

Board Meeting Handout
Post-Implementation Review of Topic 606, Revenue from Contracts with Customers
July 28, 2021

Meeting Purpose

1. The purpose of this meeting is to provide the Board with an update on the public company post-implementation review (PIR) activities that have been completed to date for Revenue from Contracts with Customers (Topic 606). The discussion will primarily focus on PIR activities conducted from 2018 to 2021 in the post-effective date phase.

Questions for the Board

1. For public companies, does the Board have any questions or comments on the feedback received to date as part of the PIR process?
2. Would Board members like the staff to perform additional research on the issues in paragraph 127 of this handout? Do Board members have any feedback on other areas for the staff to focus on as we continue the PIR process?
3. For nonpublic entities, does the Board have any feedback on the PIR plan?

Background

2. The main objectives of the PIR process are to determine whether a standard is accomplishing its stated purpose, evaluate the selected standard's implementation and continuing compliance costs and related benefits, and provide feedback to improve the standard-setting process. There are three stages in the PIR process:
 - (a) Stage 1: Post-Issuance Date Implementation Monitoring of the PIR Process
 - (b) Stage 2: Post-Effective Date Evaluation of Costs and Benefits
 - (c) Stage 3: Summary of Research and Reporting.

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

3. Stage 1 PIR activities started after the issuance of Topic 606 in 2014, with a focus on monitoring and assisting stakeholders with the implementation of the new standard. Given that Topic 606 was effective for public companies in 2018 and for nonpublic entities in 2020, the Stage 1 PIR process has been mostly completed other than implementation monitoring through technical inquiries. The following table summarizes the completed Stage 1 PIR activities.

Implementation Efforts	Number of Public Meetings / Webcasts	Number of Submissions / Comment Letters	Number of TRG Memos / ASUs Issued
Transition Resource Group (TRG)	8	100	60
Technical Inquiries	-	327	-
Accounting Standards Updates—Effective Date Deferral	3	113	2
Accounting Standards Updates—Clarification or Simplification	25	158	7
Total	36	698	69

4. In 2018, following the adoption of Topic 606 by public companies, the staff began the Stage 2 PIR activities for public companies to evaluate the costs and benefits associated with Topic 606, while also continuing the implementation monitoring activities for nonpublic entities. As of July 2021, the staff has completed the majority of the stakeholder outreach for public companies and started the outreach for nonpublic entities. The primary focus of this memo is on Stage 2 PIR activities.
5. In May 2019, the Board added Emerging Issues Task Force (EITF) Issue No. 19-B, “Revenue Recognition—Contract Modifications of Licenses of Intellectual Property,” to the technical agenda based on agenda requests received from two stakeholders. The scope of that project included (a) accounting for contract modifications for which the contract term for existing rights is extended while adding new rights and (b) accounting for the revocation of licensing rights (including conversion of term software licenses to software as a service (SaaS) arrangements). At its meeting on March 11, 2021, the EITF recommended moving this project back to the Board for consideration as part of the PIR process. At the March 24, 2021 meeting, the Board removed the project from its technical agenda and decided to consider the issue as part of the PIR process for Topic 606. All the stakeholder feedback received on this EITF issue has been communicated to the Board in the [EITF Issue Summaries which are available on FASB’s website](#). Accordingly, the staff has not repeated that research or outreach in this handout.

PIR Activities Related to Post-Effective Date Evaluation of Costs and Benefits

6. During the Stage 2 PIR process, the staff solicited feedback from stakeholders on the adoption and recurring costs, as well as the benefits associated with the implementation of Topic 606 through individual meetings, group meetings, and surveys. The following table summarizes the outreach that the staff conducted with all types of stakeholders through June 2021.

Stakeholder Category	Number of Stakeholders	Interactions with Stakeholders
Users (Buy-Side, Sell-Side, and Credit)	61	82
Preparers – Public Companies	11	17
Preparers – Nonpublic Entities	-	-
Preparers Survey	42	42
Trade Groups	1	1
Academics	2	2
Auditors	16	24
Regulators	1	3
Advisory Groups	5	11
Total	139	182

7. Overall, stakeholders' feedback on Topic 606 is positive. Investors, which accounted for nearly half of the outreach population, generally agreed that Topic 606 provides more useful and transparent information, especially through improved disclosures, and achieves its expected benefits for a majority of sectors. Although there were some challenges to understand revenue trends during the transition period, the costs incurred by the users were mostly one-time occurrences. Many preparers noted that the implementation of Topic 606 was challenging, and they incurred costs, primarily one-time costs, in the areas such as personnel (including redeploying current employees and hiring external consultants or hiring new employees), audit costs, and IT systems. However, preparers generally agreed that over the long term, revenue recognition changes were viewed positively. Many preparers also noted that Topic 606 had no material effects on their financial statement amounts. Practitioners observed that many preparers underestimated the efforts and resources required to implement Topic 606, but the types of costs incurred were in line with the FASB's expectations.

Financial Statement User Focus

8. Overall, users that participated in the revenue PIR process stated that Topic 606 provides more useful and transparent information, especially through the disclosure about revenue recognition which has been expanded under Topic 606. Participants that usually are generalists (users that are not sector or industry specific) observed that Topic 606 improves the consistency or comparability of revenue across sectors, although they noted that many sectors did not experience significant changes in recognition and measurement under Topic 606. However, some participants that focus on certain sectors, such as software/licensing, observed reduced comparability resulting from the changes made to the revenue recognition timing and measurement under Topic 606. As a result, those users have been using some non-GAAP metrics (such as annual recurring revenue (ARR), average contract duration, etc.) in their analyses and would prefer that disclosure of disaggregated revenue by recognition timing (point in time versus over time) be required. Particularly, some users said that upfront revenue recognition in certain sectors does not align with the economics of the transactions and creates comparability issues with companies that recognize similar transactions over time. Many participants observed that they experienced some challenges to understand the trend of revenue under the modified retrospective method and/or that the practical expedients decreased comparability among the companies. Although users incurred costs to familiarize themselves with the new standard, update their analyses or maintain dual models, those costs were mostly one-time occurrences.

User Outreach

9. The staff has communicated with users to provide educational materials and resources about the standard and to discuss their questions and observations since the issuance of the guidance. For example, in 2017, FASB hosted a series of user focused education sessions for the aerospace and defense, software, airline, and healthcare industries. Feedback also was received from IAC in 2018 immediately following the effective date of the guidance for public companies. Noting that feedback was so close to the adoption date and focused on transition rather than ongoing costs and benefits, the staff waited to complete the additional user outreach until users had been able to have three-year trend data (that is, once all comparative periods in the financial statements would be reported under Topic 606).
10. Accordingly, in 2021, 3 years after public company adoption, the staff, accompanied by some Board members, conducted user outreach to solicit feedback about costs and benefits of Topic 606. The users that participated in the outreach include 10 sell-side analysts, 7 buy-side analysts, and 4 credit analysts. Some users are generalists while

others cover specific sectors, such as technology, healthcare, industrials, consumer packaged goods, cable, and telecommunications, etc.

Benefits

11. Users generally agreed that Topic 606 achieved its expected benefits. Topic 606 provides more useful and transparent information to help users understand an entity's contract term, revenue recognition policy, and revenue reported on the financial statements. Users stated that disclosures about revenue recognition have been improved under the guidance in Topic 606.
12. Users that usually are generalists or cover a wider range of sectors also observed that Topic 606 improves the consistency or comparability of revenue across sectors. However, other users that focus on certain sectors, such as software/licensing, observed reduced comparability. Users (including buy-side analysts, sell-side analysts, and credit analysts) noted that their understanding of revenue recognition policies across sectors is improved because of consistency in and broad understanding of the recognition model. Most users in the 2021 outreach only followed U.S. companies and did not comment on convergence with IFRS Standards although one user noted the increased comparability among aerospace companies in different jurisdictions as a result of the converged guidance under GAAP and IFRS Standards.
13. Some users, such as those who focus on industrials, consumer packaged goods, and cable and telecommunications, indicated that Topic 606 improves the timing of revenue recognition and better reflects the underlying economics. Some users, particularly those that cover companies in the software industry and healthcare industry, stated that the revenue recognition and measurement guidance under Topic 605, Revenue Recognition, better served their needs.
14. One credit analyst noted that many sectors did not have significant changes in recognition and measurement when adopting Topic 606. This analyst was unaware of any rating change related to the implementation of Topic 606 because this analyst's models are based heavily on cash flows and changes in recognition timing of revenue do not affect the economics of the transactions. Another credit analyst added that the judgment used in their models regarding timing of revenue recognition is different from those under Topic 606 in many cases in which cash net income is being calculated to determine funds from operations (for example, because of the disconnect in timing between cash collection and revenue recognition in some cases).

Disclosures

15. Users generally agreed that, compared with Topic 605, disclosures under Topic 606 provide more context around revenue numbers. Three users (two buy-side analysts and one credit analyst) observed that most of the public companies they follow did a good job of disclosing the transition effect of the new standard. One sell-side analyst commented that the disclosures can be a bit generic. Therefore, that analyst said that it would be helpful if a company were required to explain the revenue model for each product or service. Another sell-side analyst noted that Topic 606 has provided more useful disclosures, including some new metrics related to remaining performance obligations. However, many users observed that there is inconsistency in the level of details disclosed by companies (which is likely affected by the principle-based disclosure guidance). That is, not all companies disclose the same categories of disaggregation. One credit analyst commented that some information that used to be gathered outside the financial statements is now included in the financial statements and having that information audited is beneficial. Although those new disclosures requirements are useful, they do not help the credit analyst assess reasonableness of add-backs to Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) or calculate funds from operations (FFO). The following paragraphs summarize the key comments provided by users on disclosures.

Disaggregated Revenue

16. Most users agreed that the disaggregated revenue disclosure is helpful. One buy-side analyst said that the information provided in the disaggregated disclosure is typically more detailed than existing segment reporting. Another buy-side analyst noted that the disclosure disaggregates revenue to a much greater degree than had been provided before the adoption of Topic 606 and is very informative. However, some users said that they would prefer a further level of disaggregation. One buy-side analyst would like to have disclosure about revenue streams within a segment, especially when a company has different products with different recognition timing. Another sell-side analyst would prefer a disaggregated disclosure by different products or services to be required. For example, for software companies, this analyst would like to have maintenance revenue disaggregated from products and have product revenue disaggregated by types of software. One sell-side analyst observed that more software companies are moving away from purely contractually fixed revenue (such as a three-year subscriptions) to a consumption-/usage-/transaction-based approach, and/or a mixed fixed/not fixed approach. Therefore, this analyst suggested that a disaggregation of revenue based on earning pattern (that is, fixed/variable/as-delivered) would be helpful, in addition to mandated disclosure of revenue recognized at a point in time versus over time. One sell-side analyst said that the

disaggregated disclosure about the recognition timing (point in time versus over time) is helpful when a company provides that level of disaggregation. One buy-side analyst preferred a further breakdown of revenue. This analyst and one sell-side analyst also observed diversity in the disaggregated information provided by companies.

Remaining Performance Obligation (RPO)

17. Most users agreed that the disclosure about remaining performance obligation provides them with a more granular view into revenue recognition than previous disclosure requirements. One buy-side tech analyst noted that it is helpful to have a common definition of remaining performance obligation because there was so much variety in backlog information included in the management discussion and analysis (MD&A) section of annual reports. Another buy-side analyst said that the RPO disclosure provides information that is consistently requested by users. One credit analyst and one sell-side analyst stated that this information is frequently used. Another credit analyst thought that the RPO disclosure is the best thing that came out of Topic 606 even though there is inconsistency in this disclosure (for example, the inconsistency in how companies explain when the RPO amount is expected to be recognized as revenue). Several sell-side analysts, two buy-side analysts, and one credit analyst said that they would prefer more standardization in the disclosure as well as further disaggregation of RPO, such as disaggregation by segment, by year, or by nature of revenue (acquired versus organic). One sell-side analyst would like to see a rollforward of RPO during the reporting period. Another sell-side analyst would prefer a reconciliation from backlog (which is included in MD&A) to RPO (which is included in the footnotes).

