

# EITF Update

EITF meeting highlights

## November 2019 meeting highlights

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Members of the Emerging Issues Task Force (EITF or Task Force) reached a final consensus on one issue. The final consensus is subject to ratification by the Financial Accounting Standards Board (FASB) at the 20 November 2019 meeting.

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

- ▶ Issue 19-A: The Task Force affirmed its decision that an entity that applies the measurement alternative in Accounting Standards Codification (ASC or Codification) 321<sup>1</sup> should consider all observable transactions, including those that result in the entity initially applying or discontinuing the use of the equity method of accounting under ASC 323.<sup>2</sup> The Task Force also affirmed its decision that certain forward contracts and purchased options on equity securities that are not deemed to be in-substance common stock or accounted for as derivatives under ASC 815<sup>3</sup> are in the scope of ASC 321.

The Task Force also discussed but did not reach a consensus on Issue 19-B.

## Final consensus

Issue 19-A: Financial Instruments – Clarifying the Interactions between Topic 321, Topic 323, and Topic 815

### *What's the issue?*

*ASC 323 requires an investor to apply the equity method of accounting if an investor has significant influence (e.g., ownership of 20% to 50% of voting common stock) over the operating and financial policies of an investee.*

*Equity investments (except those accounted for under the equity method and those that result in consolidation of the investee and certain other investments) are in the scope of ASC 321. Equity investments in the scope of ASC 321, including certain forward purchase contracts and call options, are generally measured at fair value, and any changes in fair value are recognized through net income. However, investors are permitted to elect a measurement alternative for equity investments that (1) do not have readily determinable fair values and (2) do not qualify for the practical expedient in ASC 820<sup>4</sup> to measure fair value using the net asset value per share. Under the measurement alternative, if an entity identifies observable price changes in orderly transactions for the identical investment or a similar investment of the same issuer, it remeasures the equity investment at fair value as of the date the observable transaction occurred.*

*Stakeholders have raised questions about the interaction between ASC 323 and ASC 321. The questions include (1) whether to consider observable transactions under the measurement alternative in ASC 321 when either initially applying or discontinuing the equity method of accounting under ASC 323 and (2) how to account for certain forward contracts and purchased options where the underlying equity, individually or with existing investments, would be accounted for under the equity method when the forward contract is settled or the purchased option is exercised.*

In its final consensus, the Task Force affirmed its previous decision that an entity that applies the measurement alternative in ASC 321 should consider observable transactions that result in the entity initially applying the equity method of accounting or discontinuing the use of the equity method under ASC 323.

The Task Force also affirmed its decision that an entity should not consider whether the equity security underlying the forward contract or purchased option would be eligible, individually or with existing investments, to be accounted for under the equity method upon settlement of the forward contract or exercise of the purchased option when determining the accounting for the forward or option in the period before it is settled or exercised, respectively. That is, an entity should account for the forward contract or purchased option under ASC 321. This final consensus would apply to forward contracts and purchased options on equity securities that are not deemed to be in-substance common stock or are not accounted for as derivatives under ASC 815.

The Task Force decided not to address as part of Issue 19-A questions that have arisen about the sequence of the allocation of equity method losses under ASC 323 to other investments in the investee (e.g., preferred stock) that are accounted for under the measurement alternative in ASC 321 and remeasurements of those investments under the measurement alternative due to an observable transaction. The Task Force had discussed this topic as part of Issue 19-A at the June 2019 meeting.

At the November meeting, the Task Force discussed research the FASB staff performed on this topic, including the staff's review of public company financial statements. The Task Force then asked the staff to discuss the topic with the Private Company Council and to perform additional research to determine how often private companies have equity method investments that have incurred losses and other investments in the investee.

***Effective date and transition***

Entities would apply the final consensus prospectively.

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

## Issues discussed

### Issue 19-B: Revenue Recognition – Contract Modifications of Licenses of Intellectual Property

#### *What's the issue?*

*The guidance in ASC 606 is not clear on when revenue should be recognized if a modification of a license of intellectual property (IP) is not solely a renewal of the same terms and conditions as the original license. As a result, some entities believe that revenue for a license renewal should be recognized when the modification is approved by both the licensor and licensee, while others believe revenue should be recognized at the end of the original license term, which may be later than when the modification is approved.*

*The licensing guidance states that "an entity would not recognize revenue before the beginning of the license period even if the entity provides (or otherwise makes available) a copy of the intellectual property before the start of the license period or the customer has a copy of the intellectual property from another transaction. **For example, an entity would recognize revenue from a license renewal no earlier than the beginning of the renewal period.**" (Emphasis added.) The guidance also includes an example (Example 59) that illustrates the application of this guidance for a renewal of a license of IP under the same terms and conditions as the original license.*

*Because the licensing guidance doesn't address modifications that are not solely a renewal of the terms and conditions of the original license (e.g., the modification also adds other goods or services, the modification changes the pricing), questions have arisen about whether an entity is required to defer revenue recognition until the end of the original license term in these situations or whether it can recognize revenue earlier than the entity in the example in the guidance.*

*Questions have also arisen about how to account for a modification that includes a reduction in the rights conveyed by the license (e.g., the number of users of a license) or when the license is revoked (e.g., a software license is converted into a software-as-a-service arrangement).*

The Task Force discussed but did not reach a consensus on when revenue should be recognized if a modification of a license of IP is not solely a renewal of the same terms and conditions as the original license or how to account for a modification when a license is revoked (e.g., a software license is converted into a software-as-a-service arrangement). The FASB staff will perform additional research on these issues and will discuss alternatives with a working group comprising experts in the technology, pharmaceutical and media and entertainment industries.

#### Endnotes:

- <sup>1</sup> ASC 321, *Investments – Equity Securities*.
- <sup>2</sup> ASC 323, *Investments – Equity Method and Joint Ventures*.
- <sup>3</sup> ASC 815, *Derivatives and Hedging*.
- <sup>4</sup> ASC 820, *Fair Value Measurement*.

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