accordance with Topic 606 as if it had originated the contracts. To achieve this, an acquirer may assess how the acquiree applied Topic 606 to determine what to record for the acquired revenue contracts. Generally, this should result in an acquirer recognizing and measuring the acquired contract assets and contract liabilities consistent with how they were recognized and measured in the acquiree's financial statements (if the acquiree prepared financial statements in accordance with generally accepted accounting principles [GAAP]). However, there may be circumstances in which the acquirer is unable to assess or rely on how the acquiree applied Topic 606, such as if the acquiree does not follow GAAP, if there were errors identified in the acquiree's accounting, or if there were changes identified to conform with the acquirer's accounting policies. In those circumstances, the acquirer should consider the terms of the acquired contracts, such as timing of payment, identify each performance obligation in the contracts, and allocate the total transaction price to each identified performance obligation on a relative standalone selling price basis as of contract inception (that is, the date the acquiree entered into the contracts) or contract modification to determine what should be recorded at the acquisition date. The amendments in this Update also provide certain practical expedients for acquirers when recognizing and measuring acquired contract assets and contract liabilities from revenue contracts in a business combination.

The amendments in this Update primarily address the accounting for contract assets and contract liabilities from revenue contracts with customers in a business combination. However, the amendments also apply to contract assets and contract liabilities from other contracts to which the provisions of Topic 606 apply, such as contract liabilities from the sale of nonfinancial assets within the scope of Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets.

The amendments in this Update do not affect the accounting for other assets or liabilities that may arise from revenue contracts with customers in accordance with Topic 606, such as refund liabilities, or in a business combination, such as customer-related intangible assets and contract-based intangible assets. For example, if acquired revenue contracts are considered to have terms that are unfavorable or favorable relative to market terms, the acquirer should recognize a liability or asset for the off-market contract terms at the acquisition date.

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

Under current GAAP, an acquirer generally recognizes assets acquired and liabilities assumed in a business combination, including contract assets and contract liabilities arising from revenue contracts with customers and other similar contracts that are accounted for in accordance with Topic 606, at fair value on the acquisition date. The amendments in this Update require acquiring entities to apply Topic 606 to recognize and measure contract assets and contract liabilities in a business combination.

The amendments in this Update improve comparability for both the recognition and measurement of acquired revenue contracts with customers at the date of and after a business combination. The amendments improve comparability by specifying for all acquired revenue contracts regardless of their timing of payment (1) the circumstances in which the acquirer should recognize contract assets and contract liabilities that are acquired in a business combination and (2) how to measure those contract assets and contract liabilities. The amendments improve comparability after the business combination by providing consistent recognition and measurement guidance for revenue contracts with customers acquired in a business combination and revenue contracts with customers not acquired in a business combination.

When Will the Amendments Be Effective and What Are the Transition Requirements?

For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. The amendments in this Update should be applied prospectively to business combinations occurring on or after the effective date of the amendments.

Early adoption of the amendments is permitted, including adoption in an interim period. An entity that early adopts in an interim period should apply the amendments (1) retrospectively to all business combinations for which the acquisition date occurs on or after the beginning of the fiscal year that includes the interim period of early application and (2) prospectively to all business combinations that occur on or after the date of initial application.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–7. 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 <u>underlined</u>, 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, Contract Asset,* 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.

Standalone Selling Price

The price at which an entity would sell a promised good or service separately to a **customer**.

Transaction Price

The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a **customer**, excluding amounts collected on behalf of third parties.

Contract

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

Contract Asset

An 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).

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. Amend paragraphs 805-20-25-16 through 25-17 and add paragraph 805-20-25-28C 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

General

> Exceptions to the Recognition Principle

805-20-25-16 This Topic provides limited exceptions to the recognition and measurement principles applicable to business combinations. Paragraphs 805-20-25-17 through <u>25-28C</u> ~~25-28B~~ specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the recognition principle in paragraph 805-20-25-1. The acquirer shall apply the specified GAAP or the specified requirements rather than that recognition principle to determine when to recognize the assets or liabilities identified in paragraphs 805-20-25-17 through <u>25-28C</u> ~~25-28B~~. That will result in some items being recognized either by applying recognition conditions in addition to those in paragraphs 805-20-25-2 through 25-3 or by applying the requirements of other GAAP, with results that differ from applying the recognition principle and conditions in paragraphs 805-20-25-1 through 25-3.

805-20-25-17 Guidance is presented on all of the following exceptions to the recognition principle:

a. Assets and liabilities arising from contingencies
b. Income taxes
c. Employee benefits
d. Indemnification assets
e. Leases
f. **Contract assets** and **contract liabilities.**

> > Contract Assets and Contract Liabilities

805-20-25-28C The acquirer shall recognize a contract asset or contract liability in accordance with Topic 606 on revenue from **contracts** with **customers**. This includes a contract asset or contract liability from the following:

a. Contracts with customers
b. Other contracts to which the provisions of Topic 606 apply.

4. Amend paragraphs 805-20-30-10 through 30-12 and add paragraphs 805-20-30-27 through 30-30 and their related heading, with a link to transition paragraph 805-20-65-3, as follows:

Initial Measurement

> Exceptions to the Measurement Principle

805-20-30-10 Paragraph 805-20-25-16 notes that the Business Combinations Topic provides limited exceptions to the recognition and measurement principles applicable to business combinations. Paragraphs 805-20-30-12 through 30-30 ~~30-26~~ specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the paragraph 805-20-30-1 measurement principle. The acquirer shall apply the specified GAAP or the specified requirements rather than that measurement principle to determine how to measure the assets or liabilities identified in paragraphs 805-20-30-12 through 30-30 ~~30-26~~. That will result in some items being measured at an amount other than their acquisition-date fair values.

805-20-30-11 As noted in paragraph 805-20-25-17, income taxes, employee benefits, indemnification assets, ~~and~~ leases, and **contract assets** and **contract liabilities** are also exceptions to the recognition principle in paragraph 805-20-25-1.

805-20-30-12 Guidance is presented on all of the following exceptions to the measurement principle:

a. Income taxes
b. Employee benefits
c. Indemnification assets
d. Reacquired rights
e. Share-based payment awards
f. Assets held for sale
g. Certain assets and liabilities arising from contingencies
h. Leases
i. **Purchased financial assets with credit deterioration**
j. Contract assets and contract liabilities.

