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# ASU 2021-08

## Business Combinations: Contract Assets & Liabilities

On October 28, 2021, the FASB issued Accounting Standards Update (ASU) 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*. ASU 2021-08 changes the accounting for contract assets and liabilities acquired in a business combination by requiring an acquiring entity to measure contract assets and liabilities in accordance with FASB *Accounting Standards Codification* (FASB ASC) 606, *Revenue from Contracts with Customers*.

Under current U.S. generally accepted accounting principles (U.S. GAAP), an acquirer generally recognizes assets acquired and liabilities assumed in a business combination, including contract assets and contract liabilities arising from revenue contracts with customers and other similar contracts that are accounted for in accordance with FASB ASC 606, at fair value on the acquisition date. Initial fair value measurement for acquired revenue contracts in a business combination can be complex and require significant judgment. Moreover, diversity exists in current practice for determining the fair value of contract liabilities for certain revenue arrangements and stakeholders have raised questions about how to apply FASB ASC 805, *Business Combinations*, to contracts with a customer acquired in a business combination.

To address those issues, ASU 2021-08 requires an acquirer to recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with FASB ASC 606. At the acquisition date, an acquirer should account for the related revenue contracts in accordance with FASB ASC 606 as if it had originated the contracts.

***Practice Note***: There are exceptions in FASB ASC 805 to the principle of fair value measurement of assets and liabilities acquired in a business combination, including assets and liabilities arising from contingencies, income taxes, employee benefits, indemnification assets, and leases. ASU 2021-08 adds contract assets and contract liabilities to the list of exceptions.

In accounting for revenue contracts in accordance with FASB ASC 606 at the acquisition date, the acquirer may assess how the acquiree applied FASB ASC 606 to determine what to record for the acquired revenue contracts. Generally, this should result in an acquirer recognizing and measuring the acquired contract assets and contract liabilities consistent with how they were recognized and measured in the acquiree's financial statements (if the acquiree prepared financial statements in accordance with U.S. GAAP). However, there may be circumstances in which the acquirer is unable to assess or rely on how the acquiree applied FASB ASC 606, such as if the acquiree does not follow U.S. GAAP, if there were errors identified in the acquiree's accounting, or if there were changes identified to conform with the acquirer's accounting policies. In those circumstances, the acquirer should consider the terms of the acquired contracts, such as timing of payment, identify each performance obligation in the contracts, and allocate the total transaction price to each identified performance obligation on a relative standalone selling price basis as of contract inception (that is, the date the acquiree entered into the contracts) or contract modification to determine what should be recorded at the acquisition date.

ASU 2021-08 provides practical expedients for acquirers when recognizing and measuring acquired contract assets and contract liabilities from revenue contracts in a business combination. An acquirer may use one or more of the following:

- For contracts that were modified before the acquisition date, an acquirer may reflect the aggregate effect of all modifications that occur before the acquisition date when:
    - Identifying the satisfied and unsatisfied performance obligations
    - Determining the transaction price
    - Allocating the transaction price to the satisfied and unsatisfied performance obligations
- For all contracts, for purposes of allocating the transaction price, an acquirer may determine the standalone selling price at the acquisition date (instead of the contract inception date) of each performance obligation in the contract

For any of the practical expedients that an acquirer uses, the acquirer should apply that expedient on an acquisition-by-acquisition basis. Each practical expedient that is elected should be applied consistently to all contracts acquired in the same business combination. In addition, the acquirer should disclose the expedients that have been used and, to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

ASU 2021-08 primarily addresses the accounting for contract assets and contract liabilities from revenue contracts with customers in a business combination. However, ASU 2021-08 also applies to contract assets and contract liabilities from other contracts to which the provisions of FASB ASC 606 apply, such as contract liabilities from the sale of nonfinancial assets within the scope of FASB ASC 610-20, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets*.

ASU 2021-08 does not affect the accounting for other assets or liabilities that may arise from revenue contracts with customers in accordance with FASB ASC 606, such as refund liabilities, or in a business combination, such as customer-related intangible assets and contract-based intangible assets. For example, if acquired revenue contracts are considered to have terms that are unfavorable or favorable relative to market terms, the acquirer should recognize a liability or asset for the off-market contract terms at the acquisition date.

Effective Date and Transition

For public business entities, the amendments in ASU 2021-08 are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. The amendments in ASU 2021-08 should be applied prospectively to business combinations occurring on or after the effective date of the amendments.

Early adoption of the amendments is permitted, including adoption in an interim period. An entity that early adopts in an interim period should apply the amendments (1) retrospectively to all business combinations for which the acquisition date occurs on or after the beginning of the fiscal year that includes the interim period of early application and (2) prospectively to all business combinations that occur on or after the date of initial application.

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