Contract Balance and Changes

18. One sell-side analyst said that changes to contract assets and contract liabilities are helpful to determine future differences between revenue and cash flow. Another sell-side analyst said that the disclosure about out-of-period revenue is helpful although the utility is limited without a rollforward of contract liabilities. Another sell-side analyst noted that disclosure about contract assets is useful to get information about billings, but that it would be more useful to know how much revenue went to contract assets (that is, how much revenue has been recognized but not billed). One credit analyst said that they use this disclosure frequently but ultimately do not focus much on changes to the balance sheet unless those changes affect cash flow statement presentation. One buy-side analyst noted that some analysts continue to use the term *deferred revenue* (from Topic 605) when discussing this topic because some users do not understand what contract assets or contract liabilities represent. In addition, this analyst stated that decisions usually are not made based on the

information provided by this disclosure. Another credit analyst observed that when a company has term licenses, contract assets that represent the difference between revenue recognized and cash received are usually included in other assets. The lack of transparency in the presentation caused some complexity in the analysis. Although a few users provided feedback about these disclosures, feedback about contract assets and contract liabilities was not pervasive throughout the outreach discussions.

Significant Judgment Disclosure

19. One credit analyst said that the disclosure about significant judgment on the amount and timing of revenue has been the most helpful disclosure because it gives insight into how revenue contracts are structured. One sell-side analyst would prefer a greater amount of quantification in the significant judgment disclosure. One buy-side analyst noted that the qualitative information of the significant judgment disclosure is helpful to the extent it is company-specific, rather than boilerplate.

Costs

20. Users noted that although they incurred costs to become familiar with the new standard, update models, or maintain dual models during the transition period, most of those costs were nonrecurring. For users that are generalists or that cover sectors that did not have significant changes to revenue recognition measurement or timing under Topic 606, the costs were not significant.
21. About half of the users mentioned that they experienced some challenges to understand the trend of revenue under the modified retrospective method or that the practical expedients (such as the practical expedients for RPOs) decreased comparability among companies. Two sell-side analysts said that the disruption caused by the transition has resolved itself because enough time has passed to build up the trend. Two buy-side analysts commented that there would be long-term cost saving from the transparency provided by the improved disclosures. Another buy-side analyst would have preferred retrospective application or transition disclosures provided for multiple years (the modified retrospective disclosures were required only in the year of adoption). One buy-side analyst also stated that even the three-year restated revenue data provided under retrospective application might not be enough to capture the whole trend in a cycle.

Other Feedback

22. Users also shared their observations and comments on the implementation of Topic 606 in various industries and circumstances.

Software/Licensing Model

23. Many users shared their views on the software/licensing model under Topic 606. They generally understood the new model under which term licenses are recognized upfront and software as a service is recognized over time. Besides the feedback on software companies covered earlier in the memo, they also shared the following feedback:
- (a) One credit analyst said that it is an improvement to link recognition to performance and eliminate the requirement for vendor specific objective evidence (VSOE).
 - (b) One sell-side analyst said that this new model is concerning because, in this analyst's view, it has created distortions in financial reporting. This analyst disagreed with upfront recognition for term licenses because, in this analyst's view, it does not reflect the commercial economics. This analyst preferred the model under Topic 605. One buy-side analyst said, although it was not their personal preference, upfront recognition of term license revenue is not a concern.
 - (c) One sell-side analyst observed that there is a lack of comparability in the software industry, which could get resolved if all software revenue was treated the same way. This analyst said that the software industry is shifting to usage-based billing, which affects variable consideration and may cause more incomparability in the future. A credit analyst agreed that there is a high degree of inconsistency in the software industry, especially for companies with hybrid models (that is, companies that have both term licenses and Software as a Service (SaaS) products). Accordingly, this analyst commented that it is challenging for users to determine what portion of operating results are based on changes related to accounting rather than changes in business models. Another sell-side analyst confirmed that when a software company is switching from on-premise software product to a cloud product, while bundling the cloud product with the license product and/or something else in an arrangement, it is hard to distinguish the impact of the changes in business models from the impact of the changes in accounting models. One buy-side analyst commented that there was a big change with implementation of Topic 606, especially for software companies with mixed models. However, this analyst stated that ultimately many of the hybrid models in software industry will move to the cloud (SaaS) and, as a result, the difference in revenue accounting should be reduced over time. Because of the lack of transparency and comparability in the revenue reported

by software companies with multiple products, some users proposed a disclosure requirement that companies disaggregate revenue by recognition timing (that is, disaggregating revenue recognized at a point in time versus over time).

- (d) Several users mentioned that they are using some non-GAAP metrics in their analyses. One buy-side analyst currently focuses more on non-GAAP metrics (such as annual recurring revenue (ARR)) rather than reported revenue for companies in the software industry. Another buy-side analyst stated that the disclosure about a churn rate (that is, the rate at which customers stop doing business with an entity) would help users better understand this industry. One sell-side analyst noted that it would be useful to have GAAP-defined revenue-related metrics required for companies, such as ARR, dollar based net recurring revenue (DBNRR), annual product volumes (APV), and average contract duration. However, it was noted that, as used today, these non-GAAP metrics are highly inconsistent across companies.

Disconnect between Revenue Recognition and Cash Collection

- 24. Two sell-side analysts said that Topic 606 creates a significant disconnect in certain sectors (such as software companies) between the timing of revenue recognition and the timing of cash collection. One buy-side analyst observed a disconnect from the timing of cash payment and revenue recognition for insurance brokers.

Principal versus Agent / Gross versus Net Consideration and Consideration Payable to a Customer

- 25. One sell-side analyst said that there are challenges for tech platform companies to identify their customer, which can result in different principal versus agent views and, accordingly, different gross versus net revenue presentations. The identification of the customer also affects costs (such as commissions) to be capitalized and whether incentives provided to certain parties are recorded as marketing expense or revenue reduction. Another sell-side analyst agreed that gross versus net presentation is a major issue in certain industries, including tech platform companies. That analyst also observed negative revenues reported by companies in the initial public offering process. One sell-side analyst noted that hospitals previously presented both gross revenue (invoiced revenue) and the revenue net of bad debt and contractual allowances. However, Topic 606 only requires net revenue to be reported (as a result of the removal of healthcare industry guidance). Therefore, this analyst commented that previous accounting provided a better view into the difference between invoiced and net revenue. One buy-side analyst indicated a preference for disclosure of the difference between gross and net revenues as well as additional disclosure to explain the distinction between (or shift from) reduction of revenue to cost of sales (that is, trade spending versus advertising).

Capitalized Sales Commission

26. One sell-side analyst noted that there are mixed views on the capitalization of sales commissions. Some users are concerned that management teams can manage earnings based on how they structure employees' compensation (that is, they can adjust what is capitalized or expensed by changing the commissions program), while other users could find it useful to see if a company is investing in sales efforts. One analyst observed that some companies in the telecom industry deferred the sales cost and incentives and, therefore, reported a less volatile sales commission expense under Topic 606 as compared with Topic 605. Two sell-side analysts commented that Topic 606 increased the disconnect between timing of revenue and costs because revenue is accelerated as compared with Topic 605. One sell-side analyst expressed concern about the mismatch between upfront revenue recognition and delayed recognition of costs related to sales commissions observed in software industry. One credit analyst noted that companies either do not report the amortization of deferred contract costs consistently or it is not disaggregated in the cash flow statement.

GAAP versus IFRS Standards

27. One buy-side analyst observed that disclosures provided by companies under IFRS Standards seem anecdotally to be "lighter" than those provided under GAAP, while one sell-side analyst did not observe a difference in the disclosure information provided. One buy-side analyst noted that there was increased comparability between two specific aerospace companies in different markets as a result of the converged guidance under GAAP and IFRS Standards. Two sell-side analysts indicated that benefits from future improvements to GAAP may outweigh the concern over convergence with IFRS Standards.

Other Aspects

28. Some users provided their feedback on the following aspects of the revenue guidance:
- (a) One buy-side analyst commented that it would be interesting and challenging to see how the revenue model continues to evolve with emerging digital industries.
 - (b) One sell-side analyst expressed disagreement with how Topic 606 treats certain transactions, including separating equipment and installation in a bundle transaction into multiple transactions (and recognizing revenue separately), changing the timing of revenue from free on board (FOB) destination to FOB shipping point for certain entities or in certain situations, and, generally, recognizing revenue over time for contract manufacturing arrangements. This analyst stated that, in their view, these

changes made under Topic 606 would make it easier for management to manipulate earnings.

- (c) One sell-side analyst suggested a quarterly disclosure about changes to or a rollforward of variable consideration (such as discounts and allowances, returns, rebates, chargebacks, distribution fees, etc.) to improve the understanding about the magnitude of the amounts, how they are affected by assumptions, and how they affect performance of the company.
- (d) One sell-side analyst expressed concern about the subjectivity and management judgment involved in separating performance obligations in a bundle transaction and in the determination of standalone selling price.

IAC Meeting

29. The staff met with the IAC in June 2018, shortly following the adoption of Topic 606 by public companies, to discuss IAC members' experience with and observations on the implementation of Topic 606 based on their analyses of companies' first quarter financial reports under the new standard since it became effective.

- (a) One IAC member (the same analyst who provided feedback regarding healthcare companies in the individual outreach above) stated that, under Topic 606, about 50 percent of the hospitals analyzed by this member no longer present bad debt expense at all, and the allowance for doubtful accounts also is not presented on the balance sheet. This member explained that some significant share price deteriorations in this subsector could have been identified earlier by analyzing those two line items. This member also discussed the lack of explanation of what is driving the transition adjustments that bridge between prior year ending balance sheet and the current year beginning balance sheet for the first period under the new revenue recognition model. In addition, this IAC member noted that, for the first quarter reporting of cyclical entities, because only the first quarter balance sheet of the current year and the year-end balance sheet of the prior year are presented under the fully retrospective transition method to Topic 606, it is hard for analysts to perform any balance sheet analysis between the first quarter 2018 that is presented under the new standard and the first quarter 2017 that is not presented. [*The staff noted that the year-over-year balance sheet (prior year first quarter) is not required to be presented.*]
- (b) Another IAC member stated that, under the new standard, some industries, including retail and software, have provided disclosures that disaggregated revenue into more informative components, such as different types of performance obligations, which

provides useful information. However, this IAC member noted that for some other industries including aerospace and defense with very complex revenue contracts, the amount of disclosure was less than expected by the user community on implementation of Topic 606.

- (c) One IAC member observed the level of transparency provided by entities about changes in revenue recognition under the modified retrospective transition method is inconsistent. The level of disclosures provided by entities varied and the efforts taken by entities to inform users varied.
30. At the May 2021 meeting, IAC members discussed complexities arising from the growth in new business models, specifically platform business models that create value by facilitating exchanges between groups that using a technology platform. One IAC member explained that there are challenges identifying the customer for these companies, which affects how certain items such as incentives offered are presented (that is, either as contra-revenue or expense).

User Publications

31. In addition to the user outreach above, the staff has reviewed various research reports published by financial statement users in order to understand overall trends about Topic 606 adoption. The staff observes that the content in those reports is generally consistent with the areas described in this handout.

Preparer Focus

32. The staff has solicited feedback from preparers on their implementation of Topic 606, including surveys with public companies, outreach calls with preparers in the licensing industry, discussions with preparers at advisory group meetings, review of revenue disclosures of public companies, and review of reports produced by practitioners for their surveys with preparers. This section focuses on the feedback received during the staff's surveys with public companies and outreach calls with licensing preparers. The feedback received from other channels, such as advisory group discussion and review of third-party preparer survey, is discussed in subsequent sections.
33. Overall, the majority of preparers that responded to the staff's survey indicated that Topic 606 had no material effect on amounts recognized in their financial statements. Most preparers that responded to the survey noted that they applied modified retrospective transition method and used one or more practical expedients under Topic 606. The software/licensing preparers that responded to the staff's request for outreach noted that certain areas of complexity continue to exist in the software/licensing industry since the

implementation of Topic 606. Although most participants did not agree with upfront point in time revenue recognition for functional intellectual property (IP), they did not support broad changes to the licensing model as part of PIR.