> > Contract Assets and Contract Liabilities

805-20-30-27 An acquirer shall measure a contract asset or contract liability in accordance with Topic 606 on revenue from **contracts** with **customers**. This includes a contract asset or contract liability from the following:

a. Contracts with customers
b. Other contracts to which the provisions of Topic 606 apply.

805-20-30-28 An acquirer shall measure the contract assets and contract liabilities of the acquired contract as if the acquirer had originated the acquired contract. Topic 606 specifies when certain assessments and estimates should be made, for example, as of contract inception or on a recurring basis. At the acquisition date, the acquirer shall make those assessments as of the dates required by Topic 606.

805-20-30-29 An acquirer may use one or more of the following practical expedients when applying paragraphs 805-20-30-27 through 30-28 at the acquisition date:

a. For contracts that were modified before the acquisition date, an acquirer may reflect the aggregate effect of all modifications that occur before the acquisition date when:
   1. Identifying the satisfied and unsatisfied **performance obligations**
   2. Determining the **transaction price**
   3. Allocating the transaction price to the satisfied and unsatisfied performance obligations.
b. For all contracts, for purposes of allocating the transaction price, an acquirer may determine the **standalone selling price** at the acquisition date (instead of the contract inception date) of each performance obligation in the contract.

805-20-30-30 For any of the practical expedients in paragraph 805-20-30-29 that an acquirer uses, the acquirer shall apply that expedient on an acquisition-by-acquisition basis. Each practical expedient that is elected shall be applied consistently to all contracts acquired in the same business combination. In addition, the acquirer shall provide the disclosures in paragraph 805-20-50-5.

5. Add paragraph 805-20-50-5 and its related heading, with a link to transition paragraph 805-20-65-3, as follows:

Disclosure

> Exceptions to the Measurement Principle

805-20-50-5 ~~Paragraph not used.~~For any of the practical expedients in paragraph 805-20-30-29 that an acquirer uses, the acquirer shall disclose all of the following information:

a. The expedients that have been used
b. To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

6. 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. 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*

805-20-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*:

a. For **public business entities**, the pending content that links to this paragraph shall be effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2022.
b. For all other entities, the pending content that links to this paragraph shall be effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2023.
c. An entity shall apply the pending content that links to this paragraph prospectively to **business combinations** that occur after the effective date.
d. Early application of the pending content that links to this paragraph is permitted, including in any interim period, for:
    1. Public business entities for periods for which financial statements have not yet been issued
    2. All other entities for periods for which financial statements have not yet been made available for issuance.

e. An entity that elects early application of the pending content that links to this paragraph in an interim period shall apply the pending content:
   1. Retrospectively to all business combinations for which the acquisition date occurs on or after the beginning of the fiscal year that includes the interim period of early application
   2. Prospectively to all business combinations that occur on or after the date of initial application.

Amendments to Status Sections

7. Amend paragraph 805-20-00-1, by adding the following items to the table, as follows:

805-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	**Action**	**Accounting Standards Update**	**Date**
Contract Liability	Added	2021-08	10/28/2021
Performance Obligation	Added	2021-08	10/28/2021
Standalone Selling Price	Added	2021-08	10/28/2021
Transaction Price	Added	2021-08	10/28/2021
805-20-25-16	Amended	2021-08	10/28/2021
805-20-25-17	Amended	2021-08	10/28/2021
805-20-25-28C	Added	2021-08	10/28/2021
805-20-30-10 through 30-12	Amended	2021-08	10/28/2021
805-20-30-27 through 30-30	Added	2021-08	10/28/2021
805-20-50-5	Added	2021-08	10/28/2021
805-20-65-3	Added	2021-08	10/28/2021

The amendments in this Update were adopted by the affirmative vote of five members of the Financial Accounting Standards Board. Ms. Botosan dissented, and Mr. Cannon abstained.

Ms. Botosan dissents from the issuance of this Update because she does not support the change in measurement basis for contract assets and contract liabilities (as defined in Topic 606) that are acquired in a business combination. That change creates both an exception to the fair value measurement required by Topic 805 and an additional difference between generally accepted accounting principles and International Financial Reporting Standards related to accounting for business combinations. As more fully explained in the following paragraphs, she believes that the Update does not improve the accounting for business combinations and does not meet the objective of financial reporting of providing more decision-useful information. She also believes that the expected benefits do not justify the expected costs.

As amended, an acquiree's preacquisition measures of contract assets and liabilities will in most situations carry over to the postacquisition financial statements of an acquirer. Ms. Botosan believes that simply carrying over the same basis does not faithfully represent the economics of a business acquisition transaction and could result in an overstatement of postacquisition revenues and income. This concern is not new; it was raised in the basis for conclusions in FASB Statement No. 141 (revised 2007), *Business Combinations,* which stated in part that "by recording assets and liabilities at the carrying amounts of predecessor entities, postcombination revenues may be overstated (and expenses understated) as the result of embedded gains that were generated by predecessor entities but not recognized by them" (paragraph B38).

Ms. Botosan is concerned that potential overstatement of postacquisition revenues and income by the acquirer resulting from carrying over the acquiree's basis may create perverse incentives for entities to "buy revenues." Exacerbating this concern is that an increase in contract liabilities (related to the application of carryover-basis measurement) often will produce an offsetting increase in goodwill, which generally is not subject to systematic amortization. Moreover, she believes that these resulting effects on postacquisition revenues and income will not be transparent to investors and other users of the financial statements.

Ms. Botosan agrees that investors and other users of financial statements require information to distinguish and separately evaluate acquired and originated revenues. She acknowledges the relevance of that information and would support enhanced disclosures of carryover-basis information to help users of financial statements assess the longer term implications of a business combination on revenue, revenue growth, and margins.

Ms. Botosan recognizes that the application of carryover-basis measurement incorporates certain information on the face of the financial statements that is useful for assessing the longer term implications of a business combination. However, its application also eliminates existing fair value information that is necessary to evaluate the soundness of managers' business acquisition decisions. She notes that to meet the objective of financial reporting, financial statements should provide information useful in assessing not only an entity's prospects for future net cash inflows but also the efficiency and effectiveness with which “the entity’s management and governing board have discharged their responsibilities to use the entity’s resources” (paragraph OB4 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 1, The Objective of General Purpose Financial Reporting;* footnote reference omitted). Accordingly, she believes that the Update’s change in measurement basis for contract assets and contract liabilities acquired in a business combination and the loss of key decision-useful fair value information does not achieve the objective of financial reporting.

