

March 15, 2021

Technical Director

Financial Accounting Standards Board

401 Merritt 7, P.O. Box 5116

Norwalk, CT 06856-5116

File Reference No. 2020-1000

The Accounting Principles Committee of the Illinois CPA Society (“Committee”) appreciates the opportunity to provide its perspective on the *Proposed Accounting Standards Update, Business Combinations (Topic 805) Accounting for Contract Assets and Contract Liabilities from Contracts with Customers* (herein referred to as the “Update”).The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

The Committee supports the Board’s efforts to reduce diversity in practice and improve comparability by specifying the circumstances in which an acquirer should recognize either assets or liabilities from revenue contracts with customers that are acquired in a business combination. However, we disagree with the Board’s measurement of acquired contract assets and liabilities. We do not support further exceptions to the fair value measurement principle in ASC 805 and do not believe the Update as currently drafted will simplify an area of business combination accounting. The basis for conclusions for the acquisition method of accounting in FAS 141R cited the use of fair value for almost all of the assets acquired and liabilities because that information allows users of those financial statements to better assess the initial investment made and related subsequent performance of those assets and liabilities. While the Update may improve comparability after a business combination, the Committee believes measuring acquired assets and liabilities in business combination at fair value provides more relevant information regarding future cash flows associated with acquired assets and liabilities and that the Update would merely reduce but not eliminate comparability issues associated with business combination; e.g., measuring acquired inventories at fair value also distorts gross margin. The Committee notes that the core principle in ASC 606 is to reflect revenue that *“..depict the transfer of a promised goods or services to customers in an amount that reflects the consideration [emphasis added] to which the entity expect to be entitled in the exchange*” and that continuing the acquiree’s accounting for contract liabilities does not reflect the inherent economics to the acquirer as a result of the business combination. The Committee also believes the Update will not reduce complexity in accounting for business combinations because, as noted by the Board in paragraph BC28, application of the Update may not be as simple as carrying over the acquiree’s recorded contract assets or contract liabilities. Acquirors will need to evaluate all acquired customer contracts for recognition and measurement versus only those contracts that have contract assets or outstanding performance obligations at the date of acquisition. In addition, as noted by the Board in paragraph BC29 and BC30, while currently not prevalent in practice today, the Board elevated the expectation that acquired revenue contracts would need to be evaluated for off-market contract terms, which could give rise to the measurement and recognition of an additional asset or liability beyond the acquiree’s ASC 606 contract assets and contract liabilities. This provision in the Update’s basis for conclusion may result in diversity in practice. Some entities may now evaluate acquired contracts for off-market terms notwithstanding this is not current practice, while others may continue current practice. Further, to the extent a customer contact is off-market, the valuation, which will result in an additional asset or liability, would presumably result in an accounting outcome not significantly different from that required by ASC 805 currently in so far as those contract liabilities are also legal obligations, thereby negating the objective of the Update. If that was the intent of the Board, we recommend the Board consider including that guidance in the standards versus the basis for conclusion (and therefore not in the Codification), and provide guidance on the appropriate measurement and presentation of off-market assets and liabilities post combination.

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Our responses to the questions posed in the Update are set out below. We appreciate the opportunity to provide our comments and observations on the proposed Update and would be pleased to discuss them with the Board members or the FASB staff at your convenience.

Sincerely,

**William Keirse, CPA**
Chair, Accounting Principles Committee

**Matt Mitzen, CPA**
Vice Chair, Accounting Principles Committee

**Question 1:** Should an entity be required to recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with Topic 606? If not, please explain why and what alternative would be more appropriate.