Preparer Survey

34. In order to solicit more feedback from preparers, the staff created a survey on the implementation activities of public companies and related cost-benefit considerations. The questions in the survey were evaluated by the FASB's post-doctoral fellow to ensure the survey and questions were framed in a neutral way. The staff conducted the first round of the anonymous survey in November 2018 with public companies for their implementation activities. This was followed by the second round of the anonymous survey in March 2019. The survey was distributed to preparers from the EITF and the FASB's advisory groups and to some professional associations. The survey questions cover expected costs as described in the basis for conclusions of Update 2014-09, which includes the following costs: personnel (employees or external personnel), departments other than accounting and IT (such as human resources, sales, tax), dual bookkeeping, IT systems, audit costs, investor/lender education, and post-implementation guidance.
35. In total, 42 companies responded to the survey. Thirty-three companies had FY 2017 revenue of more than \$10 billion, 7 between \$2 billion to \$10 billion, and 2 below \$2 billion. The industries include manufacturing (10 companies); technology (8); finance and insurance (8); healthcare (3); mining, oil, and gas (3); biotech and pharma (2), communications (2); other services (1); information, publishing, broadcasting, and data processing (1); retail trade (1); arts, entertainment, and recreation (1); and other (such as conglomerate and aerospace/defense) (2).
36. According to the survey response, 26 companies (62 percent) said that Topic 606 had no material effect on their financial statement amounts, while 16 companies (38 percent) noted material effect on financial statement amounts, such as contract asset or contract liability and sales/revenue. Those companies whose financial statement amounts were materially affected were more likely to incur more implementation costs than the budgeted amount and provide users with some forms of education about Topic 606.
37. Thirty-two companies (76 percent) chose modified retrospective transition method when adopting Topic 606, while 10 companies (24 percent) chose retrospective method. Those companies that chose modified retrospective method were more likely to have fully converged reporting between GAAP and IFRS Standards after implementing Topic 606, have their IT systems ready before the effective date, and redeploy current personnel to accommodate implementation activities, while those that chose retrospective method were

more likely to provide users some forms of education. The detailed survey responses are summarized by topic as follows.

General Questions

38. Forty companies (95 percent) chose to adopt Topic 606 at the effective date, while 2 (5 percent) chose to adopt before the effective date. Thirty-two companies (76 percent) chose the modified retrospective transition method and 10 (24 percent) chose retrospective method. The average time spent on implementation activities is 33 months (1 company (2 percent) for less than 12 months, 13 companies (31 percent) for 12 to 24 months, 12 companies (29 percent) for 24 to 36 months, 14 companies (33 percent) for 36 to 48 months, and 2 companies (5 percent) for more than 48 months).
39. Out of 23 companies (55 percent) that set budget for the implementation costs for Topic 606, 13 companies incurred the cost more than the budgeted amount, primarily in the areas of personnel (13 companies), audit costs (11 companies), and IT systems (7 companies).

Personnel

40. Thirty-four companies (81 percent) made 1 or more personnel changes to accommodate implementation activities, including redeploying current personnel (29 companies), hiring external personnel (for example, consultants, contractors, and software vendors) (25 companies), and hiring new employees (9 companies).
41. The reasons for the personnel changes include process or system changes (including internal control) (26 companies), technical accounting expertise (25 companies), contract review (25 companies), external reporting (disclosures) (19 companies), and project management and others (15 companies).
42. About half of the companies did not expect that the personnel changes would persist beyond the transition period. The rest of the companies expected that at least a portion of the personnel changes would persist because of the ongoing compliance with revenue standard (including internal controls), refining revenue standard implementation and other reasons.

Departments Other Than Accounting and IT

43. Thirty-eight companies (90 percent) made changes to 1 or more departments other than accounting and IT, including tax (29 companies), sales (21 companies), finance (13 companies), internal audit (12 companies), and others (such as business development, investor relationship, local statutory reporting, pricing/underwriting, legal, and business operations) (18 companies).

44. The reasons for the changes to those departments include training for internal staff (37 companies), IT system update or new systems (20 companies), external specialists (7 companies), contract renegotiations (4 companies), others (such as tax department review, and supply chain/logistics) (3 companies).
45. Thirty companies (71 percent) stated that reviewing sales contracts as part of implementing Topic 606 led to 1 or more of the changes, including a better understanding of what is offered to customers (23 companies), improvements to internal controls over contracts (14 companies), changes to sales contract terms (9 companies), and others (such as harmonization between policies and practices) (2 companies). For those companies that made changes to sale contract terms, they were driven by one or more reasons, including achieving a desirable accounting outcome (five companies), simplifying contract terms (four companies), and eliminating dual bookkeeping (one company).

Dual Bookkeeping

46. Eight companies (19 percent) stated that they need to track revenue on a basis other than Topic 606. Three of them expected to separately track the revenue indefinitely, 4 expected 2 or 3 years, and 1 expected 25 years.
47. Thirty-five companies (83 percent) prepared financial statements under IFRS Standards for statutory reporting purposes as well as under GAAP, of which 19 companies observed increased convergence (the way in which the revenue is tracked is more closely aligned between GAAP and IFRS Standards) and 16 observed no change. Twenty-two companies stated that their revenue recognition practice is fully converged under IFRS Standards and GAAP after Topic 606 became effective (do not distinguish between the 2 for revenue recognition purposes), 11 companies stated partially converged (only distinguish between the 2 in a few areas for revenue recognition purpose), and 2 companies stated not converged (still need to track revenue separately for IFRS Standards and GAAP). The companies who replied that they had partial or no convergence indicated that this related to using practical expedients that lead to differences between GAAP and IFRS Standards (four companies), continuing to follow IAS 18, *Revenue*, in certain jurisdictions (three companies), and others (such as some transactions being within the scope of other Topics rather than Topic 606) (six companies).
48. Eight companies (19 percent) provided additional comments on dual bookkeeping under Topic 606, which mentioned a list of various other aspects such as incremental time incurred for assessing and accounting for inter-company revenue arrangements for statutory reporting purposes, indefinite statutory reporting requirements for insurance

entities, significant cost required to prepare and then have audited the company's determination that there was virtually no difference between IFRS Standards and GAAP.

IT Systems

49. Twenty-six companies (62 percent) had their IT systems ready to implement Topic 606 *before* the effective date. Half of them updated their existing IT systems, while the other half neither acquired new IT systems nor updated their existing IT systems. Twelve companies had their IT systems ready *at* the effective date, by acquiring a new IT system (1 company), updating their existing IT systems (9 companies), or neither of the actions (2 companies). Four companies had their IT systems ready *after* the effective date by updating their existing IT systems, except for one company that took neither of the actions.
50. Of 16 companies (38 percent) that responded to a question on how they developed the IT changes, 11 developed the changes internally, 4 relied on a third party for development, and 1 updated its internal IT system to interface with a third-party software.
51. Of 26 companies (62 percent) that responded to a question on whether their IT systems were changed to comply with Topic 606, 20 noted that changes were made to the IT system and 6 noted no changes.
52. Fifteen companies (36 percent) answered "none" to the question on the data that are now captured by the company's IT system under Topic 606 that were not previously captured. Twenty-seven companies (64 percent) observed changes in the available data in 1 or more areas, including contract asset/contract liability (14 companies), variable consideration (6 companies), remaining performance obligation (5 companies), asset and amortization related to contract costs (4 companies), material rights (options or loyalty points) (3 companies), significant financing component (3 companies), and others (such as revenue recognition timing, noncash consideration, other information for disclosure purposes, etc.) (12 companies).
53. Noting that the change to its revenue recognition is minor, one company questioned whether the benefit of Topic 606 justifies the millions of dollars of cost incurred for significant changes to its IT system. Another company commented that Topic 606 has created manual work that has not yet been built into its systems, particularly related to new required disclosures, many of which, in this respondent's view, may not be used by its investors.

Audit Costs

54. Four companies (10 percent) reported no change to their audit fee as a result of implementing Topic 606. Thirty-eight companies (90 percent) reported a higher audit fee as a result of implementing Topic 606, of which 24 companies estimated that 75 percent to 100 percent of the change in fees was related to the transition period only (that is, a one-time occurrence), 8 estimated 20 percent to 50 percent, and 6 estimated 0 percent to 12 percent. A few companies explained that the increase in audit costs was related to the implementation effort, such as review of scope, contract reviews, documentation and white papers, practical expedients, internal controls, and disclosures, or was related to the change of auditors. Two companies commented that, in their opinion, the benefits of Topic 606 do not justify the increased costs, including audit costs.
55. Six companies (14 percent) reported “none” to the question on the judgments that they spend significant time discussing with auditors. Thirty-six companies (86 percent) reported 1 or more of the judgments that they spend significant time discussing with auditors, including variable consideration (23 companies), identifying performance obligations (22 companies), determining the standalone selling prices (12 companies), applicability of the series provision (11 companies), determining whether revenue is identified at a point in time or over time (11 companies), identifying a contract (9 companies), measuring progress towards satisfying a performance obligation (7 companies), allocation objective (5 companies), principal versus agent (5 companies), and other (such as scoping, consideration payable to a customer, and transfer of control) (7 companies).
56. Eight companies (19 percent) reported “none” to the question on disclosure requirements that they spend significant time discussing with auditors. Thirty-two companies (81 percent) reported 1 or more of the disclosure requirements that they spend significant time discussing with auditors, including disaggregation of revenue (18 companies), significant judgments (11 companies), transaction price allocated to remaining performance obligations (10 companies), contract balances (10 companies), performance obligation (9 companies), determining the transaction price (5 companies), out-of-period revenue recognized (3 companies), backlogs (2 companies), and others (such as contract asset/liability and validating materiality assessments for certain disclosures) (3 companies).

Investor/Lender Education

57. Twenty-six companies (62 percent) reported that none of their reported amounts were materially different as a result of Topic 606. Sixteen companies (38 percent) reported material effect of Topic 606 in 1 or more of the areas, including contract asset or contract

- liability (11 companies), sales/revenue (9 companies), contract cost asset (7 companies), accounts receivable (5 companies), and other (such as deferred income related to collaborative arrangement and future remaining performance obligations) (2 companies).
58. Twenty companies (48 percent) said that they did not provide educational assistance to investors/lenders about Topic 606 aside from disclosures in the notes to financial statements. Twenty-two companies (52 percent) provided additional educational assistance to investors/lenders through 1 or more ways, including discussion in quarterly earnings conference calls (17 companies), pro forma financial information (5 companies), materials published on website (4 companies), standalone investor/lender call focused on revenue (2 companies), and other (response to questions from analysts through investor relations, earnings release, Form 8-K filing, etc.) (7 companies).

Post-Issuance Guidance

59. Seven companies (17 percent) reported that they did not use any of practical expedients under Topic 606. Thirty-five companies (83 percent) utilized 1 or more of practical expedients, including immaterial promised goods or services [paragraph 606-10-25-16A] (20 companies), shipping and handling [paragraph 606-10-25-18B] (19 companies), significant financing component [paragraph 606-10-32-18] (17 companies), incremental cost of obtaining a contract [paragraph 340-40-25-4] (17 companies), sales taxes [paragraph 606-10-32-2A] (16 companies), and portfolio approach [paragraph 606-10-10-4] (8 companies).
60. Half of the companies had to modify existing implementation preparations as a result of post-issuance guidance on Topic 606, while the other half did not.
61. Of the 18 companies (43 percent) that responded to the question on the cost reduction from the post-issuance guidance (which was only included in the second round of the survey), only 4 said that the post-issuance guidance reduced their entities' implementation costs overall.
62. One company commented that the delay in the effective date helped because it was able to adapt to decisions from the TRG, which saved a lot of headaches if it had to change its accounting after adoption. Another company said that while it had to modify existing preparations because of changes in guidance, it supported the changes because those changes related to additional clarification, simplification, or introduction of additional expedients.

Licensing Preparer Outreach

63. In March 2021, when the Board removed Issue 19-B from its agenda, the Board observed that stakeholders' feedback received during the PIR process indicated concerns regarding the licensing model in Topic 606. Additionally, the Board considered users' feedback about the licensing guidance (as included earlier in this handout). Accordingly, the staff performed outreach with preparers in the licensing industry to solicit their feedback on areas of recurring cost and complexity in Topic 606.