Members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Fred L. Cannon
Susan M. Cosper
Marsha L. Hunt

Background Information and Basis for Conclusions

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The Board decided to undertake this project to improve the accounting for acquired revenue contracts with customers in a business combination by addressing diversity in practice and inconsistency related to the following:

a. Recognition of an acquired contract liability
b. Payment terms and their effect on subsequent revenue recognized by the acquirer.

Background Information

BC3. 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 additional 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* (as issued in December 1985). The definition of a liability in Concepts Statement 6 clarifies that a present obligation is broader than a legal obligation.

BC4. Emerging Issues Task Force (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.

BC5. 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 using 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.

BC6. In May 2014, the Board issued Update 2014-09, which provides a single comprehensive accounting model on revenue recognition for contracts with customers. Among other things, Topic 606 introduced the term *performance obligation*, which is defined in the Codification Master Glossary as follows:

> 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.

BC7. 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.

BC8. The discussion in paragraphs BC32 and BC87 of the basis for conclusions of Update 2014-09 further explains that customary business practices or other implied promises in a contract with a customer do not need to be legally enforceable.

BC9. Stakeholders indicated that it is unclear how an acquirer should evaluate whether to recognize a contract liability from a revenue contract with a customer assumed in a business combination after Topic 606 is adopted. Some stakeholders stated that an entity should use the definition of *performance obligation* introduced by Topic 606 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 indicated that Topic 606 did not amend the guidance in Topic 805 and stated that an entity should continue to use the legal obligation concept from Issue 01-3 when applying the guidance in Topic 805. For example, an entity will recognize 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 acquiree's balance sheet may have a contract liability (a remaining performance obligation) under Topic 606 at the acquisition date. However, the entity may have no legal obligation other than to allow for the continued use of its intellectual property because the remaining activities to support and maintain the underlying intellectual property are not legal obligations.

BC10. On March 28, 2018, the Board added a narrow-scope project to the EITF's 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 indicated that questions may arise under Topic 606 about measurement of contract liabilities from revenue contracts with customers in a business combination. The Board also asked the EITF to consider those measurement issues.

BC11. Under Topic 805, the general measurement principle in paragraph 805-20-30-1 explains that an acquirer must initially measure all assets acquired and liabilities assumed, with limited exceptions, at their acquisition date fair values in accordance with Topic 820, Fair Value Measurement. There is no specific guidance or exception related to the measurement of revenue contracts with customers, and, thus, the contract assets and contract liabilities that arise from them follow the overall measurement principle. Topic 805 generally requires that an acquirer subsequently measure and account for assets acquired and liabilities assumed in a business combination in accordance with other applicable GAAP; therefore, acquired contract assets and contract liabilities would subsequently be accounted for under Topic 606.

BC12. During the deliberations of EITF Issue No. 18-A, "Recognition under Topic 805 for an Assumed Liability in a Revenue Contract," Task Force members considered whether two acquired revenue contracts with identical performance obligations but with different payment terms would result in different amounts of postacquisition revenue for the acquirer. Most Task Force members indicated that, theoretically, the timing of payment should not affect the amount of revenue recognized by the acquirer after the acquisition for the acquired contract (other than perhaps because of a significant financing component). However, in current practice, a revenue contract that is paid upfront before the acquisition likely will result in different postacquisition revenue compared with an identical revenue contract that is paid over time after the acquisition.

BC13. When a revenue contract is paid upfront, an acquirer recognizes an assumed contract liability at fair value when the acquiree has received consideration from the customer and there is still a remaining unsatisfied, or partially unsatisfied, obligation as of the acquisition date. The resulting fair value measurement will often be lower than the contract liability balance that is recorded by the acquiree. Under fair value measurement techniques, the costs or activities to enter into the contract are considered to have already been performed by the acquiree before the acquisition and, therefore, are not included in the measurement of the remaining obligation for the related contract liability. However, under Topic 606, the costs to enter into the contract are not considered for purposes of revenue recognition, and contract liabilities are derecognized as the corresponding performance obligation is satisfied by transferring either a good or service to the customer. Alternatively, when a contract is paid over time as performance occurs, an acquirer likely would not analyze the specific revenue contract at the acquisition date because there would be no identifiable assets or liabilities assumed to measure at fair value for that contract (absent assumed intangible assets). Therefore, there is no contract-specific fair value adjustment, and an acquirer likely would subsequently recognize the same amount of revenue that the acquiree would have recognized if no business combination took place.

BC14. At the October 10, 2018 Board meeting, the Board authorized the staff to prepare an Invitation to Comment, *Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805,* as part of a research project to address the measurement and payment terms issues. On February 14, 2019, the Board issued proposed Accounting Standards Update, *Business Combinations (Topic 805): Revenue from Contracts with Customers—Recognizing an Assumed Liability,* as part of Issue 18-A to address the recognition issue and the related Invitation to Comment concurrently.

BC15. At the June 13, 2019 EITF meeting, the Task Force considered the feedback received from the Invitation to Comment and the February 2019 proposed Accounting Standards Update and decided not to affirm its consensus-for-exposure on Issue 18-A. Several respondents identified implications of providing the recognition for acquired revenue contracts in a business combination without providing corresponding measurement guidance. For example, some respondents suggested that determining the fair value of performance obligations as defined in Topic 606 may be complex and could lead to diversity. On the basis of stakeholders' feedback, the Task Force recommended to the Board that the issues related to recognition and measurement be addressed holistically. At the July 31, 2019 Board meeting, the Board decided to subsume Issue 18-A on recognition into the Board's research project, Recognition and Measurement of Revenue Contracts with Customers under Topic 805. On September 23, 2020, the Board added the project to its technical agenda.

