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March 26, 2021

Ms. Hillary H. Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7 P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2020-1000

Re: Proposed Accounting Standards Update, Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities From Contracts With Customers

Dear Ms. Salo:

CFA Institute appreciates the opportunity to comment on the FASB's proposed Accounting Standards Update (ASU), *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities From Contracts With Customers* (the "Proposal"). CFA Institute[1] is providing comments consistent with our objective of promoting fair and transparent global capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures – and the related audits – provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

As an overall matter, we strongly object to the issuance of the Proposal, as we believe that by creating an exception to the general concept of fair value measurement for business combinations, the Proposal will result in a loss of important information to investors and will fail to hold management accountable for its investments and their subsequent performance. It would also create an additional difference between US GAAP and International Financial Reporting Standards (IFRS) in the accounting for business combinations, which is lamentable, given all the effort the FASB and IASB made to achieve convergence in this area. Thus, ***we are of the view that the Proposal would not improve the accounting for business combinations and it would not meet the objective of financial reporting of providing more decision-useful information.***

1 CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154-member societies in 77 countries and territories.

Our chief concerns and suggestions are summarized as follows. Our responses to the FASB's questions are provided in the **Appendix**.

Fair Value Accounting Produces the Most Useful Information Regarding Business Combinations – We strongly object to the issuance of this Proposal because it would create an exception to the fair value measurement basis required by Topic 805. Fair value measurement reflects the expected cash flows associated with acquired assets and assumed liabilities and therefore produces the most useful information in evaluating the soundness of a business acquisition decision.

We note that the objective of financial reporting is to provide information useful in assessing an entity's prospects for future net cash inflows and the efficiency and effectiveness with which "the entity's management and governing board have discharged their responsibilities to use the entity's resources."[2] Accordingly, we believe that the proposed change in measurement basis for contract assets and contract liabilities acquired in a business combination would result in the loss of fair value information that is useful in evaluating the soundness of the business acquisition decision. Simply carrying over the acquiree's basis of accounting does not faithfully represent the economics of a business acquisition transaction. It is akin to pooling-of-interests accounting which was rejected by the FASB and IASB. The Proposal would therefore result in the loss of decision-useful information for investors and would thus fail to achieve the objective of financial reporting.

Carryover Basis Accounting Will Inflate Post-Acquisition Revenues – We are also concerned that, since an acquiree's preacquisition measurement of contract assets and liabilities would, in most situations, carry over to the post-acquisition financial statements of an acquirer, this would lead to an overstatement of post-acquisition revenues and income by the acquirer. This same concern was discussed back in 2007 in the basis for conclusions in Statement 141(R), which stated that "by recording assets and liabilities at the carrying amounts of predecessor entities, post-combination revenues may be overstated (and expenses understated) as the result of embedded gains that were generated by predecessor entities but not recognized by them." We believe that this concern remains exactly the same today. While the intervening years have seen the introduction of a change to the revenue recognition model with the implementation of Topic 606, we note that contract assets and liabilities have existed both before and after the introduction of the new model, albeit previously with different names (deferred and unearned revenue), and we do not believe that the amendments introduced by Topic 606 have resulted in a significant enough change to the nature of these assets and liabilities that would warrant a wholesale overturning of fair value accounting for them.

Moreover, as certain of the FASB members correctly note in their alternative views, ***the potential overstatement of post-acquisition revenues and income by the acquirer resulting from carrying over the acquiree's basis may create perverse incentives for entities to "buy revenues."*** Many companies are by their nature serial acquirers, and as a result their true financial results would be thoroughly muddied after just a few acquisitions. Thus, rather than improving financial reporting, the Proposal would actually make post-acquisition results less transparent to investors.
We further disagree with the view that the proposed application of carryover-basis measurement would incorporate certain information that is useful in assessing the longer term implications of a business

[2] FASB Concepts Statement 8, Conceptual Framework for Financial Reporting—Chapter 1, The Objective of General Purpose Financial Reporting, paragraph OB4; footnote reference omitted.

