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EITF reaches consensus-for-exposure on accounting for certain equity method investments

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EITF discusses accounting for revenue contract liabilities in business combinations, certain equity method investments and licensing contract modifications.

Applicability

- **Recognizing revenue contract liabilities in business combinations.**[1] All companies that assume a contract liability in a business combination after adopting ASC 606.[2]
- **Clarifying the interactions between ASC 321 and ASC 323**[3]
  - All companies that invest in equity securities without readily determinable fair values that are accounted for under the ASC 321 measurement alternative.
  - All companies that hold certain non-derivative[4] forward contracts and purchased options to acquire equity securities without readily determinable fair values.
- **Licensing contract modifications.**[5] Licensors that modify licenses of intellectual property.

Revenue contract liabilities assumed in a business combination

The EITF previously reached a consensus-for-exposure to require companies to use the ASC 606 performance obligation definition to determine whether to recognize a contract liability from a revenue contract with a customer that is acquired in a business combination. The FASB subsequently ratified the consensus-for-exposure and issued a corresponding proposed Accounting Standards Update (ASU).[6] When it issued the proposed ASU, the FASB also issued an Invitation to Comment (ITC) to solicit feedback on the measurement of the assumed contract liability and the effect of payment terms on the recognition of revenue for the contract following the acquisition.[7] April 30, 2019 was the comment deadline for both documents.

1 EITF Issue No. 18-A, Recognition under Topic 805 for an Assumed Liability in a Revenue Contract

2 ASC 606, Revenue from Contracts with Customers

3 EITF Issue No. 19-A, Financial Instruments—Clarifying the Interactions between Topic 321 and Topic 323; ASC 321, Investments—Equity Securities; ASC 323, Investments—Equity Method and Joint Ventures

4 Contracts that do not meet the criteria in ASC 815, Derivatives and Hedging, to be accounted for as derivatives.

5 EITF Issue No. 19-B, Revenue Recognition—Contract Modifications of Licenses of Intellectual Property

6 Proposed ASU, Revenue from Contract with Customers – Recognizing an Assumed Liability

7 FASB Invitation to Comment, Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805

At its June 13, 2019 meeting, the EITF decided to defer a decision about whether to affirm its consensus-for-exposure until the FASB considers the issues in the ITC. The EITF concluded that proceeding with a final standard on when to recognize a revenue contract liability in a business combination, without considering the measurement and other issues discussed in the ITC, would not sufficiently improve financial reporting or reduce diversity in practice. The EITF also agreed with concerns raised by some financial statement preparers that finalizing the proposed ASU without addressing these issues could require multiple and potentially contradictory accounting change implementation efforts.

Clarifying the interactions between ASC 321 and ASC 323

The EITF reached a consensus-for-exposure on two issues related to the interactions between ASC 321 and ASC 323. The proposed guidance would clarify:

- the accounting for certain equity securities without readily determinable fair values on application and discontinuation of the equity method of accounting;
- the accounting for certain non-derivative forward contracts and purchased call options to acquire equity securities without readily determinable fair values.

The EITF did not reach a consensus-for-exposure on a third issue related to when an investor should attribute equity method losses to equity investments without readily determinable fair values that do not qualify as common stock or in-substance common stock of the investee (e.g. some preferred stock). The EITF asked the FASB staff to perform further research to better understand the magnitude and extent of the issue.

The consensus-for-exposure is subject to ratification by the FASB.

Equity method accounting

ASC 321 provides a measurement alternative that permits certain equity investments without readily determinable fair values to be measured at cost, minus impairment (if any), and subsequently remeasured to fair value using prices from identical or similar securities of the same issuer in observable transactions.

Equity securities initially within the scope of ASC 321 may subsequently fall within the scope of ASC 323, and vice versa. The EITF reached a consensus-for-exposure that when applying the measurement alternative under ASC 321, equity securities should be remeasured to fair value both immediately before, and on discontinuation of, the equity method of accounting using the observable transaction that triggered the change in applicability of the equity method.

Forward contracts and purchased call options to acquire equity securities

The EITF reached a consensus-for-exposure that when accounting for forward contracts and purchased call options to acquire equity securities, a company should not consider whether the underlying equity security would be accounted for under the equity method on settlement of the forward contract or exercise of the purchased option. Instead, the company should account for the forward contracts and purchased options under ASC 321 if the contract:

- is entered into to purchase securities that will be accounted for under either ASC 320[8] or ASC 321;
- terms require physical settlement of the contract by delivery of the securities;
- is not a derivative instrument otherwise subject to ASC 815; and
- has no intrinsic value at acquisition, if it is a purchased option.

Transition and effective date

The consensus-for-exposure would require a prospective transition method with an effective date to be determined after considering feedback on a proposed ASU. Companies would be required to disclose the nature of and reasons for the change in accounting, transition method and a qualitative description of the financial statement line items affected by the change.

[8] ASC 320, Investments—Debt and Equity Securities

Contract modifications of intellectual property licenses

The EITF discussed, but made no decisions about licensor accounting for contract modifications of licenses of intellectual property.

The EITF's discussion centered mainly on the accounting for:

- contract modifications under which the contract term for existing rights is extended while other rights are added; and
- revocation of licensing rights (including conversion of term software licenses to software as a service arrangements).

The EITF asked the FASB staff to form a working group to discuss the issues and potential accounting alternatives in greater detail.

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