BC16. On December 15, 2020, the Board issued proposed Accounting Standards Update, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers.* The Board received

43 comment letters on the proposed Update. Overall, the comment letter respondents supported the proposed recognition and measurement guidance for contract assets and contract liabilities acquired in a business combination. Respondents indicated that the proposed amendments would address the diversity in practice and inconsistency in accounting for acquired revenue contracts in a business combination, be less costly and complex compared with current accounting, and provide users of financial statements with better information. Most respondents agreed that the proposed amendments would be understandable and operable, although a few respondents requested clarifications about (a) how to apply the proposed amendments at the acquisition date, (b) contract-based intangible assets, and (c) the scope of the proposed amendments. Additionally, other comment letter respondents requested practical expedients for certain circumstances in which applying the guidance may be overly complex or burdensome. During the exposure period and redeliberations, the Board continued to interact with users of financial statements, who indicated their support for the proposed amendments and urged the Board to finalize the proposed guidance. The Board considered respondents' comments and concerns and those of participants in subsequent outreach in reaching the conclusions in this Update, as discussed further in the remainder of this basis for conclusions.

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 Board'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 Board indicated that a requirement to measure the deferred revenue (contract liability) balance at fair value generally results in an acquirer recording an amount that is less than what was previously recorded by the acquiree under the principles of Topic 606 (see paragraph BC13). Therefore, the subsequent amount of revenue recorded by the acquirer after the acquisition is often not comparable with what was recorded by the acquiree, which obscures the revenue trend information of the combined company postacquisition. Revenue trend information is a vital input that investors use to forecast a combined entity's postacquisition revenues, earnings, and cash flows.

BC19. The amendments in this Update provide specific guidance on recognition and measurement for contract assets and contract liabilities from acquired revenue from contracts with customers, resulting in consistent application of GAAP for revenue contracts. For example, by utilizing the guidance in Topic 606, identifying an obligation for a revenue contract will be consistent for all revenue contracts (that is, whether it is acquired in a business combination or originated by an entity). The amendments also eliminate differences in the subsequent amount of revenue recognized by an entity (acquirer) after a business combination based on the timing of payment, which the Board indicated results in counterintuitive outcomes and does not provide users of financial statements with decision-useful information.

BC20. The Board met with members of its Investor Advisory Committee (IAC), and substantially all its members supported the amendments in this Update because the amendments will provide decision-useful information for projecting future cash flows and revenues of the acquirer after the acquisition. Those members explained that a requirement to measure the deferred revenue (contract liability) balance at fair value (a) does not provide useful information, (b) is often challenging to understand, and (c) reduces comparability between the preacquisition and postacquisition period, disrupting the ability to predict future cash flows and revenue.

BC21. IAC members also explained that the resulting fair value adjustments are often reversed to analyze an entity after the acquisition. This analysis requires that investors search for information, such as non-GAAP disclosures or supplemental financial information, when business combinations occur to attempt to identify the acquired deferred revenue balance and the period over which that deferred revenue will be recognized. A number of the IAC members further explained that the supplemental information is sometimes unavailable or lacks the necessary information to enable investors to perform their analyses with precision. The amendments in this Update eliminate the need for entities to provide and investors to search for this non-GAAP or supplemental information because the revenue reported by the acquirer after the business combination under the amendments should be comparable with the revenue reported before the acquisition by the acquiree (that is, the accounting for contract liabilities will be consistent regardless of whether revenue contracts are acquired in a business combination or originated).

BC22. The Board believes that initial fair value measurement for acquired revenue contracts in a business combination is complex and requires significant judgment. Additionally, the Board notes that diversity exists in current practice for determining the fair value of contract liabilities for certain revenue arrangements. Additionally, even for those arrangements for which the fair value measurement is not overly complex, preparers explained that they often receive questions from users of financial statements about the fair value adjustments. To address those questions, preparers incur additional costs and complexity to maintain records that adjust revenue by reversing out the effects of the fair value adjustments in order to report and explain those revenue adjustments to users. Stakeholders observed that those adjustments often are difficult for users to understand and, in most cases, the effects of the fair value adjustments to the contract liability balance are short lived because of the contract terms of the acquired contracts. Thus, the amendments in this Update remove the costs for both preparers and investors to explain and understand the results of the fair value adjustments made to acquired contract liabilities.

BC23. The Board does not anticipate that entities will incur additional costs as a result of the amendments in this Update when compared with the accounting today for acquired revenue contracts with customers in a business combination. The Board acknowledged that the amendments may not always be as simple as recording the same contract assets and contract liabilities that were recorded by the acquiree before the acquisition and that there may be additional effort required to evaluate how the acquiree applied Topic 606. Additionally, the Board indicated that, in accordance with the existing requirements in Topic 805, acquirers still need to consider whether the terms of the contract require recognizing an additional intangible asset or liability for off-market terms (for example, if there were changes to the prevailing market terms since that contract was entered into). However, the Board acknowledged, consistent with comment letter feedback, that the level of effort required to account for the acquired revenue contracts in accordance with Topic 606 will be similar to or less than the level of effort required when applying current guidance. Additionally, the Board provided practical expedients to ease the potential burden of the amendments under certain circumstances.

BC24. The Board acknowledges that the amendments in this Update create a potential difference between GAAP and IFRS Standards in an area for which the guidance in the respective standards has converged, which could result in additional costs (see paragraphs BC45–BC47). The Board asked stakeholders whether divergence in this area of the guidance would create additional costs and complexity, and some stakeholders provided feedback that the benefit of decision-useful information about revenue trends and acquired contracts from the amendments would outweigh the potential costs of divergence with IFRS Standards. In addition, the Board understands that, while GAAP and IFRS Standards appear to converge in form, there is diversity in practice on how that guidance is applied (see paragraph BC45).

BC25. In addition, the Board considered other potential costs of the amendments in this Update and determined that they were not significant enough to outweigh the benefits. For example, the Board notes that a potential cost of the amendments is that an acquirer that recognized contract liability balances in an acquisition would recognize revenue generated by the acquiree but not recognized before the acquisition, which could create an incentive for an entity to increase revenue through acquisitions and generally result in an increase in goodwill (see paragraph BC42 and BC43). However, the Board believes that because acquired contract liabilities are recognized by the acquirer in accordance with Topic 606, including applying all of the requirements and judgments of that guidance, an entity’s incentive to enter into an acquisition with the primary goal of acquiring revenue that is attributable to an acquiree’s precombination performance is diminished. In addition, based on feedback received from respondents and other stakeholders, the Board believes that stakeholders are generally not concerned about this potential increase in goodwill.