**Response:** We agree an entity should be required to recognize contract assets and contract liabilities in a business combination in accordance with Topic 606. However, as noted in our introduction, the Committee does not believe an entity should use Topic 606 for the measurement of acquired contract assets and contract liabilities in a business combination. Said differently, we believe an acquiror should recognize an acquiree’s contract assets and contract liabilities as those terms are defined in ASC 606; however, those acquired contract assets and contract liabilities should be measured as fair value. The Committee agrees with the alternative views expressed by Ms. Botosan and Mr. Schroeder in the Update regarding why we do not support another exception to ASC 805 fair value measurement. We believe post-combination revenues would be overstated and not reflect the inherent economics of a business acquisition transaction on post-combination results of operations for the entity. The Committee supports the continued use of ASC 805 fair value measurement principles for acquired contract assets and contract liabilities. We believe practice is familiar with these measurement principles which are well established since EITF No. 01-3, “*Accounting in a Business Combination for Deferred Revenue of an Acquiree.*”

**Question 2:** Is the recognition guidance in the proposed amendments understandable and operable? If not, please explain why.

**Response**: Yes the recognition guidance in the Update is operable.

**Question 3:** Is the measurement guidance in the proposed amendments understandable and operable? If not, please explain why.

**Response**: We believe the measurement guidance in the Update is understandable and operable given it is based on ASC 606; however, the introduction and the basis for conclusions note that the Update does not affect the accounting for other assets and liabilities that may arise from revenue contracts with customers in a business combination which may create diversity in practice. Specifically, paragraphs BC29 and 30 indicate that, notwithstanding that accounting for off-market contract terms in acquired revenue contracts is not currently prevalent in business combinations, customer contracts should be evaluated for off-market terms, and “…an additional asset or liability may be recognized in the business combination for off-market terms.” If the Board intends financial statement preparers to evaluate off-market terms for customer contracts, as currently is the practice for other acquired contracts, we suggest the Board include that language in the Update and not in the basis for conclusions (and therefore not in the Codification). The Update also does not provide guidance on the subsequent accounting for any off-market asset or liability that would be recognized, which could create diversity in reporting. If the Board had intended otherwise, we suggest the Board provide further clarification and guidance regarding the identification, initial measurement, and subsequent measurement and presentation of off-market acquired customer contracts.

**Question 4:** The proposed amendments would not amend the existing guidance for other assets or liabilities that may arise from revenue contracts from customers in a business combination, such as customer-related intangible assets and contract-based intangible assets. Is the existing guidance on customer-related intangible assets and contract-based intangible assets, such as contracts with off-market terms, understandable and operable under the proposed amendments? If not, please explain why and what additional guidance would be necessary to make it operable.

**Response**: We do not believe further guidance is needed to address the accounting for customer-related intangible assets as we do not foresee the existing guidance being impacted by the Update. See our response above regarding the assessment of contracts with off-market terms.

**Question 5:** If the recognition or measurement guidance in the proposed amendments is inoperable or is overly burdensome, are there any practical expedients that should be considered?

**Response**: We do not believe any practical expedients are warranted.

**Question 6:** Would the proposed amendments result in financial reporting outcomes that are appropriate and meaningful for users of financial statements? Please explain why or why not.

**Response:** The Committee believes the Update will not result in post-combination financial reporting outcomes that are appropriate or meaningful to financial statement users and could result in entities overstating post-acquisition revenue. If the Update is approved as drafted, we encourage the Board to require additional disclosure regarding revenues that were “purchased” in a business combination and will not result in cash inflows to the entity. If the objective of financial reporting is to provide users with insight into a company’s future cash inflows and outflows, recognizing the acquired entity’s deferred revenue as post-combination revenue would not achieve that objective if the acquired entity received the consideration under the arrangement prior to the acquisition.

**Question 7:** The scope of the proposed amendments would include contract assets and contract liabilities from other contracts that apply the provisions of Topic 606, such as contract liabilities from the sale of nonfinancial assets within the scope of Subtopic 610-20. Should the proposed amendments be applied to contracts beyond contracts with customers that also are accounted for in accordance with Topic 606? If not, please explain why.

**Response:** Yes, the Committee believes the Board should consider the recognition criteria but not measurement criteria in the Update to other contracts that apply the provisions of Topic 606 such as those under Subtopic 610-20, as well as customer contracts acquired in an asset acquisition. As noted in our response above, we believe those contract assets and contract liabilities should be measured at fair value.

