Members of the Emerging Issues Task Force (EITF or Task Force) reached a final consensus on one issue and a consensus-for-exposure on another. The final consensus and the consensus-for-exposure are subject to ratification by the Financial Accounting Standards Board (FASB) at a June 2018 meeting.

The Task Force reached a final consensus on the following issue:

- **Issue 17-A**: The Task Force affirmed its decision that entities should use the guidance in Accounting Standards Codification (ASC) 350-40 to determine which implementation costs of a cloud computing arrangement that is considered to be a service contract to defer and recognize as an asset.

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

- **Issue 18-A**: The Task Force decided that the acquiring entity in a business combination accounted for under ASC 805 would use the definition of a performance obligation in ASC 606 to determine whether an assumed liability should be recognized in a contract with a customer. The Task Force also decided that these liabilities should be measured at fair value.

The Task Force also discussed the following issue at this meeting but did not reach a consensus:

- **Issue 18-B**: The Task Force tentatively decided that entities that produce episodic television series should capitalize production costs using the same guidance used to account for film production costs under ASC 926.
What’s the issue?
ASC 350-40 addresses when customers that obtain software licenses should capitalize or expense implementation, setup or other up-front costs (implementation costs). These costs may relate to activities performed by the service provider, the customer’s internal personnel or third parties.

However, US GAAP does not provide explicit guidance on how to account for similar implementation costs a customer incurs in a cloud computing arrangement that is considered a service contract. Some companies expense all of these costs. Others look to other areas of US GAAP such as the guidance in ASC 340 on prepaid assets; the guidance in ASC 360 on property, plant and equipment; or the guidance in ASC 720-45 on business and technology reengineering as a basis for capitalizing or expensing various costs. Still others analogize to the guidance in ASC 350-40.

The FASB issued guidance in 2015 on how customers in cloud computing arrangements determine whether an arrangement includes a software license but didn’t address implementation costs for a cloud computing arrangement that is considered a service contract (i.e., a hosting arrangement).

In its final consensus, the Task Force affirmed its previous decision that a customer should capitalize the implementation costs of a cloud computing arrangement that is considered to be a service contract using the guidance in ASC 350-40. As a result, entities would defer certain implementation costs incurred during the application development stage and expense those costs over the term of the hosting arrangement. That expense would be recorded in the same income statement line item as the related hosting fees.

The Task Force also clarified that an entity should classify the deferred implementation costs on the balance sheet and cash flow statement in the same line item where any related hosting fees would be classified.

In a change from its consensus for exposure, the Task Force decided that entities should be required to make significantly fewer disclosures than they would have under the exposure draft. However, entities should disclose the nature of their hosting arrangements and provide disclosures about the amount of implementation costs capitalized, amortized and impaired in each reporting period.

Effective date and transition
Entities would apply the final consensus either prospectively to implementation costs incurred after the date of adoption or retrospectively to all arrangements.

The final consensus would be effective for public business entities (PBEs) for fiscal years beginning after 15 December 2019, and interim periods within those years. For entities other than PBEs, the consensus would be effective for fiscal years beginning after 15 December 2020, and interim periods within fiscal years beginning after 15 December 2021. Early adoption would be permitted.
Consensus-for-exposure

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

What’s the issue?

ASC 805 requires the acquirer in a business combination to recognize and measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at fair value (with certain limited exceptions). The new revenue standard (ASC 606) has raised questions about when an assumed liability in a revenue contract (i.e., deferred revenue) should be recognized.

Because ASC 805 does not provide specific guidance on recognizing and measuring deferred revenue in a business combination, acquirers historically have recognized deferred revenue in a business combination if they determined that they had what is known as a legal performance obligation to transfer goods or services to a customer under the related revenue contract. ASC 606 defines a performance obligation in the Codification for the first time, and the definition of a performance obligation is broader than an obligation that is legally enforceable (e.g., a performance obligation could include constructive obligations such as the maintenance and support of symbolic intellectual property). As a result, stakeholders questioned whether they should recognize assumed liabilities in an acquired revenue contract when they have a performance obligation under ASC 606 or a legal performance obligation. Stakeholders also asked for clarifications on the measurement of these liabilities.

The Task Force reached a consensus-for-exposure that, once they adopt the new revenue standard, acquiring entities in business combinations would apply the definition of a performance obligation in ASC 606 to determine whether to recognize an assumed liability in a contract with a customer.

The Task Force also decided that a liability assumed in a business combination related to a contract with a customer should be measured at fair value. A method entities have historically used to measure the fair value of such a liability is a cost build-up approach. When an entity uses this approach, the Task Force said that it should consider the assets and liabilities included in the acquired set when determining the cost to fulfill the remaining performance obligation(s), consistent with how most entities have historically measured the fair value of legal performance obligations. For example, if the acquired set includes the intellectual property required to fulfill a licensing obligation, the measurement of costs to fulfill that obligation would not include any costs related to acquiring that intellectual property.

Effective date and transition

The Task Force tentatively decided that entities should apply the consensus-for-exposure prospectively to all business combinations on or after the effective date of a final standard. The Task Force will discuss an effective date at a future time.
Issues discussed

Issue 18-B: Improvements to Accounting for Episodic Television Series

What’s the issue?

ASC 926-20 limits the costs an entity can capitalize for each episode in a television series to contractual revenues for that episode until the entity has persuasive evidence that a secondary market exists. However, producers of films are not subject to a similar constraint. Secondary market revenues may include, for example, revenues earned from the license of content in territories other than the initial market and from the license of content on streaming platforms.

Some entities have questioned whether the constraint on the capitalization of costs for episodic television series continues to be relevant in light of the fact that some online video distributors monetize content only on their own platform and do not intend to license their content in a secondary market. These entities view the distribution of a film and an episodic television series to be the same because they generally produce and deliver the content to the consumer in the same way (e.g., they develop and release an entire season of episodic content at once, which they view as similar to the release of a film).

The Task Force tentatively decided to align the cost capitalization guidance for episodic television series with the guidance for films in ASC 926-20 by eliminating the requirement that an entity’s capitalization of costs for an episodic television service be limited to contracted revenues until it has persuasive evidence that a secondary market exists.

The Task Force discussed other potential improvements to the accounting in ASC 926-20 and ASC 920-350, including changes to the guidance on impairment, and decided to send these issues back to a working group of experts in the industry to provide more feedback on the application of recommendations from the FASB staff before making other decisions.

Effective date and transition

The Task Force will discuss the effective date and transition once it reaches a consensus-for-exposure.

Endnotes:

1 ASC 350-40, Intangibles – Goodwill and Other, Internal-Use Software.
2 ASC 805, Business Combinations.
3 ASC 606, Revenue from Contracts with Customers.
4 ASC 926-20, Entertainment – Films, Other Assets – Film Costs.
5 ASC 340, Other Assets and Deferred Costs.
6 ASC 360, Property, Plant, and Equipment.
7 ASC 720-45, Other Expenses, Business and Technology Reengineering.
8 The concept of a legal performance obligation is leveraged from previously existing guidance in EITF 01-3, Accounting in a Business Combination for Deferred Revenue of an Acquiree.
9 ASC 920-350, Entertainment – Broadcasters, Intangibles – Goodwill and Other.