BC26. Overall, the Board concluded that the amendments in this Update provide investors with more decision-useful information, reduce investor costs of analyzing and interpreting the reported information, and maintain or reduce the costs for preparers of financial statements.

Basis for Conclusions

Recognition of an Acquired Contract Liability in a Business Combination

BC27. The Board decided that an entity should use the definition of *performance obligation* as defined in Topic 606 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.

BC28. An entity should evaluate whether it has a contract liability from a revenue contract that is assumed in a business combination if the acquiree has been paid (or consideration is due) for goods or services promised in the contract for which control has not been transferred to the customer (that is, an unsatisfied performance obligation). 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).

BC29. The Board indicated that in many situations in which an acquired revenue contract has been paid upfront before the business combination, the recognition conclusion under a Topic 606 performance obligation would be the same as current practice if the acquirer used the legal obligation as the recognition criterion. However, the Board 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 an entity is not legally obligated to perform in those situations (see paragraph BC9).

Payment Terms and Their Effect on Subsequent Revenue Recognized by the Acquirer

BC30. To address the issue that the timing of payment for an acquired revenue contract affects the subsequent amount of revenue recognized by the acquirer after the business combination, the Board decided that acquired contract assets and contract liabilities arising from revenue contracts with customers in a business combination should be measured in accordance with Topic 606 at the acquisition date. Therefore, the acquirer should no longer measure the remaining obligations of the acquired revenue contract at fair value but, instead, utilize the transaction price allocated to the remaining performance obligations in accordance with the principles of Topic 606.

Application of Topic 606 at the Acquisition Date

BC31. The overall result of the Board's decisions on recognition and on payment terms will result in an entity (acquirer) accounting for contract assets and contract liabilities arising from revenue contracts with customers acquired in a business combination in accordance with Topic 606 at the acquisition date. At the acquisition date, an acquirer should account for the related revenue contract as if it had originated the contract. To achieve this, an acquirer may assess how the acquiree applied Topic 606 to determine what to record for the acquired revenue contracts. For example, if a revenue contract was paid fully upfront before the acquisition, the acquiree would have recognized a contract liability for the remaining, unsatisfied performance obligations in accordance with Topic 606. At the acquisition date, an acquirer would assess the acquiree's accounting under Topic 606 to determine what to record for the acquired contract. There may be circumstances in which the acquirer cannot assess or rely on the acquiree's Topic 606 accounting and, therefore, would have to perform the accounting for the contract in accordance with Topic 606, such as if the acquiree does not follow GAAP or there were errors identified in the acquiree's accounting. Generally, either of those efforts would result in the acquirer recording a contract liability that is the same as, or similar to, the contract liability that would have been recorded by the acquiree before the acquisition (if the acquiree had prepared financial statements in accordance with GAAP).

BC32. Topic 606 contains comprehensive guidance about the judgments and estimates that an entity must make when accounting for revenue contracts with customers. Topic 606 requires that certain of those judgments and estimates be made at the contract inception date, such as identifying performance obligations and determining standalone selling prices. Other estimates must be made on a recurring basis, such as estimates of variable consideration and measure of progress toward satisfying performance obligations. Comment letter respondents asked the Board to clarify how to apply Topic 606 at the acquisition date, including when (that is, as of which date) an entity should assess the judgments and estimates discussed in Topic 606. The amendments in this Update do not alter the timing of these judgments and estimates required by Topic 606; thus, an acquirer should assess and/or determine judgments and estimates as of both the contract inception date (or modification date in circumstances in which the contract had been previously modified) and the acquisition date (for recurring estimates). For example, an acquirer would identify the performance obligations that exist in an acquired contract as of the contract inception date and estimate the transaction price as of the acquisition date. To clarify this point, the Board added paragraph 805-20-30-28, which describes how an acquirer should apply Topic 606 at the acquisition date to acquired contract assets and contract liabilities from contracts with customers and other in-scope contracts.

BC33. The Board indicated that differences between contract assets and contract liabilities recorded by an acquirer and those recorded by the acquiree before the acquisition generally would result from (a) differences in the acquirer's and acquiree's revenue recognition accounting policies and the resulting change to the acquiree's policies, (b) differences in estimates between the acquirer and acquiree, or (c) errors in the Topic 606 accounting of the acquiree. Therefore, the Board acknowledged that the amendments in this Update may not always be as simple as carrying over the acquiree's recorded contract assets or contract liabilities for some arrangements. Based on the outreach performed and comment letter feedback, the Board concluded that the information necessary to assess the acquiree's recorded balance in accordance with Topic 606 should generally be available and that the assessment should be relatively straightforward for most revenue contracts acquired. The Board also explained that practical expedients and policy elections are not pervasive in Topic 606; therefore, conforming accounting policies and elections should not be overly burdensome. The Board acknowledged that certain areas in Topic 606 require the use of judgment, such as estimates of variable consideration or determining the method of measuring progress for performance obligations satisfied over time, especially for arrangements with longer contract terms. However, based on stakeholder outreach and comment letter feedback, the Board concluded that evaluating those areas of judgment should not be overly burdensome when compared with current practice and indicated that, in certain situations, acquirers are currently required to perform these assessments at the acquisition date and that acquirers subsequently account for those contracts in accordance with Topic 606 and their own accounting policies.

Practical Expedients

BC34. While a majority of comment letter respondents indicated that the amendments in this Update will simplify the current accounting for acquired contracts with customers in a business combination, several respondents expressed concerns about the complexity of the guidance related to circumstances in which (a) the acquirer has to assess long-term, complex contracts that may have been previously modified or (b) the acquirer is unable to assess or rely on the acquiree's accounting under Topic 606. Specifically, respondents explained that in the above circumstances, it is likely that there would be a significant amount of judgment required to evaluate or determine certain estimates as of the contract inception date or, in cases in which the contract had been previously modified, at the modification date.