Preparer Outreach

64. In May 2021, the staff performed outreach with seven preparers from the licensing industry, including software, pharma and media, to gather feedback on the ongoing application of revenue recognition guidance for licensing arrangements. Participants provided feedback on areas in Topic 606 that continue to cause complexity on a recurring basis, potential improvements, and the importance of convergence with IFRS Standards.
65. All participants noted that certain areas of complexity (as discussed further below) continue to exist after the implementation of Topic 606. One participant highlighted that those complexities are not unexpected but rather were considered in the deliberations leading up to the issuance of Topic 606. Some participants in the software and media industry generally disagreed with an upfront point in time revenue recognition for functional IP because they noted that it is an inappropriate reflection of the economics of a term license. However, a participant in the pharma industry asserted that upfront recognition of the functional license revenue is appropriate because its performance has been completed.
66. Participants provided mixed feedback about whether they thought additional standard setting should be considered in this area as part of the PIR process. While most participants noted general support for the Board's interest in improving the accounting for licensing arrangements, they opposed consideration of broad changes to the licensing model. Those participants highlighted the time and resources spent recently to implement the accounting changes introduced by Topic 606 and noted that a change at this point may disrupt the recently established systems and processes. Some of those participants had concerns about potential divergence with IFRS Standards because they are multinational companies and had achieved benefits from convergence. On the contrary, two participants recommended a reconsideration of the point in time revenue recognition model for term licenses because they believe the benefits of an improved revenue recognition model may exceed the costs of change, regardless of potential divergence with IFRS Standards. Additionally, many participants noted that more targeted improvements could be helpful to

alleviate some of the costs and complexity that currently exist, and recommended the following targeted improvements:

- (a) Requiring or allowing software companies to combine term licenses with post-contract customer support (PCS) into one performance obligation
- (b) Allowing more flexibility in determining standalone selling price (SSP)
- (c) Providing an exception from estimating variable consideration for sale of IP licenses
- (d) Changes to disclosure requirements (by adding or removing requirements) after considering feedback from the users of financial statements.

67. The issues that were highlighted by the participants are summarized in the following paragraphs.

Point in Time Revenue Recognition for Term Licenses

68. Many participants noted that point in time revenue recognition for term licenses has caused complexity in accounting for licensing arrangements under Topic 606. One preparer noted that upfront point in time revenue recognition does not provide decision-useful information to that company's users and non-GAAP information is provided to them for term licenses (such as the ARR metric or information about the term of the license so that users can calculate future cash flows). Other preparers that do not provide additional non-GAAP information to users noted that in analyzing licensing arrangements the general desire on the part of preparers is to depict more revenue under the over time model. One preparer that does not agree with upfront revenue recognition for term licenses compared the economics of a term license to a lease for which the lessee derives the economic benefit from the leased asset over the period of usage.

69. Overall, while many participants do not support upfront point in time revenue recognition for term licenses, almost all outreach participants noted that any broad changes to the licensing model may necessitate costs that may not be justified by the expected benefits of the changes. One preparer, however, encouraged the Board to revisit the existing upfront point in time revenue recognition pattern for term licenses. That preparer added that while an accounting change in this area would have associated costs, additional time and resources to prepare non-GAAP information for term licenses is already being expended by that company. Additionally, that preparer noted that certain complexities related to the identification of performance obligations, determination of SSP and accounting for contract modifications (as discussed further below) would be alleviated by changing the upfront point in time revenue recognition of term licenses to over time.

Identification of Performance Obligations

70. One preparer discussed typical licensing arrangements to highlight the complexities that may arise in identifying performance obligations in their company's arrangements. That preparer generally negotiates or renegotiates its contracts individually based on specific customers' needs which, this preparer noted, can change over the course of an arrangement. This preparer discussed the prevalence of hybrid arrangements in which the customer has rights to both term licenses and SaaS; for example, a customer is planning to transition to SaaS in the future but requires ongoing support for term licenses until the SaaS transition is complete. In another fact pattern, a customer could purchase a specified amount of "value" (in dollars) that could be used towards term licenses only, SaaS only, or a mix of term licenses and SaaS. This preparer highlighted that there is no objective basis at contract inception (or contract modification) for determining the customer's expected usage of term licenses or SaaS in such an arrangement and that, in fact, the customer also may not know their expected usage (which may have led the customer to negotiate such hybrid arrangements).
71. Another preparer acknowledged that when licensing arrangements are analyzed and relevant guidance is applied to identify performance obligations, the intent generally is to achieve more revenue recognition on an over time basis. That preparer highlighted that the evaluation of the class of customer in determining whether a material right (a performance obligation under Topic 606) exists is another area of judgment for which their company continues to spend significant time and resources.
72. Overall, most participants agreed that while the structure and pricing of licensing arrangements continues to evolve, making the identification of performance obligations complex, preparers are generally able to apply the existing requirements to reach reasonable conclusions.

Determination of SSP and Allocation of Transaction Price

73. Participants provided mixed feedback on complexities surrounding the determination of SSP for licensing arrangements. Approximately half of the preparers noted that they have robust processes in place to determine SSP for the performance obligations in their licensing arrangements. One of those preparers noted that most of the company's contracts are standardized and PCS is sold separately from licenses. However, the remainder noted continuing challenges in determining SSP because of variations in products or pricing for the same product for different customers or geographies.

74. One preparer noted that more flexibility should be allowed for management judgment in determining the SSP. That preparer noted that currently the determination of SSP relies heavily on past information. However, past information may not be an appropriate indicator of pricing for new products or new markets.
75. Another preparer, who encouraged the Board to reconsider point in time revenue recognition for term licenses, emphasized the challenges in allocating the consideration between a license and PCS because their company typically does not sell/price PCS separately. That preparer recommended that the Board consider an accounting change to permit term licenses to be combined with PCS into one performance obligation because it could allow an over time revenue recognition pattern for term licenses without making broad changes to the licensing model and align the pattern of revenue recognition for term licenses with previous practice under Topic 605. That preparer also noted that if the Board were to make such a change, it should consider excluding perpetual licenses from the scope (that is, revenue recognition for perpetual term licenses would continue to be at a point in time, which would also align with practice under Topic 605).
76. One preparer noted that the guidance on allocation of discount for purchasing a bundle of licenses of IP or goods or services to one or more performance obligations in a contract (paragraphs 606-10-32-36 through 32-38) is not well understood in practice and, therefore, is not appropriately applied.

Contract Modifications

77. One preparer highlighted that determining SSP is especially challenging in contract modifications (rather than at contract inception) because the commercial structure and economics are clearer in the initial transaction with a customer. This preparer indicated that they often agree to customer-driven modifications to existing contracts to incentivize existing customers (for example, by providing small discounts) or remain competitive in the market. This preparer added that while those changes could be small in the context of the existing contract, analyzing SSP to account for the modification is complex and time consuming. Multiple preparers noted that they regularly modify existing contracts, and that application of contract modification guidance is complex and time consuming. However, all of the participants agreed that the guidance allows enough room for judgment for companies to reach a reasonable conclusion for different fact patterns. Many preparers supported principles-based accounting guidance rather than specific rules for specific fact patterns. Additionally, all preparers noted that while they continue to have modifications within the scope of Issue 19-B occur in practice, they have established accounting policies and are able to reach reasonable accounting conclusions within the existing framework.

Principal versus Agent Considerations

78. Two preparers highlighted the challenges with applying the principal versus agent guidance. One of those preparers noted that the indicators specified in the guidance to determine whether an entity is the principal in a revenue arrangement are confusing and recommended removing the indicators so that the focus of the guidance is on the principle of transfer of control. Those indicators include an assessment of whether an entity has the inventory risk or is responsible for the acceptability of the specified good or service by the customer. That preparer, however, acknowledged that those indicators may be more useful in some industries.

Other Issues

79. Certain preparers highlighted some issues that were specific to their businesses.

Identification of a Customer

80. One preparer highlighted international arrangements in which the company reaches the customer base through a distributor. That preparer highlighted that some of the key performance indicators in the media industry are based on the subscriber base, such as number of subscribers or revenue per subscriber. As such, considerable emphasis is placed on who is the company's "customer" under Topic 606 (that is, the end user customer or the distributor).

Analysis of Termination Provisions

81. Two preparers highlighted that they spend considerable time analyzing the termination provisions in their agreements. Under Topic 606, termination provisions may affect the contract term, transaction price and, therefore, the amount and timing of revenue. These preparers did not raise any specific problems with the guidance but rather highlighted the operational challenges of applying that guidance.

Minimum Volume/Sale Guarantee

82. One preparer highlighted challenges with accounting for arrangements that provide the customer rights to multiple media titles along with a minimum guaranteed amount that the customer is required to pay regardless of its usage of the media titles. That preparer highlighted challenges in allocating the minimum guarantee across the different performance obligations and tracking (a) whether the allocated minimum levels were met for each performance obligation and (b) whether the contractually specified minimum level was met for the entire contract.

Exception from Estimating Variable Consideration

83. One preparer appreciated the benefits of the exception for a sales-based or usage-based royalty promised in exchange for a license of IP which does not require entities to estimate variable consideration if certain conditions are met. The preparer noted that some of the arrangements have long terms (such as 10 or 20 years) and relief from estimation of revenue over that period reduces costs and complexity in applying the guidance. The preparer recommended that the Board consider expanding that exception to sales of licenses of IP.

Enforceable Rights and Obligations

84. One preparer highlighted the challenges associated with a license supply arrangement whereby a functional IP to a molecule is licensed to a customer and there is an agreement to manufacture and supply a drug. However, because the terms of the agreement do not include enforceable rights and obligations (such as minimum volume) for the drugs to be supplied, this preparer typically concludes that the term license is the only performance obligation in the contract and all of the consideration received from the customer is allocated to that term license and recognized upfront. This preparer asserted that this accounting does not reflect the economics and encouraged the Board to reconsider whether industry-agnostic standards are effective in appropriately reflecting the economics of transactions across multiple unique industries.

Disclosures

85. One preparer emphasized operational challenges in tracking and disclosing revenue backlog (or remaining performance obligation) disclosures and contract liability rollforwards for each reporting period. This preparer encouraged the Board to understand from users whether that information is decision useful to determine whether those disclosures should continue to be required (feedback from users on these disclosures and other topics is discussed earlier in this memo).

Convergence with IFRS Standards

86. In discussing whether the Board should consider any changes to the licensing model, some participants emphasized convergence as a key benefit of Topic 606 that they would like to see maintained. However, some multinational preparers noted that while further divergence may cause complexity at statutory or local reporting level, they would appreciate the benefits of improved guidance in the GAAP financial statements at the parent entity level.

Auditor Focus

87. As part of the PIR process, the staff wanted to better understand the challenges that auditors and other practitioners faced both during the implementation process and on an ongoing basis. The staff conducted multiple rounds of outreach with both auditors and professional services firms and analyzed publications issued by audit firms leading up to the effective date of Topic 606. Overall, most auditors and professional services firms stated that the implementation process went well and that the standard has held up well. The COVID-19 pandemic created stress on many accounting standards, but one practitioner observed that the revenue guidance was able to be applied to the unprecedented economic challenges and a significant number of contract modifications without the need for FASB to provide any clarifying guidance.

Auditor Outreach

88. The staff performed two rounds of outreach with six audit firms, and two professional services firms to discuss the implementation and ongoing challenges of Topic 606. The first round of outreach was performed in the fourth quarter of 2019 and focused on initial adoption, including implementation costs and benefits, significant challenges for recognition and disclosure, and the usefulness of FASB clarifications and educational materials. The second round of outreach was conducted in the first quarter of 2021 and focused on ongoing costs and challenges related to Topic 606.
89. In the first round of outreach, the staff asked each firm six standard questions. The feedback received is summarized below:

Question 1: Describe your experience to date with the implementation from a change management process and a cost perspective.

90. A common theme identified in outreach with auditors is that preparers underestimated the effort and resources required for implementation of Topic 606. There was a preconceived notion that the standard would cause minimal changes to the financial statements, which led many companies to delay implementation activities. Preparers often expressed surprise when they discovered the level of time and effort necessary to implement the standard. Many outreach participants indicated that the effort required was disproportionate to the effect of the standard in some cases.
91. The professional services firms indicated that their clients did not expect significant changes as a result of applying Topic 606, so the desire to reach positions under Topic 606 that were consistent with their prior accounting affected judgments and implementation strategies. However, implementation took more time and effort than expected, meaning that clients often needed more help than they were initially expecting. Those firms indicated

that many clients used the implementation process to upgrade systems or seek automation, which required more change management and added more time to implementation projects. Professional services firms also indicated that there was some change management inefficiency between preparers and auditors, which stemmed from a combination of preparers not being fully prepared for the adoption of Topic 606 (including not expecting the level of effort that was required for adoption) and auditors increasing required documentation, analysis, and detail.

Question 2: How do the actual categories (that is, IT systems, additional personnel, education etc.), nature, and amount of the implementation costs incurred by your clients compare with the anticipated costs? Were there unanticipated costs of applying Topic 606? If so, please describe.

