Members of the Emerging Issues Task Force (EITF or Task Force) reached a consensus-for-exposure on one issue. The consensus-for-exposure is subject to ratification by the Financial Accounting Standards Board (FASB) at a meeting later this month.

The Task Force reached a consensus-for-exposure on the following issue:

**Issue 19-A:** The Task Force decided that an entity that applies the measurement alternative in Accounting Standards Codification (ASC or Codification) 321 should consider all observable transactions, including those that result in the entity initially applying or discontinuing the use of the equity method of accounting under ASC 323. The Task Force also decided that certain forward contracts and purchased options on equity securities that are not deemed to be in-substance common stock or accounted for as derivatives under ASC 815 are in the scope of ASC 321.

The Task Force also discussed the following issue but did not reach a final consensus:

**Issue 18-A:** The Task Force discussed its consensus-for-exposure that would require an acquiring entity in a business combination accounted for under ASC 805 to use the definition of a performance obligation in ASC 606 to determine whether an assumed liability should be recognized in a revenue contract with a customer. However, the Task Force decided to defer affirming the consensus-for-exposure until the FASB decides whether it will address questions about how to measure an assumed liability in a revenue contract.

The FASB staff led an educational discussion for the Task Force on EITF Issue 19-B, Revenue Recognition – Contract Modifications of Licenses of Intellectual Property. No decisions were made.
Consensus-for-exposure


What’s the issue?

ASC 323 requires an investor to apply the equity method of accounting if an investor has significant influence (e.g., ownership of 20% to 50% of voting common stock) over the operating and financial policies of an investee.

Equity investments (except those accounted for under the equity method and those that result in consolidation of the investee and certain other investments) are in the scope of ASC 321. Equity investments in the scope of ASC 321, including certain forward purchase contracts and call options, are generally measured at fair value, and any changes in fair value are recognized through net income. However, investors are permitted to elect a measurement alternative for equity investments that (1) do not have readily determinable fair values and (2) do not qualify for the practical expedient in ASC 820 to measure fair value using the net asset value per share. Under the measurement alternative, if an entity identifies observable price changes in orderly transactions for the identical investment or a similar investment of the same issuer, it remeasures the equity investment at fair value as of the date the observable transaction occurred.

Stakeholders have raised questions about the interaction between ASC 323 and ASC 321. The questions include (1) whether to consider observable transactions under the measurement alternative in ASC 321 when either initially applying or discontinuing the equity method of accounting under ASC 323; (2) the sequence of the allocation of equity method losses under ASC 323 to other investments in the same investee that are accounted for under the measurement alternative in ASC 321 and remeasurements under the measurement alternative due to an observable transaction; and (3) how to account for certain forward contracts and purchased options where the underlying equity, individually or with existing investments, would be accounted for under the equity method when the forward contract is settled or the purchased option is exercised.

The Task Force reached a consensus-for-exposure that an entity that applies the measurement alternative in ASC 321 should consider observable transactions that result in the entity initially applying the equity method of accounting or discontinuing the use of the equity method.

The Task Force also decided that an entity should not consider whether the equity security underlying the forward contract or purchased option would, individually or with existing investments, be accounted for under the equity method upon settlement of the forward contract or exercise of the purchased option when determining the accounting for the forward or option in the period before it is settled or exercised, respectively. That is, an entity should account for the forward contract or purchased option under ASC 321. This consensus-for-exposure would apply to forward contracts and purchased options on equity securities that are not deemed to be in-substance common stock or accounted for as derivatives under ASC 815.

The Task Force discussed but did not reach a consensus on the sequence of the allocation of equity method losses under ASC 323 to other investments in the investee (e.g., preferred stock) that are accounted for under the measurement alternative in ASC 321 and remeasurements under the measurement alternative due to an observable transaction. The FASB staff will perform further research on whether this issue is pervasive before the Task Force decides whether (and, if so, how) to move forward.

Effective date and transition

The consensus-for-exposure would be applied prospectively. The Task Force will discuss an effective date after it considers feedback on the consensus-for-exposure.
Issues discussed

Issue 18-A: Recognition under Topic 805 for an Assumed Liability in a Revenue Contract

What’s the issue?
ASC 805 requires the acquirer in a business combination to recognize and measure the identifiable assets it acquires, the liabilities it assumes and any noncontrolling interest in the acquiree at fair value (with certain limited exceptions). Because the new revenue standard (ASC 606) defines a performance obligation more broadly than what is known in practice as a legal performance obligation, questions have arisen about when an assumed liability in a revenue contract (i.e., deferred revenue) should be recognized.