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combination into the face of the financial statements because the pre combination revenues are not necessarily reflective of the post combination revenues and the post combination revenues would include amounts as revenue that do not represent cash flows of the new company. In fact, the revenues to be included under such a carry-over basis approach should be subtracted from any EBITDA as they do not represent cash flows of the post-acquisition entity nor the performance of the post-acquisition management.

Increased Contract Liabilities Results in Increased Goodwill – The application of carryover-basis measurement would also result in an increase in contract liabilities, which would then produce an offsetting increase in goodwill, which for public companies is not, yet, subject to systematic amortization. As we have discussed in our previous comment letters to the FASB and the IASB on the accounting for goodwill, we are concerned that goodwill impairments are not recognized by many companies on a timely basis. Thus, the Proposal would merely exacerbate this situation. Goodwill currently represents 40% of the S&P 500 equity at year-end 2018. We need not increase it artificially through this accounting gross up. See CFA Institute 2020 comment letter to FASB on goodwill accounting.

We would also note that the FASB seems to be heading in the direction of amortizing goodwill over a period of 10 years. One of our reasons for opposing such change to amortization is that it is not decision-useful. We have indicated an amortization period that correlates to the cash flows of the acquired business would be most appropriate – though we prefer impairment. If this Proposal is adopted the revenue to be recognized is likely to be over a much different period than the 10-year arbitrary amortization period of the goodwill created by the Proposal – and the goodwill amortization would not correlate to cash flows of the acquired business because there are no cash flows accruing to the company over that revenue or goodwill amortization period. The cash flows happened prior to acquisition. In such a scenario, investors are likely to see the acquiree company adding back the goodwill amortization to arrive at EBITDA but retaining the revenue generated by the carry-over proposal. This is an illogical and misleading result as there is no cash related to the revenue in such EBITDA measure.

Non-GAAP Measures Can be Deployed To Achieve the Same Result – We also note that the proposed changes are wholly unnecessary, because companies already have a viable means of disclosing pre-acquisition revenues – that is, via the use of non-GAAP disclosures. Non-GAAP disclosures can be easily deployed by companies to distinguish acquired and originated revenues so that investors can evaluate them separately, should they so desire. Our preference is for acquiree companies to prepare Non-GAAP measures to add back revenue thus highlighting the non-cash nature of that revenue rather than including such revenue in the GAAP financials (increasing goodwill amortization as we note above) and not highlight the non-cash nature of this proposed accounting adjustment.

Maintaining Global Convergence is Essential for Investors – Our investor members have been clear that retaining international convergence in accounting for business combinations is of paramount importance. The FASB has expended a large amount of energy in the past to achieve convergence on business combination accounting. We would therefore view it as a major step backwards for financial reporting and financial markets if the Board decided to diverge on such a key area that affects the measurement of top line revenues. We find that the more nuanced and subtle differences in major standards are the most pernicious, as over time they tend to get lost and are therefore more difficult for investors to keep track of. We believe that keeping the business combination model simple (i.e., rooted in a uniform fair value model with no exceptions), and harmonized globally, is the most efficient long-term approach for capital markets.

If the Board Proceeds With the Proposal, Disclosures are Essential – Finally, if the Board decides to proceed with the Proposal, we are extremely concerned that the Board has not proposed any new disclosures to highlight the change. The resulting effects of the Proposal on post-acquisition revenues and income will not be transparent to investors and other users of the financial statements; thus, ***additional disclosures to highlight these changes are essential*****,** especially for investors who are attempting to make apples-to-apples comparisons between companies who follow IFRS and those who follow US GAAP. Therefore, if the Proposal is finalized, we strongly recommend that companies be required to disclose the amount of purchased revenues and their effect on contract assets and liabilities in each period following an acquisition as long as the differences between the fair value approach and the new approach are material.