92. Auditors indicated that costs and efforts during implementation varied by industry. Costs and efforts frequently depend on the types of contracts, complexity of revenue streams, size of entities, capacity for implementing change, need for process changes, and industry-specific issues. Most auditors indicated that the implementation process was typically a one-time effort. Once preparers made changes to processes, systems, and controls, less change was required on an ongoing basis. Auditors indicated that the standard is more costly to implement than previous guidance because it is a principles-based standard, which requires more estimates and use of management judgment. This makes a company's analysis more subjective and complicated to audit.
93. Professional services firms also indicated that costs varied, noting that some companies spent more than expected. Factors that influenced total cost included the degree of change required from Topic 605, client preparedness, transition method selected, accounting complexity, and operational or business complexity. Those firms also anticipated that ongoing costs would primarily be spent on upgrading systems and seeking process improvements, especially if initial implementation efforts were rushed.
94. All auditors and professional services firms indicated that the types of costs were in line with the Board's expectations. Having proper systems in place throughout the business was crucial to minimizing costs; companies without an IT solution faced additional costs. Some unexpected costs included understanding the nature of contracts, identifying performance obligations and prices, and estimating variable consideration.

Question 3: Which areas of the guidance, if any, did you spend significant time discussing with your clients? How did the implementation of Topic 606 affect the audit fees (in both year of transition and going forward)?

95. Auditors and professional services firms both indicated that the topics covered by the TRG were areas that required more significant effort during implementation. One such area was the identification of performance obligations. This area was particularly challenging when

a company had multiple products or offerings combined into in a single performance obligation and had to determine a single method for measuring progress and recognizing revenue. The other area of difficulty was the allocation of the transaction price, including determining the standalone selling prices of software arrangements. Another area of increased effort across all industries was the estimation of variable consideration, such as price concessions, rebates, and returns. Some also faced challenges determining the difference between a material right and variable consideration. Many noted increased time spent with contract manufacturers regarding the change from historical point in time revenue recognition to over time revenue recognition. Auditors also noted increased effort spent on principal versus agent determinations (particularly for platform companies) and on the accounting for licenses of intellectual property (particularly for software, media, and pharmaceutical companies).

96. Auditors noted a range of increase in fees in the year of adoption depending on a client's size and circumstances. Companies on the lower range typically had small financial statement effect but undertook an extensive process to demonstrate that the change was immaterial. Companies on the higher end of the range typically utilized the full retrospective transition method, had significant accounting system changes, and/or had many new areas of judgment and estimation. The auditors observed that larger companies usually were on the lower end and smaller or mid-size companies on the higher end because Topic 606 had a greater effect on those entities' financial statements. For ongoing audit fees, the auditors anticipate a range of increases depending on the degree of change from Topic 605 and related audit work involved.

Question 4: How did the FASB clarifying the guidance (that is, through TRG discussion or amendments to guidance) affect the cost of implementing the standard? Which practical expedients were the most helpful?

97. Auditors and professional services firms indicated that the TRG discussions provided clarification, helped with client discussions, encouraged consistency in practice, and likely lowered the costs of implementation. However, they also noted that the TRG discussions added some complexity when the IASB did not make the same amendments or decisions as the FASB. Auditors and professional services firms noted that the practical expedients were utilized based on the relevance of the expedients to the industry or type of contract. Practical expedients were preferred by companies adopting Topic 606 if they allowed the company to keep the accounting used before implementing Topic 606. Several auditors specifically noted the usefulness of the practical expedient allowing companies to account for multiple similar contracts as a portfolio.

Question 5: Describe your experiences with the new disclosure requirements. Did your clients need to implement new data collects or systems to comply with the disclosures? Were there any disclosure requirements that were difficult to implement. If so, why?

98. Auditors and professional services firms provided mixed feedback on the disclosure requirements. Specifically, some disagreed on the significance of the implementation effort and the usefulness of the new disclosures. Many auditors noted that assessment of costs and benefits of revenue disclosures depends on relevance to company/industry. Specifically, several noted the challenges and inconsistencies in the requirement to disclose remaining performance obligations. Others questioned the usefulness of the requirement to disclose contract assets and contract liabilities in industries in which those balances are not as relevant to financial statement users.
99. For the disaggregated revenue disclosure, many auditors observed significant discussion and effort around determining the level of detail required. Although this information was not as difficult to obtain, judgment was needed to determine the appropriate level of disaggregation to provide useful and relevant disclosures to financial statement users while protecting the company from a competitive disadvantage.

Question 6: How do the actual categories, nature, and amount of the implementation benefits compare with the anticipated benefits? Were there unexpected benefits of applying Topic 606?

100. Auditors and professional services firms highlighted several benefits received by preparers during implementation of Topic 606. One benefit was a better understanding of business practices and operations throughout the company, including improved knowledge of a company's revenue contracts. The other benefit was that the implementation process allowed companies the opportunity to revisit revenue-related processes and streamline or automate certain systems or controls. One significant benefit was increased convergence with IFRS Standards. Another benefit was improved documentation, policies, and transparency. Many also noted that the accounting under Topic 606 better reflects the economics for most transactions. The standard also provided one framework that allows all companies and industries to apply consistent revenue guidance and reduced industry-specific and other sources of revenue recognition guidance. Despite the benefits, a few auditors expressed some skepticism that the financial reporting benefits alone justified the costs of the change.
101. In the second round of outreach conducted in 2021, the staff asked auditors and professional services firms more targeted questions to better understand areas for which challenges persist and steps the Board could take to address those challenges.

Principal versus Agent Determination

102. Auditors noted continuing challenges with determining whether a company is a principal or an agent. Many auditors indicated that emerging business models for platform companies, advertising technology companies, healthcare companies, and payment processor companies have led to ongoing challenges. Auditors observed that the control principle is a difficult concept to apply in instantaneous transactions and in transactions in which both parties have some influence. One auditor stated that the consultation volume on principal versus agent determination is unusually high (as compared with consultations under Topic 605), and that even minor changes to contracts can lead to reassessments of whether a company is a principal or an agent. Other auditors observed that principal versus agent determinations were complex under previous revenue guidance and that the issues would have existed even if no accounting change had occurred. One consultant noted that companies going through the principal versus agent analysis are generally getting to the answer they think reflects the economics of their transactions. In addition, no auditor during outreach shared any specific potential solutions to improve the existing principal versus agent guidance, but more than one auditor suggested that additional guidance may be necessary. One auditor observed that guidance on how pricing discretion factors into the control determination could be helpful for companies applying the model.

Consideration Payable to a Customer

103. Another related ongoing issue identified by auditors was consideration payable to a customer. Auditors observed that this issue arises when companies that are acting as an agent provide a marketing incentive to the end consumer. Companies must determine whether to present these incentives as a contra-revenue or as a marketing expense. Auditors note that many companies acting as an agent do not want to net incentives against revenue because the payments are not payments to a customer, but rather payments to their customer's customer. However, auditors noted that there is no framework in the guidance for determining when incentives should be treated as consideration payable to a customer (and thus a decrease in revenue) when the end user is not technically a customer and the contracts are not contractually linked. More than one audit firm indicated that the Board could issue authoritative or interpretative guidance on how companies look at those arrangements, noting that the TRG had discussed this topic but did not fully resolve the issue. Several auditors also noted issues related to a large amount of marketing incentives netting against gross revenues such that total net revenue is negative. Those auditors noted that there is diversity in practice on how to present negative revenue, with some referring to prior guidance in Topic 605.

Identification of Performance Obligations

104. Auditors also observed that identification of performance obligations is an ongoing challenge, particularly for licenses of functional IP. As software companies move functionality to cloud arrangements from on-premise arrangements, new issues emerge. The auditors indicated that it is challenging to determine when promises in a software arrangement are “highly interrelated.” Another challenge in the software industry is establishing standalone selling prices of post-contract customer support (PCS). Many companies do not sell PCS or perpetual licenses on a standalone basis, making it difficult to determine a method of allocating the transaction price to those performance obligations. Other auditors indicated that determining whether performance obligations constitute a series is somewhat challenging. This auditor suggested that many clients would prefer the single unit of accounting that is achieved when performance obligations constitute a series.

Variable Consideration

105. Auditors also noted variable consideration as an ongoing challenge and an area for potential improvement. Several auditors noted that many of their clients want to avoid the process of estimating variable consideration and attempt to constrain the revenue to zero by default. Those auditors have to continually educate their clients that they cannot default to variable consideration equaling zero. Several auditors noted that allocating variable consideration for usage-based SaaS arrangements is an emerging issue. The guidance states that variable consideration may be attributable to one or more, but not all, distinct goods or services if certain criteria are met. However, it is difficult to determine whether allocating variable consideration to a distinct service in a SaaS arrangement is consistent with the variable consideration allocation objective when considering all the performance obligations and payment terms in a contract. One auditor noted that the guidance could be changed so that companies do not have to estimate variable consideration that may not occur for many years. Another auditor suggested extending the existing exception for estimating variable consideration in arrangements with sales-based or usage-based royalties of intellectual property to other arrangements with other long-tailed variable consideration provisions that are difficult to estimate.

Commission Revenue

106. Another issue related to variable consideration mentioned by several auditors is the accounting for commission revenue. Some auditors observed that the accounting for commissions arrangements in which an insurance broker or similar entity receives a commission contingent on customer retention or some other metric is not intuitive and challenging to apply. In those arrangements, all performance obligations have been

satisfied, so the commissions expected to be received in future periods are treated as variable consideration. This means that a company immediately recognizes expected commissions for which it is probable a significant reversal will not occur, which creates a disconnect between the cash from commissions and revenue recognition.

Capitalized Commissions

107. Auditors and professional services firms also observed that some clients were confused by the requirement to capitalize and amortize commission expenses, with many clients questioning why a change was necessary in this area. One professional services firm observed that many companies struggled with identifying which costs are eligible for capitalization, but that the firm has not identified any possible solutions to address this challenge. Another professional services firm observed that determining the period over which a company should amortize any capitalized commissions is challenging, but that the challenges applying the cost guidance in Subtopic 340-40 are less significant than the challenges of applying the revenue guidance in Topic 606.

Auditor Publications

108. In addition to the outreach above, the staff has reviewed some auditors' publications on the benefits, costs, and challenges of adopting Topic 606. The staff observes that the content in those publications is generally consistent with the areas described in this handout.

Regulator Focus

109. As part of the PIR process, the FASB monitors enforcement of Topic 606. The staff has reviewed published reports on SEC comment letter trends, PCAOB inspections trends, and reports about restatements. Additionally, the staff has performed outreach with regulators to obtain feedback about Topic 606.

Accounting System Focus

110. In addition to outreach, the staff performed some analysis related to the adoption of Topic 606 using XBRL data and engaged with academia for potential research on the new standard. The staff also met with FASB's advisory groups to discuss costs and benefits related to the implementation of Topic 606.
111. The staff worked with the XBRL team to identify the amount of cumulative catch-up adjustments recorded by companies in adopting Topic 606 in order to analyze the amount of companies that had material impacts from adoption. By reviewing a sample of 2018 annual filings (approximately 100 companies that completed the filings in early March

- 2019), it was noted that a vast majority of the filers (70 percent of the sampled companies) disclosed that the adoption did not have a material effect.
112. The staff also participated in several discussions related to the academic research on certain aspects of Topic 606. In March 2021, the staff presented at a webinar with about 90 academic participants on opportunities for research on Topic 606. This webinar provided an overview of Topic 606 and the PIR process and discussed the potential areas of academic research that could support the PIR process. Academic research will be one of the focuses of the PIR activities in future years, particularly in 2022 when the IASB and FASB hold their joint academic conference with *The Accounting Review*.

Advisory Groups Outreach

113. Since 2018, the staff has been meeting with advisory groups to discuss the FASB's post-effective date assessment of costs and benefits of Topic 606. Before 2018, the staff met with the advisory groups as part of Stage 1 PIR activities that are summarized earlier in this memo.
114. In general, the advisory groups agreed that the implementation guidance and educational resources provided by the FASB were helpful. Preparers and practitioners noted that the initial implementation costs were higher than anticipated and the time and, to some extent, the effort required to appropriately implement the standard was underestimated. Investors noted some difficulties in performing their analyses during the transition period as a result of lack of comparability and transparency in the information provided by entities. The advisory groups also commented on the benefits of implementing the standard, such as better cross-functional communication, management's better understanding of the business, improved internal controls, and additional information provided to investors.