Acquirers historically have recognized deferred revenue in a business combination if they determined that they had a legal performance obligation to transfer goods or services to a customer under the related revenue contract. That’s because ASC 805 does not provide guidance on recognizing and measuring deferred revenue in a business combination.

ASC 606 defines a performance obligation in the Codification for the first time, and the definition of a performance obligation is broader than an obligation that is legally enforceable (e.g., a performance obligation could include a constructive obligation to provide maintenance and support of symbolic intellectual property). As a result, stakeholders questioned whether they should recognize assumed liabilities in an acquired revenue contract when they have a performance obligation under ASC 606 or a legal performance obligation. Stakeholders also asked for clarification on how liabilities should be measured.

The Task Force discussed feedback from stakeholders on a proposed Accounting Standards Update (ASU) that is based on its consensus-for-exposure that would require the acquiring entity in a business combination to apply the definition of a performance obligation in ASC 606 to determine when contract liabilities in a revenue contract with a customer should be recognized. Most respondents to the ASU supported applying the definition of a performance obligation to determine when contract liabilities in a revenue contract with a customer should be recognized, but many respondents said that finalizing the recognition guidance before considering the measurement issues described in an Invitation to Comment (ITC) the FASB issued as a companion to the ASU would not reduce diversity in practice.

While the Task Force continues to support its consensus-for-exposure, the Task Force decided not to move forward with a final consensus on the issue of recognition until the FASB determines whether it will address how to measure an assumed liability in a revenue contract.

The FASB will consider stakeholder feedback on the ITC at a future meeting and decide how to move forward.

How we see it
We continue to believe that an acquiring entity should consistently apply the definition of a performance obligation. That is, we believe an acquirer should apply the definition of a performance obligation in ASC 606 to determine whether it has assumed a performance obligation from the acquired entity receiving consideration (or the amount is due) from the customer.

Because the Task Force has decided to delay moving forward with a final consensus, it is possible that there may be some diversity in practice in how acquiring entities identify a performance obligation in a business combination. Stakeholders should monitor developments.
What’s the issue?
The guidance in ASC 606 is not clear on when revenue should be recognized if a modification of a license of intellectual property (IP) is not solely a renewal of the same terms and conditions as the original license. As a result, some entities believe that revenue for a license renewal should be recognized when the modification is approved by both the licensor and licensee, while others believe revenue should be recognized at the end of the original license term, which may be later than when the modification is approved.

The licensing guidance states that “an entity would not recognize revenue before the beginning of the license period even if the entity provides (or otherwise makes available) a copy of the intellectual property before the start of the license period or the customer has a copy of the intellectual property from another transaction. For example, an entity would recognize revenue from a license renewal no earlier than the beginning of the renewal period.” (Emphasis added.) The guidance also includes an example (Example 59) that illustrates the application of this guidance for a renewal of a license of IP under the same terms and conditions as the original license.

Because the licensing guidance doesn’t address modifications that are not solely a renewal of the terms and conditions of the original license (e.g., the modification also adds other goods or services, the modification changes the pricing), questions have arisen about whether an entity is required to defer revenue recognition until the end of the original license term in these situations or whether it can recognize revenue earlier than the entity in the example in the guidance.

Questions have also arisen about how to account for a modification that includes a reduction in the rights conveyed by the license (e.g., the number of users of a license) or when the license is revoked (e.g., a software license is converted into a software-as-a-service arrangement).

The FASB staff led an education session with the Task Force about the issue. No decisions were made. Instead, the Task Force provided the FASB staff with preliminary feedback and identified questions for a working group comprising experts in the technology, pharmaceutical and media and entertainment industries to consider as part of their feedback on the application of the alternatives identified by the FASB staff.

Endnotes:

1  ASC 321, Investments – Equity Securities.
2  ASC 323, Investments – Equity Method and Joint Ventures.
3  ASC B15, Derivatives and Hedging.
4  ASC 805, Business Combinations.
5  ASC 606, Revenue from Contracts with Customers.
6  ASC 820, Fair Value Measurement.
7  The concept of a legal performance obligation is leveraged from previously existing guidance in EITF 01-3, Accounting in a Business Combination for Deferred Revenue of an Acquiree.
9  Invitation to Comment, Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805.