BC35. In response to those concerns, the Board decided to provide certain practical expedients in paragraph 805-20-30-29. The practical expedients are designed to alleviate the complexity of the amendments in those circumstances described by comment letter respondents. The Board indicated that in circumstances in which the acquirer could not assess or rely on the acquiree's Topic 606 accounting, the acquirer would, in effect, need to adopt Topic 606 for all of the acquiree's contracts with customers at the acquisition date. Therefore, the Board decided to provide a similar practical expedient to one of the transition practical expedients in paragraph 606-10-65-1(f). That practical expedient provides relief for contracts that have been previously modified before the acquisition date. Additionally, the Board provided a practical expedient about when (that is, at which date) an acquirer would have to determine the standalone selling price of each performance obligation in the acquired contract. Although no criteria must be met to apply the practical expedients, the Board's primary reason for providing the practical expedients is to provide relief for situations in which the acquirer does not have the appropriate data or expertise to analyze the historical periods in which the contract was entered into.

BC36. The Board concluded that an acquirer would be more likely to utilize the practical expedients if it was unable to reasonably assess the acquiree's Topic 606 accounting (for example, because of errors in the acquiree's Topic 606 accounting or if the acquiree had not previously performed Topic 606 accounting) and, therefore, does not expect that the use of practical expedients would be widespread. Thus, the Board decided to provide those practical expedients to all acquirers and require that they be applied on an acquisition-by-acquisition basis. To be consistent with the requirements in Topic 606, the Board decided to require that entities disclose (a) the practical expedients that have been used and (b) to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of the expedients.

Other Topic 805 Considerations

BC37. The amendments in this Update relate only to contract assets and contract liabilities as defined in Topic 606. Therefore, the amendments do not affect the accounting for associated customer-related intangible assets (paragraph 805-20-55-20) or contract-based intangible assets (paragraph 805-20-55-31) that also may arise from revenue contracts with customers in a business combination. A majority of comment letter respondents explained that the existing guidance for intangible assets that may arise from revenue contracts in a business combination remains understandable and operable. However, several respondents requested that the Board clarify whether the process or result of evaluating contracts for off-market elements should be different under the proposed amendments. That is, because contract liabilities would not be measured at fair value under the proposed amendments, they questioned whether the proposed amendments would require recognition of additional off-market contracts. Additionally, other respondents questioned whether the amendments in the proposed Update on off-market contracts suggested that current practice for off-market contracts was no longer acceptable.

BC38. The Board considered the feedback provided and confirmed that contracts with customers should continue to be evaluated for related intangible assets and liabilities, such as customer relationships and contracts with off-market terms, in accordance with existing guidance. To alleviate the uncertainty expressed by comment letter respondents, the Board removed the proposed amendments that referenced customer-related intangible assets and contract-based intangible assets. Based on the outreach performed, the Board observed that assets and liabilities related to off-market contract terms in acquired revenue contracts are not currently prevalent in business combinations. Stakeholders should continue to assess revenue contracts for off-market terms and recognize and measure them in accordance with the current guidance in Topic 805.

BC39. Under the amendments in this Update, future expected variable consideration that is constrained under the constraint on estimates of variable consideration (paragraphs 606-10-32-11 through 32-14) or the guidance for sales-based and usage-based royalties (paragraph 606-10-55-65) in Topic 606 are precluded from being recognized in the acquired contract asset balance until the variable consideration is no longer constrained. While the future expected variable consideration that is constrained under Topic 606 is precluded from being measured and recognized in the contract asset balance, the fair value of that expected variable consideration could still be captured as part of the valuation of other intangible assets. The Board understands that this is similar to how revenue contracts with variable consideration are generally valued and accounted for in current practice.

BC40. The Board concluded that the amendments in this Update will simplify an area of business combination accounting that is complex and costly to apply. Both outreach participants and comment letter respondents explained that the amendments do not have significant implications on how other identifiable assets and liabilities that arise from revenue contracts are recognized and measured in a business combination in current practice. For acquired revenue contracts that do not have an associated contract liability at the acquisition date, the Board understands that the amendments are generally consistent with current practice. That is, the acquiree’s revenue accounting likely will be retained, and the fair value of those acquired revenue contracts will be captured within other identifiable assets or liabilities recognized in the business combination, such as customer-related intangible assets and contract-based intangible assets (for example, contracts with unfavorable terms compared with market terms).

BC41. The amendments in this Update generally align the accounting for acquired revenue contracts that were paid upfront before the acquisition and have an associated contract liability at the acquisition date with the current accounting for acquired revenue contracts that do not have an associated contract liability at the acquisition date. That is, the amendments likely will retain the acquiree's revenue accounting under Topic 606 and if there are other identifiable assets or liabilities associated with the contract, they should be recognized in the business combination. For example, if an acquired contract with an associated contract liability is considered to have off-market terms, the off-market terms should be recognized and measured consistent with how they are currently recognized and measured for acquired contracts that do not have an associated contract liability (see paragraph BC38). The Board acknowledged that there is likely to be an increase in the acquired contract liabilities balance because of the amendments in this Update. The Board indicated that this is primarily because the preacquisition balance under Topic 606 would not be subject to the downward adjustments that usually result from fair value measurement of those liabilities related to the selling and marketing efforts to enter into the related contracts (see paragraph BC13). The Board believes that the corresponding increase to the acquired contract liabilities balance for those adjustments will generally be recognized in goodwill. The Board also believes that the resulting effects to the contract liabilities balance from these amendments should not affect how entities consider which underlying assets contribute to fulfilling contract liability obligations.

Postacquisition Revenue Recognition Considerations

BC42. The Board acknowledged that the expected increase in contract liabilities in a business combination will result in an increase in the subsequent revenue recognized by an acquirer, which a few stakeholders equated to creating an opportunity to "buy revenue." That is, the acquirer may be able to recognize revenue for activities performed by an acquiree before the acquisition (for example, selling and marketing efforts to enter into the contracts). This concern was included in the basis for conclusions of Statement 141(R) as support for why previous business combination accounting under the pooling-of-interests method was inappropriate. However, the comprehensive guidance in Topic 606, which was issued after Statement 141(R), limited the number of arrangements that present this opportunity. Additionally, the model in Topic 606, which requires that an entity recognize revenue as the entity satisfies performance obligations, represents a faithful representation of performance and the revenue recognized for that performance. Accordingly, satisfying a performance obligation postacquisition will result in a consistent approach to recognizing revenue that is generally not affected by the timing of payment or by whether it was originated by the acquiree or the acquirer. The Board also indicated that stakeholders understand the Topic 606 guidance and its resulting outcomes and that the amendments in this Update provide subsequent revenue information that users seek when an entity completes a business combination. Additionally, the Board explained that certain intangible assets and liabilities (favorable or unfavorable contracts) would be recognized if the acquired revenue contract contains identified off-market terms or conditions, which limits the ability for an entity to acquire revenue contracts with favorable conditions and not depict those conditions in the financial statements.