FASAC

115. The staff met with FASAC in March 2018, March 2019, and September 2019. According to some FASAC members, particularly preparers and practitioners, although they were able to leverage their existing information technology systems, initial costs were somewhat higher than anticipated because of the need to review all contracts or revenue streams even in areas for which their expected outcomes of applying Topic 606 was substantially the same as prior accounting. Some of those costs were minimized because the information technology systems did not need to be modified. Some members also observed that their contract review processes provided some benefits to their companies, such as changes to how they negotiated certain contract provisions or increased efficiency from centralizing contract information.

116. FASAC members further indicated that the costs have declined significantly since initial implementation and that the ongoing costs are generally in line with expectations. Some benefits of applying Topic 606 noted by preparers include (a) better cross-functional communication between those involved in contract negotiations and those involved in financing and accounting for the revenue generated from those contracts and (b) more robust conversations with investors. Investors and other users supported the consistency of the requirements for all entities on a global basis; they commented that the additional disclosures provided enough information to ask probing questions.
117. FASAC members also indicated that implementation and educational materials were useful to help preparers and practitioners apply the standards, for investors and other users to gain a better understanding about the expected changes to the financial statements and industry-specific effects, and for academics in educating students. Overall, FASAC members commended the Board on the sufficiency and usefulness of the FASB's implementation guidance efforts, including the effectiveness of the TRG. Some FASAC members suggested that the Board expand the use of TRGs to all major standards going forward.

SBAC

118. The staff met with SBAC in May 2018 and May 2019. SBAC members observed that the initial implementation costs included additional systems and internal controls, as well as increased audit costs. Many of those implementation costs were expected to be nonrecurring or to decrease after the transition period.
119. SBAC members noted that smaller public companies often have limited personnel resources and, therefore, usually wait until the third quarter in the year before the effective date to start implementation. Furthermore, because of limited budget and business priorities, implementing accounting changes is not a priority for these entities. In addition, many small businesses underestimated the effort that would be required to implement Topic 606 related to the larger public companies disclosing that the standard would not have a material effect, resulting in increased costs in the form of hiring third-party resources.
120. SBAC members generally agreed that the TRG discussions and clarifying amendments that were finalized in 2016 were helpful. However, they also stated that they find it most helpful to see the disclosures of larger companies. They also mentioned that the practical expedients as well as firm interpretations were helpful to their implementation efforts. Some SBAC members, particularly preparers, noted that their banks or lenders still require either dual bookkeeping based on historical GAAP or renegotiation of loan covenant terms.

121. The staff also met with the PCC and SBAC at a joint meeting in December 2019. Some SBAC members shared ways to begin the process of implementation, such as mapping contracts to the five-step revenue recognition model to identify potential issues and beginning with a small population of contracts and aligning them with the new standard before looking at the entire population. Several members from both advisory groups agreed that companies generally underestimated the time and effort required to appropriately implement the standard, which contributed to a lag in implementation. The two advisory groups also discussed the benefits resulting from implementation, such as helping management better understand contracts and revenue streams and having better controls. Users from both advisory groups commented that the improved disclosures help them clarify different types of contracts and provide decision-useful disaggregated information.

PCC

122. The staff met with PCC in April 2021 to solicit feedback on the implementation experience of private companies. Some PCC members indicated that they leveraged the resources on the FASB's website. They also noted that the extra adoption time for private companies was helpful in preparing for adoption and to leverage public company filings.
123. Some PCC members, particularly preparers and practitioners, noted that determining performance obligations, the principal versus agent analysis, accounting for variable consideration, and evaluating the cost to acquire contracts are all areas that have presented implementation challenges. They commented that complexities still exist in certain industries that previously applied industry guidance or industry practice for key revenue recognition issues and policy elections. PCC members who are practitioners further noted that the franchisors and insurance brokers noticed changes to reported revenue because of Topic 606, but most entities generally did not experience a major change in the measurement of revenue. A PCC member who is a user commented that one-time transition effects were observed when analyzing period-over-period trends.

International Accounting Standard Setters Focus

124. Because Topic 606 is converged with IFRS 15, *Revenue from Contracts with Customers*, the FASB has continued to engage with the IASB about revenue implementation during the adoption period. In addition to the joint meetings of the Transition Resource Group (TRG) from 2014-2015, and the joint Board meetings held when issuing various amendments to the guidance (2015-2016), the FASB and IASB also discussed updates on implementation progress in 2018 and 2019 during joint Board meetings.

125. Additionally, the FASB staff continues to monitor IASB activities regarding revenue recognition. While those meetings are IASB-only (not joint with FASB), the FASB continues to monitor issues discussed by IFRIC.
126. Additionally, the FASB staff and Board members participated in the meetings with other international standard setters to discuss issues related to the new revenue recognition standards as follows.

Meeting Date	Organization
October 2016	Korea Accounting Standards Board
January 2017	China - ARD
January 2017	Japan – ASBJ
May 2017	Italy – ORD
June 2017	ANC France
July 2017	Japan – ASBJ
October 2017	Canadian Accounting Standards Board
June 2018	Italy – ORD
August 2018	Japan – ASBJ
August 2019	Japan – ASBJ

Preliminary Observations

127. This section includes a summary of key themes that the FASB staff has identified during the PIR process to date. These items represent areas where the Board will be asked whether they would like to consider additional research as part of the ongoing PIR process.
- (a) *Principal vs. agent and related consideration payable to a customer:* It can be challenging, in certain situations, to (i) identify the customer, (ii) determine which party controls the good or service before it is transferred to the customer, or (iii) determine which payments should be accounted for as a reduction to revenue.

- (b) *Licensing*: It is challenging to determine when a license is distinct from other services in the contract (such as software with updates) and to allocate the total transaction price when the contract includes a sales-based or usage-based royalty.
- (c) *Variable consideration*: There are challenges in applying the guidance on estimates of variable consideration and determining when and how estimated amounts should be constrained. Estimating variable consideration for contracts with sales or usage-based royalties that are not licenses of intellectual property can be difficult.
- (d) *Disclosures*: No significant issues were identified with the disclosure requirements. However, further research about improvement to the disclosures could be considered, such as providing more specificity around disaggregated revenue and remaining performance obligation disclosures.
- (e) *Short cycle contract manufacturing*: The criteria for determining whether revenue should be recognized over time or at a point in time can be challenging for contract manufacturers to apply and can result in different revenue recognition timing for similar transactions depending on customization of goods.
- (f) *Standalone selling prices (SSP)*: SSP estimation has been challenging in certain situations, especially when the new performance obligation has never been sold on a standalone basis or has little or no cost basis (or an undeterminable cost basis). The guidance on allocating a discount and determining SSP using the residual method could be further clarified.
- (g) *Identifying performance obligations*: Assessing the nature of a promise and whether or not goods or services are distinct requires significant management judgment. Conclusions about separation of performance obligations can have an effect on the timing of revenue recognition.
- (h) *Incremental cost of obtaining a contract*: There are difficulties, in some situations, in determining which costs should be capitalized and determining the amortization period.

Board Meeting Handout

Recognition and Measurement of Revenue Contracts with Customers under Topic 805

July 28, 2021

Meeting Purpose

1. The purpose of this meeting is for the Board to discuss the comments received and begin redeliberations on the proposed Accounting Standards Update, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*.

Questions for the Board

1. Does the Board want to affirm its decision on recognition and measurement of contract assets and contract liabilities arising from acquired revenue contracts with customers in a business combination (Issue 1)?
2. Which alternative does the Board prefer regarding whether the current expected credit losses (CECL) allowance related to a contract asset should be within the scope of the guidance (Issue 1A):
Alternative 1: Clarify that the CECL allowance for contract assets is within the scope of the proposed amendments
Alternative 2: Clarify that the CECL allowance for contract assets is not within the scope of the proposed amendments?
3. Does the Board want to provide any practical expedients, and related disclosures, to the recognition and measurement guidance in Topic 606 for contract assets and contract liabilities acquired in a business combination (Issue 2)?
4. Which alternative does the Board prefer for the scope of the proposed amendments (Issue 3):
Alternative 1: Affirm the scope in the proposed amendments
Alternative 2: Include within the scope any assets or liabilities that affect revenue under Topic 606
Alternative 3: Include within the scope any assets or liabilities that affect revenue under Topic 606 or Topic 805?

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

5. Does the Board want to affirm its decision to not require any incremental disclosures (transition or general) for contract liabilities and contract assets acquired in a business combination (Issue 4)?
6. Does the Board want to affirm its decision on transition method (Issue 5)?
7. Does the Board want to affirm its decision on early adoption, including allowing early adoption in an interim period (Issue 5)?
8. What effective dates does the Board select for the amendments in the Accounting Standards Update (Issue 5)?

Sufficiency of Information and Cost-Benefit Analysis [Note: These questions assume that the Board addresses Question 1–8 above.]

9. Has the Board received sufficient information and analysis to make an informed decision about the expected costs of the changes? If not, what other information or analysis is needed?
10. Does the Board think that the benefits justify the costs? If so, does the Board authorize the staff to proceed to drafting a final Accounting Standards Update for vote by written ballot?

Issue Background

2. On March 28, 2018, the Board added Issue 18-A, “Recognition under Topic 805 for an Assumed Liability in a Revenue Contract,” to the Emerging Issues Task Force’s (EITF’s) agenda to address the recognition of a revenue contract with a customer acquired in a business combination after an entity has adopted Topic 606. The Board also directed the Task Force to provide educational information on measurement topics that may arise from the application of Topic 606 to a business combination.
3. The Task Force reached a consensus-for-exposure on Issue 18-A that would require that an entity use the Topic 606 performance obligation definition in determining whether an assumed contract liability from a revenue contract represents a liability that is recognized in a business combination at the acquisition date. As a part of the consensus-for-exposure, the Task Force decided that the timing of payment of consideration (or payment terms) should not affect the amount of revenue recognized by the acquirer related to the acquired revenue contract. The Task Force also reached a consensus-for-exposure that an acquirer would consider the assets and liabilities assumed in the acquired set when determining the fair

value of an assumed contract liability. However, Task Force members identified potential unintended consequences of their decisions on payment terms and the acquired set measurement concept. The Task Force discussed different alternatives for the recognition and measurement of an assumed liability from a revenue contract in a business combination to address the potential unintended consequences, but the Task Force determined that it needed additional feedback from stakeholders. Therefore, the Task Force recommended that the Board direct the staff to issue an Invitation to Comment (ITC) to solicit input about measurement and other topics related to revenue contracts acquired in a business combination and to research those issues separately from Issue 18-A to not delay the issuance of a proposed Accounting Standards Update.

4. At the October 10, 2018 Board meeting, the FASB authorized the staff to prepare an ITC, *Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805*, as part of the Board research project, Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805 (that is, separate from the proposed Update for Issue 18-A). On February 14, 2019, the FASB issued the proposed Accounting Standards Update, *Business Combinations (Topic 805): Revenue from Contracts with Customers—Recognizing an Assumed Liability* resulting from Issue 18-A and the ITC concurrently. The comment deadline for both documents was April 30, 2019.
5. After considering the feedback received on the ITC and on the proposed Update, the Task Force decided not to affirm its consensus-for-exposure on Issue 18-A and recommended to the Board that the issues in the proposed Update be considered holistically.
6. At the July 31, 2019 Board meeting, the Board voted to subsume Issue 18-A on the recognition of an assumed liability from a revenue contract in a business combination into the Board's research project and retitled the research project, Recognition and Measurement of Revenue Contracts with Customers under Topic 805.
7. On September 23, 2020, the Board voted to add the project to the technical agenda and issue a proposed Update that would require an entity to recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with Topic 606.

Comment Letter Demographics

8. Forty-three comment letters were received in response to the proposed Update. Not all respondents addressed each question and the level of detail in the responses varied. Overall, the Questions for Respondents were general in nature.

9. The following table lists the composition of the comment letter respondents by respondent type:

Type of Respondent	Number of Respondents
Accounting Society	2
Academic	5
Preparer	15
Preparer Association	2
State CPA Society	6
Practitioner	8
User	2
Valuation Specialist	2
Other	1
Total Respondents	43

10. Of the five academic comment letters, four were submitted by Master of Accountancy students from Kennesaw State University and Metropolitan State University of Denver.