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If you have any questions or seek further elaboration of our views, please contact Sandra J. Peters at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters, CPA, CFA
Senior Head, Global Financial Reporting Policy Advocacy
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Appendix
Responses to Proposed ASU's Questions for Respondents

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

ASC 805 currently provides limited exceptions to the recognition and measurement principles within the business combinations topic. We do not believe that further exceptions to the fair value principle are necessary, and in fact, we believe that further exceptions will undermine the clarity and consistency of the existing business combinations model.

As discussed in paragraph BC 12 of the Proposal, the Board appears to believe that a measurement inconsistency arises under current fair value measurement techniques, because the costs or activities to enter into a contract are considered to have already been performed by the acquiree before the acquisition and, therefore, are not included in the measurement of the remaining obligation for the related acquired contract liability. If this is the case, we would encourage the Board to consider providing additional fair value measurement guidance for acquired contract assets and liabilities that would address this issue, rather than abandoning the fair value measurement basis in its entirety.

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

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

We understand that under the proposed amendments, entities would need to continue to assess whether the terms of a contract require recognition of an additional intangible asset or liability for off-market terms. Because the proposed amendments do not provide for an exception, we presume that the Board's intent is for off-market assets or liabilities to be separately recognized at fair value. As a result, part of an acquired customer contract may be recognized in accordance with ASC 606 and another part at fair value, thus creating a mixed measurement model for a single contract. We observe that requiring entities to separately recognize and account for off-market assets and liabilities will therefore result in more, rather than less, complexity in initial measurement and the subsequent accounting for acquired contracts), thereby undermining one of the key reasons the Board is issuing the Proposal. Accordingly, we question whether the perceived benefits of the Proposal are actually being achieved.

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

We believe the existing guidance on customer-related intangible assets and contract-based intangible assets, such as contracts with off-market terms, is clear and has proved understandable and operable and our understanding is that the Proposal will not result in any changes to the current guidance, a stance which we support.

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

We do not believe that any practical expedients are necessary given that we are opposed to the finalization of this Proposal for the reasons stated herein.

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

As explained above, we believe the Proposal would not result in financial reporting outcomes that are more useful. Rather, we believe the Proposal represents a step backwards in financial reporting.

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

We believe that the Proposal should not be extended to other contracts that are accounted for under ASC 606. In our opinion, every step away from the fair value measurement framework of Topic 805 is a step backwards.

Moreover, we are concerned that eliminating fair value-based adjustment through an exception specific to acquired revenue contracts could lead to potential justification for similar exceptions with respect to other assets and liabilities acquired in a business combination for which there are specified GAAP or specified measurement principles. For example, we note that several comment letters have suggested that inventory also be included in the scope of the Proposal. The resulting “scope-creep” will only move the Board further away from the overall concept of fair value based measurement of business combinations, potentially leading to a messy, mixed-model approach that will be difficult for investors to untangle.

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

If the Board proceeds with the Proposal, we strongly believe that additional disclosures are required. As noted above, the Proposal will result in a loss of information to investors and a lack of consistency with IFRS. We recommend that companies be required to disclose the amount of purchased revenues arising

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from acquisitions, and the impact on contract assets and liabilities in each period thereafter for which the impact is material.

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

Question 10: How much time would be needed to implement the proposed amendments? Should entities other than public business entities be provided with an additional year to implement the proposed amendments? Please explain why or why not.

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

We do not support finalization of this Proposal. We are concerned that if adopted, and a retrospective basis is applied, that there will be significant distortion and lack of comparability of top-line revenue for serial acquirers.

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

Differences between the Codification and IFRS Standards create additional costs and complexities for investors. The constant introduction of subtle yet important changes to the two frameworks constitutes a kind of "death by a thousand cuts" for investors, as the list of differences grows ever longer and investors struggle to keep track of the myriad changes that affect their analyses. Since the purpose of the Proposal is to *reduce* complexity, we believe the divergence from IFRS will undermine if not negate the achievement of this goal.