BC43. The Board also acknowledged that there may be circumstances in which the revenue recognized by an acquirer after the acquisition may be different from what would have been recognized by an acquiree if there was no acquisition. For example, a contract liability balance may be higher or lower because of differences in accounting policies or an additional asset or liability may be recognized in the business combination for off-market contract terms (assuming the amortization of that asset or liability is presented in revenue). While this may cause users of financial statements some difficulty in analyzing revenue trends, the Board concluded that the subsequent revenue reported will provide decision-useful information because it better reflects future revenue of the acquirer. In situations in which there are adjustments recorded because of differences in accounting policies between the acquirer and acquiree, the resulting subsequent revenue will better indicate future revenue because it reflects how the acquirer will account for similar contracts after the acquisition. In situations in which contracts have off-market terms that are identified in accordance with current guidance and recorded as off-market terms (assuming the amortization of the asset or liability is presented as revenue), the resulting subsequent revenue will better indicate future revenue because it reflects the current market terms for the acquired contract.

BC44. As described in paragraphs BC20 through BC22, financial statement users explained that they currently seek additional information in order to reverse the effects of the fair value measurement of acquired revenue contracts with associated contract liabilities at the acquisition date. The Board indicated that the amendments in this Update provide the decision-useful information sought by users in the financial statements, which should further enhance the consistency and availability of this information.

Comparison of Recognition and Measurement Amendments with International Financial Accounting Standards (IFRS)

BC45. The Board acknowledges that the amendments in this Update create a potential difference between GAAP and IFRS Standards in an area for which the guidance in the respective standards has converged. Similar to GAAP, IFRS 3, *Business Combinations,* does not include specific guidance for the recognition or measurement of contract assets or contract liabilities. Therefore, entities follow principles similar to GAAP under which contract assets and contract liabilities are (a) recognized if they meet the conceptual framework definitions of assets and liabilities and (b) measured at fair value. However, while GAAP and IFRS Standards appear to converge in form, there are likely differences between the two sets of standards related to how contract liabilities are recognized and measured today because of differences in historical standard-setting efforts and existing diversity in how contract liabilities for certain arrangements are measured at fair value. Furthermore, under GAAP as discussed above, there is diversity in practice and inconsistency related to both recognition and measurement. Thus, while the written guidance is converged, consistent outcomes may not always be achieved today in practice. As indicated in paragraph BC24, the Board asked stakeholders whether divergence in this area of the guidance would create additional costs and complexity, and some stakeholders provided feedback that the benefit of decision-useful information about revenue trends and acquired contracts from the amendments would outweigh the potential costs of divergence with IFRS Standards. As a result, although this will create a narrow difference between GAAP and IFRS Standards, given the facts and circumstances associated with this issue, the Board decided to adopt the amendments in this Update. Additionally, as explained in paragraph BC40, the amendments in this Update are generally consistent with how contract assets are accounted for under current practice.

BC46. The legal obligation concept included in Issue 01-3 that is used often in practice in the United States to determine whether an entity should recognize a contract liability (see paragraphs BC4 and BC5) did not previously exist in IFRS Standards. Therefore, the recognition criteria for contract liabilities in a business combination used by U.S. entities are likely different from the recognition criteria utilized by those entities that follow IFRS Standards. The difference in how the recognition criteria is applied between U.S. and international entities should be resolved by the amendments in this Update because the performance obligation criteria selected by the Board are more consistent with the conceptual definition of a liability.

BC47. Based on the research and outreach performed, the Board also observed that there is diversity in how an entity currently measures the fair value of contract liabilities for certain arrangements, such as licenses to intellectual property. That is, there may be diversity in considering which direct, incremental costs are necessary to fulfill the remaining performance obligation under fair value measurement techniques. Therefore, while both standards require that an entity measure the fair value of contract liabilities acquired in a business combination, the resulting measurement of similar contract liabilities may be inconsistent. The amendments in this Update address the diversity in current fair value measurement techniques for certain arrangements by requiring that an entity measure contract liabilities in accordance with Topic 606, although doing so will not result in enhanced convergence between GAAP and IFRS Standards.

Alternative Approaches Considered but Dismissed by the Board

BC48. The Board also considered an alternative approach that would have retained the fair value measurement principle in Topic 805. The net fair value approach would require that an entity (acquirer) measure the fair value of an acquired revenue contract at the acquisition date as the difference between the fair value of the expected remaining net contractual payments and the fair value of the remaining unsatisfied or partially unsatisfied performance obligation(s). Under this approach, an acquirer would recognize and present either a contract asset (when the fair value of the remaining contractual payments exceeds the fair value of the remaining performance obligations) or a contract liability (when the fair value of the remaining unsatisfied performance obligations exceeds the fair value of the remaining contractual payments) for acquired revenue contracts.

BC49. The approach theoretically would utilize the same contractual net cash flows to value an acquiree's revenue contracts that are currently recognized and measured within customer-related intangible assets. The net fair value approach would have effectively reclassified those cash flows from intangible assets into a separate identifiable contract asset or liability for each acquired revenue contract or aggregated group of revenue contracts.

BC50. The Board ultimately rejected this approach because it concluded that the benefits may not justify the costs after all issues were considered. The Board agreed with stakeholders' operability concerns both at the acquisition date when measuring the fair value of the acquired revenue contracts and after the acquisition date when accounting for the acquired revenue contracts under Topic 606. The Board indicated that the costs and complexity of this approach would be exacerbated by the existence of any acquired revenue contract that contained variable consideration. Additionally, the Board explained that the net fair value approach would likely have amplified the effect of fair value measurement on acquired revenue contracts and the subsequent amount of revenue recognized from those contracts. Therefore, financial statement users would have continued to request non-GAAP disclosures or supplemental information from preparers about the fair value adjustments and their effect on the revenue recognized subsequently by the entity.