**Question 8:** The proposed amendments would require no incremental disclosures. Should other disclosures be required; for example, are additional disclosures needed that would provide investors with the information necessary to distinguish between acquired revenue contracts and originated revenue contracts? If yes, please explain why and provide the additional disclosures that should be required.

**Response**: See our response to question 6.

**Question 9:** Should the proposed amendments be applied on a prospective basis? If not, what transition method would be more appropriate and why?

**Response**: The Committee supports adoption of the Update prospectively, but also supports allowing entities to adopt the Update retrospectively to the earliest period presented in comparable financial statements. Although retrospective adoption may be challenging, given some customer contract liabilities have performance obligations that span several reporting periods, allowing some entities to adopt retrospectively may result in more comparable financial statements as intended by the Update.

**Question 11:** Is the early application requirement appropriate as proposed, or should an entity not be required to apply the proposed amendments to all prior business combinations that occurred since the beginning of the annual period if the proposed amendments are applied in an interim period? Please explain why or why not.

**Response:** The Committee supports the early application requirement as proposed; however, we do not believe an entity should be required to adopt the Update to all prior business combinations that have occurred since the beginning of the annual period that includes the interim period of adoption. If the Update is to be applied prospectively as currently drafted, the period of adoption, regardless if the Update was adopted in an interim period, or at the beginning of the annual period that includes the interim period of adoption, may not be comparable to prior interim or annual periods due the past business combinations accounted for under legacy GAAP. If the Board is concern with comparability, we believe the Board should allow entities to retrospectively adopt the Update as noted above.

**Question 12:** IFRS Standards on business combinations contain guidance similar to what is currently in Topic 805. The proposed amendments would create a difference between IFRS Standards and Topic 805 for measuring contract assets and contract liabilities acquired in a business combination. Would differences in that area of the guidance create additional costs or complexity for entities or users of financial statements? Please explain why or why not.

**Response**: Under the Update, reporting entities that report under both U.S. GAAP and IFRSs and that acquire a business will, at a minimum, be required to maintain two sets of books and records, which will lead to incremental costs for reporting entities. We believe the Update will create unnecessary comparability issues between U.S. GAAP and IFRS. While we are aware of existing differences between the two sets of standards, as noted in our responses above, we do not believe the Update which will create different measurement guidance between U.S. GAAP and IFRS is warranted.

 APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE

 ORGANIZATION AND OPERATING PROCEDURES

2020-2021

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee’s comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

**Public Accounting Firms:**

 **Large:** (national & regional)

 Ryan Brady, CPA Grant Thornton LLP

 Ashley Carboni, CPA KPMG LLP

 Michael Couillard, CPA Baker Tilly Virchow Krause LLP

 Matthew Denton, CPA Sikich LLP

 Jason Eaves, CPA Crowe LLP

 William Keirse, CPA (Chair) Ernst & Young LLP

 Melissa Lynch, CPA Plante Moran, PLLC

 Jason Plourde, CPA Grant Thornton LLP

 Darshana Raigaga, CPA BKD LLP

 David Wentzel, CPA Crowe LLP

**Medium:** (more than 40 professionals)
Danielle Martin, CPA Porte Brown LLC
Jeffery Watson, CPA Miller Cooper & Company Ltd

**Small:** (less than 40 professionals)
Peggy Brady, CPA Selden Fox, Ltd.
Brian Kot, CPA Cray Kaiser Ltd CPAs

Matthew Mitzen, CPA (Vice Chair) Bronswick Benjamin P.C.

**Educators:**

 Mollie Adams, CPA Bradley University

 John Hepp, CPA University of Illinois at Urbana-Champaign

**Industry:**

 John Bercerril, CPA Elkay Manufacturing

 Jeffrey Ellis, CPA FTI Consulting, Inc.

 Michael Maffei, CPA GATX Corporation

Thomas Masterson, CPA Medix

Elizabeth Prossnitz, CPA Consultant

Lisa Sezonov, CPA Northern Trust

Richard Tarapchak, CPA II-VI Inc.

William Wang, CPA Union Tank Car Company

Daniel Wilfong, CPA Ansira, Inc.

**Staff Representative:** Rafael Wiesenberg, CPA Illinois CPA Society