Summary of Investor Feedback

11. The staff notes that it received two comment letters from users, both of which are reflected in the comment letter feedback summary below. However, in deliberations before the issuance of the proposed Update, the staff held numerous conversations with members of the Investor Advisory Committee (IAC). The majority of the IAC members supported the Topic 606 approach for the reasons stated in the basis for conclusions of the proposed Update.
12. After the issuance of the proposed Update, certain IAC members at the May 25, 2021 meeting provided feedback that their investor clients supported and were encouraged by the proposed amendments and supported the issuance of a final standard. The staff also discussed the proposed amendments with one investor from a credit rating agency, who wrote an internal paper suggesting that while the proposed amendments address the issue of projecting future cash flows and earnings trends, it may cause a loss of information for other types of analyses.

Comment Letter Summary

13. The section of this handout is organized as follows:

- (a) Issue 1: Recognition and Measurement of Contract Assets and Contract Liabilities Acquired in a Business Combination
 - (i) Issue 1A: Acquired Contract Assets and Associated Current Expected Credit Losses.
- (b) Issue 2: Practical Expedients
- (c) Issue 3: Scope
- (d) Issue 4: Disclosures
- (e) Issue 5: Transition, Early Adoption, and Effective Dates.

Issue 1: Recognition and Measurement of Contract Assets and Contract Liabilities Acquired in a Business Combination

14. Overall, the majority (36 of 41) of respondents, including 16 of 17 preparers/preparer associations, supported the proposed amendments for reasons consistent with those cited in the basis for conclusions of the proposed Update. That is, respondents explained that the proposed amendments address the diversity and inconsistency in accounting for acquired revenue contracts in a business combination, is less costly and complex compared with current accounting, and provides users of financial statements with better information.
15. Respondents explained that the proposed amendments not only address the issue of timing of payment of acquired revenue contracts affecting the amount of revenue recognized by the acquirer, but also removes the measurement discrepancy between acquired revenue contracts and those originated after the business combination.
16. Several respondents explained that the guidance in Topic 606 is comprehensive and discusses many of the estimates and items that an acquirer would need to consider, thus resulting in less complexity than fair value measurement and fewer areas of diversity. One preparer explained that “allowing acquirers to base their initial measurement of acquired contracts on the acquiree’s existing financial statements will significantly simplify the initial effort and allow companies to focus on more meaningful analysis,” such as aligning accounting policies with those of the acquiree and other critical activities for acquired revenue contracts. Many of those respondents also indicated that under current practice acquirers incur additional costs to (a) determine the fair value adjustments and (b) maintain two sets of records to explain the effect of the fair value adjustments to users (that is, explain the results

of the entity post-acquisition as if the fair value adjustments were not recorded), both of which would be alleviated by the proposed amendments.

17. In support of the overall proposed guidance, the majority of respondents answered Question 6 in the proposed Update and explained that the proposed amendments would provide users of financial statements with useful and appropriate reporting outcomes. Many respondents explained that the proposed amendments result in greater consistency of reporting for revenue contracts at the date of and after the acquisition, which will improve investors' ability to forecast entity revenues. One explained that its "investors have noted that the current approach does not provide decision-useful information and may result in an incorrect view of revenue growth." Similarly, a number of respondents explained that the proposed amendments eliminate the confusing explanations of the deferred revenue fair value adjustments to investors through non-GAAP reporting, which are often diverse in terms of the nature and amount of information provided.
18. One comment letter from three academics explained that their recently published paper¹ contained findings applicable to the relevance and decision usefulness of the information provided by the proposed amendments. The study suggests that (a) revenue under the amendments in the proposed Update would have characteristics of relevant accounting information and (b) users would find the information helpful in making investment decisions.
19. The five respondents who opposed the proposed amendments explained that the proposed amendments would cause gross margin differences for similar acquired revenue contracts, represented a deviation from the overall measurement principle in Topic 805, and would not provide as relevant information as the fair value measurement of contract assets and contract liabilities currently required.
20. Two practitioners discussed the effect of the proposed amendments on gross margin of an acquired contract after the acquisition. The practitioners noted that a contract paid upfront (that is, one with a related contract liability) likely would have a higher gross margin after the proposed amendments are applied than a similar contract paid over time after the acquisition. The two practitioners found this outcome of the proposed amendments to be unintuitive. The staff notes that the differences in gross margin were previously discussed by the Board and are primarily due to the amortization of customer-related intangible assets.
21. Both of the practitioners suggested that this outcome could be addressed by requiring a customer-related intangible asset for the difference between the fair value of the contract liability and the measurement of the contract liability under Topic 606. Both practitioners

¹ Campbell, et al. "The Determinants and Informativeness of Non-GAAP Revenue Disclosures." 2021.

noted that it would be helpful if the Board also prescribed where to classify the amortization of backlog intangible assets and require that entities disclose those amounts.

22. One respondent who supported the proposed amendments noted that there would still be related assets and liabilities, such as deferred costs under Subtopic 340-40, that are measured at fair value. The respondent noted that this would result in a higher margin for those contracts that are acquired versus similar ones that are originated. That respondent explained that this difference may be addressed by the accounting for customer-related intangible assets but could still result in a difference in EBITDA for the two contracts. Multiple other respondents who also supported the proposed amendments explained that the gross margin difference is counterintuitive, but they believe that the issue is not pervasive, and they further explained that there is already inconsistency in margins before and after an acquisition due to the fair value measurements of other acquired assets and liabilities.
23. Three of the five respondents who opposed the proposed amendments explained that the exception to the fair value measurement guidance could lead to potential justifications for other similar exceptions, thereby moving further away from the overall concepts in Topic 805. Two of those respondents (a preparer and a user) also explained that fair value produces the most useful information because it better reflects the expected cash flows associated with the acquired assets and liabilities and provides information that is useful in evaluating the soundness of the business acquisition decision.
24. Seven respondents, primarily preparers, indicated that the Board should consider addressing the accounting for inventory acquired in a business combination because it generates the same challenges for users and preparers as the deferred revenue fair value adjustments. That is, the fair value measurement of inventory usually results in an upward adjustment to the acquiree's balance, which may temporarily reduce margins and distort short-term trends. A number of those respondents noted that they would not delay the proposed Update to address the measurement of inventory in a business combination.

Understandability and Operability

25. Similar to the sentiment on the overall guidance, a majority of respondents who answered the related questions on understandability and operability found the proposed recognition, measurement, and other related intangible asset guidance to be understandable and operable. Preparers who responded to the related questions were unanimous in stating that the proposed guidance was understandable and operable, whereas in contrast, those who thought the guidance needed clarification were primarily practitioners. Despite the majority of respondents stating that the guidance was generally understandable and operable, several respondents requested clarifications be made to the proposed guidance.

26. Numerous respondents noted in their support of the proposed amendments that it likely would be simpler and less costly to apply than current amendments. Two preparers explained that in practice they already perform the assessment of acquired revenue contracts similar to what would be required under the proposed guidance. That is, they already assess acquired revenue contracts to “ensure that they understand the contractual requirements of any unsatisfied performance obligations in order to appropriately estimate their fair value.” Another preparer echoed this sentiment and explained that acquirers already have the information necessary to determine how revenue is being recognized by the acquiree and whether it is consistent with their own methods of revenue recognition. Two other preparers and other various respondents also explained that preparers are well versed with the principles in Topic 606, and, thus, the guidance is straightforward and understandable.
27. A majority of respondents further explained that the existing guidance for other assets or liabilities that may arise from revenue contracts in a business combination, such as customer-related intangible assets and contract-based intangible assets, would remain understandable and operable. Two valuation specialists were among these respondents with one stating that there would be no changes in the recognition and measurement of these intangible assets or liabilities because of the proposed guidance. Other respondents explained that because the current proposed guidance does not alter the existing guidance, it is clear it should be treated in accordance with Topic 805 principles. In recognition of other comments, one state society noted that it would be concerned if the Board were to propose changes to the existing guidance as part of this project. The state society noted that a more robust review of Topic 805 would be required if the Board would like to amend the guidance for intangible assets that arise from revenue contracts.
28. Several respondents explained that there may be circumstances in which the proposed guidance may be more complex than current guidance, such as if the acquiree did not follow GAAP before the acquisition, there were errors found in the acquiree’s Topic 606 accounting, or they had numerous complex long-term contracts that had been modified before the acquisition. Specifically, there were concerns about whether there would be appropriate historical data for contracts and the requirement for acquirers to estimate certain items such as standalone selling price in a previous period for which they did not originate the revenue contract.
29. Four respondents, including three practitioners and one accounting society, explained that the guidance was not understandable and requested clarifications to both the proposed measurement and related contract-based intangible assets (specifically, off-market contracts) guidance. Those respondents explained that they thought there were instances in which the

intent was unclear or only clear in the basis for conclusions, which they noted could drive diversity in practice in the accounting for acquired revenue contracts under the proposed guidance.

30. Several respondents, including preparers, requested clarifications related to the following areas:

- (a) Application of Topic 606 at the acquisition date
- (b) Contract-based intangible assets (off-market contracts)
- (c) Scope (see Issue 3).

31. Five practitioners, one accounting society, and one preparer association explained that wording similar to paragraph BC28 of the proposed Update about circumstances in which the measurement of contract assets and contract liabilities in accordance with Topic 606 would differ from the acquiree's recorded amounts should be codified. Specifically, they explained that the guidance should clarify which estimates in Topic 606 should be assessed based on original terms at the contract inception date versus which should be assessed as of the acquisition date. The preparer association explained that while it understands that an acquirer will perform an evaluation of the acquiree's accounting policies on all relevant topics to conform to its own accounting policies, the judgments and estimates in Topic 606 warrant specific discussion in the guidance because of their complexity. Two practitioners also were concerned that if paragraph BC28 was not codified, stakeholders may interpret the proposed guidance to mean that an acquirer should carry over the balances from the acquiree without additional analysis. Additionally, four respondents requested illustrative examples to demonstrate the accounting for acquired revenue contracts under the proposed amendments, including circumstances in which estimates, such as variable consideration, need to be updated.

32. A diverse group of nine respondents requested clarity on how to determine and account for off-market contracts under the proposed amendments. Three accounting practitioners suggested that because the proposed amendments contain a mixed measurement model for acquired revenue contracts, it is unclear whether determining off-market contracts should be different under the proposed amendments (that is, whether the proposed amendments would require recognition of additional off-market contracts) when compared with what is performed currently. One practitioner summarized the issue stating that:

The principle behind recognizing a favorable intangible asset or unfavorable liability is to make the acquirer's post-acquisition margin reflect current market terms for that contract, which is consistent with the fair value principle under Topic 805. However, the separate recognition of a favorable intangible asset or unfavorable liability is not that common because in practice

the off-market component is typically included in the fair value of a backlog intangible asset or a contract liability. That is, the fair value measurement of the asset or liability already ensures that post-acquisition performance reflected a market rate of return.

33. Because of this current practice, those practitioners were concerned that measuring a contract asset or contract liability under Topic 606 may necessitate more off-market contract recognition to achieve the results of current practice.
34. Four practitioners and one state society noted that if the Board were to provide guidance on assessing off-market contracts, then it should prescribe recognition, measurement, subsequent accounting, and presentation guidance for those types of contracts.
35. Two preparers, one preparer association, and one state society explained that the proposed amendments related to off-market contracts seemed to hint that current practice was no longer appropriate and required that all contracts needed to be assessed for off-market components on an individual contract basis. Those respondents explained that in certain circumstances, it would likely be impractical to perform this analysis on an individual contract basis.

Differences between IFRS Standards and GAAP

36. Most respondents acknowledged that an additional difference between IFRS 3, *Business Combinations*, and Topic 805 would create additional complexity and cost for preparers and users of financial statements. However, most of those respondents indicated that even given that additional cost and complexity, they would prefer that the Board continue to pursue finalizing the proposed amendments. Those respondents generally indicated that the additional cost of creating a difference between IFRS Standards and GAAP would not outweigh the benefits achieved by the proposed amendments.
37. A few respondents suggested providing a practical expedient to allow entities to continue to recognize and measure contracts assets and contract liabilities at fair value in a business combination.

Issue 1A: Acquired Contract Assets and Associated Current Expected Credit Losses (CECL)

38. Three respondents commented on whether there needs to be additional clarification on the recognition and measurement of the CECL allowance for acquired contract assets in order to avoid diversity in practice and application. Two practitioners and one preparer suggested that it is unclear whether a CECL allowance needs to be established at the acquisition date. One recommended adding an additional paragraph specific to contract assets that notes that a

corresponding CECL allowance should be recognized at the acquisition date. Another recommended that the Board tie the guidance to paragraph 805-20-30-4A on acquired financial assets that are not purchased financial assets with credit deterioration if the Board intended for contract assets recorded in a business combination to be within the scope of Subtopic 326-20. The staff notes that under that paragraph, the acquired financial assets are measured at their acquisition-date fair value, and then for those assets within the scope of Topic 326, an allowance is recorded with a corresponding charge to credit loss expense as of the reporting date.