Scope

BC51. The amendments in this Update apply to entities that enter into a business combination within the scope of Subtopic 805-10 that includes contract assets and contract liabilities as defined by Topic 606. The Board decided that the scope should be broader than revenue contracts with customers and include all contracts that contain contract assets and contract liabilities, such as contract liabilities from the sale of nonfinancial assets within the scope of Subtopic 610-20, that are recognized and measured using the guidance in Topic 606. In reaching this decision, the Board agreed with outreach participants and the majority of comment letter respondents that the amendments should apply to all contracts to which the provisions of Topic 606 apply because that will result in applying consistent principles in the Codification to similar assets and liabilities (that is, all contract assets and contract liabilities). The Board does not expect that the broader scope of the guidance will cause uncertainty about which acquired contracts are within the scope of the amendments.

BC52. While comment letter respondents generally did not have concerns about which contracts are within the scope of the amendments, some of them questioned whether specific assets and liabilities other than contract assets and contract liabilities are included within the scope. During redeliberations, the Board affirmed that the amendments in this Update apply only to contract assets and contract liabilities as defined in Topic 606 from contracts with customers and other contracts to which the provisions of Topic 606 apply. The Board indicated that other assets and liabilities that may be recognized under Topic 606, such as refund liabilities and upfront payments to customers, or under related Topics, such as deferred costs under Subtopic 340-40, Other Assets and Deferred Costs—Contracts with Customers, are not within the scope of the amendments. The Board decided not to expand the scope of the proposed amendments to those other assets and liabilities because the proposed amendments addressed the objective of providing consistency in postacquisition revenue for acquired revenue contracts and because the Board had concerns about potential consequences of further expanding the scope and delaying the timing of issuance.

BC53. A few respondents suggested that it was unclear whether the current expected credit losses (CECL) allowance for contract assets was included within the scope of the proposed amendments and whether the allowance is required to be established at the acquisition date in accordance with the guidance in the proposed Update. Paragraph 606-10-45-3 requires that an entity assess a contract asset for credit losses in accordance with Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost. Based on subsequent outreach, the Board concluded that the accounting for the CECL allowance for acquired contract assets is likely not a significant issue for most entities. The Board also indicated that the amendments in this Update focus on addressing the accounting for acquired revenue contracts in a business combination and were not intended to address application of Subtopic 326-20 to acquired contract assets.

Disclosures

BC54. The Board decided not to require additional general disclosures or transition disclosures because the disclosures would not have provided incremental information that would have been useful for users of financial statements and, therefore, would have resulted in unnecessary costs for preparers. The Board indicated that the amendments in this Update affect only the recognition and measurement of acquired revenue contracts under Topic 805 and that entities still need to adhere to the disclosure requirements in Topic 805. The majority of comment letter respondents agreed that additional general disclosures or transition disclosures should not be provided. A few respondents suggested additional disclosures such as the amount of contract liabilities (deferred revenue) acquired in a business combination as well as the effect on contract assets and contract liabilities in each period that there is a material effect from the amendments in this Update.

BC55. The Board agreed with outreach participants and comment letter respondents that the current disclosures required under Topic 805 and Topic 606 will provide sufficient information for users of financial statements both during and after the period of the business combination. Specifically, the Board considered the requirements in Topic 805, such as paragraphs 805-20-50-1(c) and 805-10-50-2(h) and in Topic 606, such as paragraphs 606-10-50-10 and 606-10-50-13. Paragraph 805-20-50-1(c) requires that an entity disclose each major class of assets acquired and liabilities assumed at the acquisition date. If the acquired contract asset or liability balance was material, it generally would be included in this disclosure. Paragraph 805-10-50-2(h) requires that a public entity disclose the amounts of revenue and earnings of the acquiree included in the consolidated income statement for the annual period of the acquisition and supplemental pro forma information about revenues and earnings of the combined entity. Paragraph 606-10-50-10 requires that an entity disclose the balance of contract assets and contract liabilities, including an explanation of the changes in the contract asset and the contract liability balance during the reporting period related to business combinations. Paragraph 606-10-50-13 requires that an entity provide information on the transaction price allocated to the remaining performance obligations (that is, revenue that will be recognized in a future period when [or as] the performance obligation is satisfied).

BC56. In response to comment letter feedback, the Board considered requiring additional disclosures as part of the amendments in this Update, such as the amount of deferred revenue acquired in a business combination. However, the Board concluded that for business combinations in which material contract liabilities are acquired, existing disclosures are sufficient to provide decision-useful information that is similar to the additional information requested by comment letter respondents and other stakeholders.

Effective Date and Transition

BC57. The Board decided that the amendments in this Update should be adopted prospectively and that early application is permitted. The majority of comment letter respondents agreed with the proposed transition and that entities should be permitted to early adopt for reasons similar to those that the Board discussed in deliberations.

BC58. The Board indicated that retrospective application of the amendments in this Update could result in unnecessary costs and complexity for preparers and that the information provided from retrospective application would have been limited. The Board indicated that some complexities that may arise as a result of requiring retrospective application include that recognizing additional performance obligations and remeasuring all acquired contract liabilities in accordance with Topic 606 (that is, reversing the fair value adjustments) could affect (a) the measurement of goodwill in the business combination, which could raise questions about whether retrospective impairment assessments need to be made, and (b) previous amounts of revenue recognized by the acquirer after the business combination, which could raise additional issues for income taxes and other projections.

BC59. With its decision to allow entities to early adopt the amendments in this Update, the Board clarified that an entity that elects to early adopt the amendments in an interim period should apply the amendments to all business combinations that have occurred since the beginning of the fiscal year that includes that interim period. The Board reached this decision because if the amendments were not adopted as of the beginning of the year, it could result in inconsistent revenue recognition policies if a business combination was completed earlier in the fiscal year and provide users of financial statements with noncomparable information.

BC60. The Board concluded that the amendments in this Update should be effective for public business entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. The effective date for public business entities is consistent with comment letter feedback that the amendments would not take a significant amount of time to implement because they simplify the current accounting in this area and likely will not require any system changes or updates. The Board also decided that for all other entities, the amendments in this Update should be effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. The effective date for all other entities responds to input from most respondents that entities other than public business entities should be provided with additional time to adopt the amendments.

Amendments to the GAAP Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require improvements to the GAAP Financial Reporting Taxonomy and SEC Taxonomy (collectively referred to as the "GAAP Taxonomy"). Those improvements, which will be incorporated into the proposed 2022 Taxonomy, are available through GAAP Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.