39. On the basis of feedback received through comment letters and subsequent outreach as well as the staff's research, the staff identified the following alternatives for the Board to consider:

- (a) *Alternative 1: Clarify that the CECL allowance for contract assets is within the scope of the proposed amendments*—The proposed amendments would require that the CECL allowance be assessed and established at the acquisition date as required by Topic 606.
- (b) *Alternative 2: Clarify that the CECL allowance for contract assets is not within the scope of the proposed amendments*—The proposed amendments would not address how to account for the CECL allowance.

Issue 2: Practical Expedients

40. In response to Question 5 of the proposed Update, several respondents suggested practical expedients primarily related to the following circumstances:

- (a) If the contracts are complex and long term
- (b) If an acquirer is unable to rely on the acquiree's Topic 606 accounting.

41. One practitioner and three preparers explained that they had some concerns about the implications of requiring measurement of acquired long-term contracts with customers at the point of contract inception and carrying the accounting forward to the business combination date. A number of those respondents explained that the term of those contracts could be several years and that it is likely that they will have been modified at least once by the acquiree before the acquisition. In those circumstances, it is likely that there would be a significant amount of judgment and estimation that would need be performed to evaluate standalone selling price at the contract inception date and subsequent transaction price allocation for each modification to the contract since inception. Most of those respondents suggested a practical expedient consistent with the one allowed under the transition provisions of Topic 606 in paragraph 606-10-65-1(f)(4). That is, an acquirer would reflect the aggregate effect of all modifications that occurred before the acquisition as of the acquisition

date in determining the transaction price, identifying the satisfied and unsatisfied performance obligations, and allocating the transaction price.

42. Eight respondents expressed concerns about potential complexity of the guidance in circumstances in which the acquirer would be unable to rely on the acquiree's Topic 606 accounting. This would primarily be related to acquisitions in which an acquiree did not perform GAAP accounting before the acquisition or errors were found in its Topic 606 accounting. For those circumstances, respondents suggested a variety of practical expedients:
- (a) Allow for applicable practical expedients offered in Topic 606 transition paragraph 606-10-65-1(f)
 - (b) Standalone selling price (SSP): Determine SSP for the acquired contract as of the acquisition date, instead of the contract inception date, and use the acquisition date SSP to allocate the transaction price for each contract.
43. Other respondents suggested practical expedients in circumstances in which the acquirer may be able to rely on the acquiree's Topic 606 accounting. Those practical expedients included:
- (a) One accounting society wanted to allow for the option to not adjust different methods of progress between the acquiree and acquirer.
 - (b) One preparer suggested that an acquirer would be permitted to carry over the acquiree's policies, estimates, and judgments if the remaining term of the acquired contract was less than a year.
 - (c) Three respondents suggested a practical expedient in which the acquirer would not be required to reevaluate those judgments determined at contract inception, such as SSP, gross versus net considerations, or identification of performance obligations, unless there was an error found in the accounting. The staff notes that each of those respondents classified this suggestion as a clarification rather than a practical expedient. However, the staff notes that the proposed guidance, if clarified in this manner, would not be relevant in situations in which the acquiree did not previously perform GAAP because there would not have been a determination at contract inception.

Issue 3: Scope

44. Most respondents agreed with the proposed scope and agreed that the proposed amendments should be applied to contracts beyond contracts with customers that also are

accounted for in accordance with Topic 606. Those respondents generally noted that this would improve consistency in accounting for similar assets and liabilities. Other respondents opposed including contracts beyond contracts with customers that are accounted for in accordance with Topic 606 because they opposed the overall proposed amendments or thought there could be unintended consequences.

45. Some respondents suggested that the Board clarify the scope by indicating whether specific assets and liabilities recognized under Topic 606 other than contract assets and contract liabilities, such as refund liabilities or assets related to upfront payments to customers, should be included within the scope. If they are included within the scope, respondents suggested that the proposed Update explain how the proposed amendments apply to those other assets and liabilities.
46. Certain respondents also discussed whether specific assets or liabilities recognized under Topic 606 other than contract assets and contract liabilities should be included within the scope. Alternatively, a practitioner explained that expanding the scope of the proposed amendments beyond contract assets and contract liabilities resulting from contracts with customers was unnecessary because the proposed amendments address stakeholders' primary concerns.
47. The staff identified the following alternatives for the Board to consider:
 - (a) *Alternative 1:* Affirm the scope in the proposed amendments—The current scope includes contract assets and contract liabilities from contracts with customers and other contracts to which the provisions of Topic 606 are applied.
 - (b) *Alternative 2:* Include within the scope any assets or liabilities that affect revenue under Topic 606
 - (c) *Alternative 3:* Include within the scope any assets or liabilities that affect revenue under Topic 606 or Topic 805.

Issue 4: Disclosures

Ongoing Disclosures

48. Generally, most respondents supported not adding incremental disclosures. Many noted that the disclosures currently required by Topic 805 and Topic 606 provide users with sufficient information. Additionally, one auditor stated that creating a disclosure to distinguish between originated and acquired revenue is outside the scope of the proposed amendments and a state CPA society stated that additional disclosures distinguishing between originated and acquired revenue would be “redundant, confusing, and not provide useful...information.”

49. The few respondents who supported adding incremental disclosures did so to provide users with additional information. One of the respondents proposed including a disclosure that described the difference between the book value and fair value of the contract liability and the average term of the contracts acquired and stating that those disclosures would help users to understand the long-term effects of the acquired contract liabilities. Additionally, a preparer and a user association recommended that the Board add a disclosure that includes the amount of 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.
50. The staff performed subsequent outreach with one additional user, who also requested information about the amount of deferred revenue acquired, and the projected run rate of the deferred revenue. The staff notes that this user acknowledged that information provided under current disclosures could address some of the concerns expressed about potentially losing information under the proposed amendments.
51. A few respondents stated that if practical expedients or any options are provided, entities should be required to disclose any it elects.
52. Additionally, a couple practitioners suggested including a disclosure of the amount and classification of customer-related intangible assets that would include backlog intangible assets and off-market intangible assets and liabilities.

Transition Disclosures

53. The proposed Update did not contain any transition disclosures related to the proposed amendments. A majority of respondents agreed with the proposed amendments. A couple of respondents suggested adding transition disclosures to facilitate a financial statement user's understanding of the adjustments made when adopting the proposed amendments.
54. One respondent suggested including a disclosure on the year-to-date effect of early adopting the proposed amendments in an interim period if it is significant. Another respondent recommended including a quantitative reconciliation to explain any differences from previously reported measurement of acquired customer contracts to measurement under the new approach. This respondent stated that this disclosure should be provided for each period presented in the year of transition.

Issue 5: Transition, Early Adoption and Effective Date

Transition Requirements

55. Most respondents agreed that the proposed amendments should be adopted on a prospective basis. Consistent with the rationale provided in paragraph BC44 of the proposed Update, a few respondents who supported prospective adoption noted that retrospective application may be too onerous and costly, thus outweighing potential benefits.
56. Some respondents suggested providing an option for entities to adopt the amendments on a retrospective and/or modified retrospective basis. Those respondents noted that allowing some entities to adopt the amendments retrospectively could result in more comparable financial statements. A practitioner stated that it does not support requiring or allowing an option for retrospective application because it would create inconsistencies between entities, although a few respondents noted that this could be addressed via additional disclosures.
57. A couple of respondents supported modified retrospective application over prospective application to provide users with more comparable financial statements.

Early Adoption

58. Most respondents agreed with the early adoption guidance as proposed. Those respondents indicated that if an entity early adopts the proposed amendments in an interim period, that entity should adopt the proposed amendments as of the beginning of the annual period that includes that interim period to maintain consistent accounting for business combinations throughout the annual period. One preparer noted that the proposed early adoption guidance would not require a significant amount of work and that preparers likely would still be within the measurement period and finalizing assessments of the acquired contracts.
59. While most respondents agreed with the early adoption guidance, some suggested clarifying how an entity should retrospectively adopt the proposed amendments as of the beginning of the annual period if an entity early adopts in an interim period.
60. A few respondents suggested aligning the requirements of early adoption with the guidance on the measurement period of a business combination and the recognition of provisional amounts.
61. Other respondents disagreed with the early adoption guidance as proposed. Those respondents noted that not all business combinations within an annual period need to have the same treatment. A few respondents also commented that the proposed early adoption guidance may deter entities from early adopting.

62. Some respondents suggested providing entities with the option to retrospectively adopt the proposed amendments as of the beginning of the annual period or to apply a modified retrospective approach in which an entity would do a cumulative catch-up adjustment in the period of adoption.

Effective Date

63. Generally, most respondents agreed that entities would not need a significant amount of time to adopt the proposed amendments. Those respondents stated that most entities should have the necessary processes already in place and that the proposed guidance is a simplification. Other respondents noted that entities should have at least a year to implement the proposed amendments.

64. Most respondents also agreed that entities other than public business entities should be allowed to have more time to adopt the proposed amendments. Generally, those respondents indicated that nonpublic entities typically get additional time to adopt new guidance.

65. A few respondents commented that nonpublic business entities would not need more time than public entities to adopt the proposed amendments primarily because the proposed amendments would simplify the accounting, and improve comparability.

Board Meeting Handout
Conceptual Framework—Elements
July 28, 2021

Meeting Purpose

1. The Board will discuss the following issues related to proposed FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4: Elements of Financial Statements*:
 - (a) Issue 1: Element for common control equity transactions of not-for-profit entities
 - (b) Issue 2: Recognized assets and liabilities in the definition of equity or net assets
 - (c) Issue 3: Appendix A, *Accrual Accounting and Related Concepts*, of proposed Chapter 4 (content drawn from FASB Concepts Statement No. 6, *Elements of Financial Statements*).
2. Assuming that the Board can make a decision on all of the issues above, the staff will ask the Board for permission to proceed to draft the final Chapter 4 of Concepts Statement 8 for vote by written ballot.

Questions for the Board

1. Does the Board want to create a new element for equity transfers in common control transactions of not-for-profit entities?
2. Should the term *recognized*, with respect to assets and liabilities, be included in the definition of equity or net assets?
3. Does the Board want to retain the concepts from Appendix A of proposed Chapter 4? If so, does the Board agree with the staff recommendation to relocate the information to the introduction of Concepts Statement 8?
4. Does the Board give the staff permission to proceed to draft the final Chapter 4 of Concepts Statement 8 for vote by written ballot?

Issue 1: Element for Common Control Equity Transactions of Not-for-Profit Entities

3. The majority of respondents agreed that the elements described in the proposed chapter, other than noted exceptions, would apply to not-for-profit entities. Some respondents

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

asserted that confusion exists in practice around how equity transfers between entities under common control fit into any of the proposed definitions. Those respondents asserted that this is also an issue with the current definitions and that it would be helpful if the final chapter provided clarity to help resolve existing diversity in practice in net asset classification of equity transfers.

Issue 2: Recognized Assets and Liabilities in the Definition of Equity or Net Assets

4. One respondent suggested changes to the proposed definition of equity or net assets by adding the word *recognized* before both the words *assets* and *liabilities* to avoid assets and liabilities that are not recognized from being incorporated in the calculation of equity or net assets. The proposed definition of equity or net assets in financial statements is as follows:

E65. Equity or net assets is the residual interest in the assets of an entity that remains after deducting its liabilities. [Footnote reference omitted]

Issue 3: Appendix A, *Accrual Accounting and Related Concepts*, of Proposed Chapter 4

5. Respondents had mixed feedback on whether Appendix A is useful in the proposed chapter. Some respondents commented that the appendix was helpful overall, whereas others provided feedback for the Board to consider. The following feedback was provided on Appendix A:
 - (a) Multiple respondents stated that it was not clear how the appendix should be considered when specifically discussing elements and suggested it be moved to a chapter on recognition or removed altogether.
 - (b) One respondent commented that the material in the appendix is not sufficiently linked to core guidance, which decreases its usefulness, and requested that the Board explain the application of the appendix to elements.
 - (c) One respondent suggested incorporating the discussion of accruals and deferrals related to deposits, initial costs, and other items as examples in the text of the proposed chapter rather than in an appendix.
 - (d) One respondent had concerns about the use of the term *matching* in the appendix.