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Summary of the March Meeting of the Emerging Issues Task Force

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This *EITF Snapshot* summarizes the March 11, 2021, meeting of the Emerging Issues Task Force (EITF or "Task Force"). Initial Task Force consensuses ("consensuses-for-exposure") are exposed for public comment upon ratification by the Financial Accounting Standards Board (FASB). After the comment period, the Task Force considers comments received and redeliberates the issues at a scheduled meeting to reach a final consensus. Those final consensuses are then provided to the FASB for final ratification and, ultimately, issuance as an Accounting Standards Update (ASU).

After that meeting, the official EITF minutes, including the results of the FASB's ratification process, will be posted to the Deloitte Accounting Research Tool (DART) and to the FASB's Web site (note that the official EITF minutes may contain details that differ from those in this publication). EITF Issue Summaries (released before the meeting and used to frame the discussion) are also available on those sites.

Issue 19-B, "Revenue Recognition — Contract Modifications of Licenses of Intellectual Property"

Status: Initial deliberations.

Affects: Entities that recognize revenue from licenses of functional intellectual property with contract modifications that extend license terms.

Background: Under ASC 606,[1] entities that license functional intellectual property (e.g., software providers) generally recognize revenue at a point in time (provided that the conditions for such recognition have been met) instead of over the license term. The "use and benefit" guidance in ASC 606 indicates that revenue should not be recognized until the customer has a copy of the intellectual property and the license period has commenced. That guidance also requires an entity to recognize revenue for license renewals no earlier than the beginning of the renewal period. A contract modification, which is a change in price or scope, must be accounted for as a separate contract if (1) the additional goods and services are distinct and (2) an increase in the price of the contract reflects the entity's stand-alone selling price of those additional goods or services, adjusted to reflect the circumstances of the contract. If the contract modification does not result in a separate contract, the entity must determine whether the modification constitutes (1) the termination of the existing contract and the creation of a new contract, (2) a part of the existing contract, or (3) a combination of both.

A modification of a license of intellectual property may include an extension of the term of the original license along with other changes to the rights in the contract. Views differ on whether to apply the guidance on license renewals or the guidance on modifications when modifications of licensing arrangements include an extension to the term of the license along with other changes (e.g., those that grant or revoke additional rights).

An additional issue is emerging in the software industry regarding contracts that include (or are modified to include) an option that allows the customer to convert from a license arrangement to an arrangement in which the software is hosted as a service (i.e., software as a service or SaaS). Views differ on how to account for the revocation of licensing rights and the conversion to a SaaS arrangement.

At its May 8, 2019, meeting, the FASB decided to add to the EITF's technical agenda a project on contract modifications of licenses of intellectual property. The scope of the project includes:

- Accounting for contract modifications in which another right is added to the existing rights and the contract term is extended.
- Accounting for situations in which licensing rights are revoked, "including conversion of term software licenses to software as a service (SaaS) arrangements."[2]

At its June 13, 2019, meeting, the FASB staff held an educational session on this Issue. No formal votes were taken, and no decisions were made. In addition, the FASB staff's industry working group met on July 16, 2019, to discuss the Issue.

At its November 7, 2019, meeting, the Task Force deliberated potential accounting alternatives for contract modifications that include both an extension of the contract term for existing rights and the addition of new rights. The Task Force also deliberated possible accounting alternatives for the revocation of licensing rights, including the conversion of term software licenses to SaaS arrangements. The Task Force did not make any decisions on Issue 19-B and asked the FASB staff to perform additional research on the Issue. See Deloitte's November 2019 *EITF Snapshot* for more information.

Summary: At its March 11, 2021, meeting, the Task Force recommended that the Board address this Issue.

Effective Date and Transition: The effective date and transition will be discussed at a future meeting.

Next Steps: The FASB will discuss this Issue at a future Board meeting and decide whether to address it through standard setting or as part of the postimplementation review of ASC 606.

[1] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

[2] Quoted text is from the meeting handout.

Issue 19-C, “Issuer’s Accounting for Certain Modifications of Freestanding Equity Classified Forwards and Options”

Status: Final consensus.

Affects: Entities that issue freestanding equity-classified warrants or written call options that are similar to warrants in economic substance when the warrants are modified and classified in equity after modification.

Background: A warrant is a written call option under which the holder has the right, but not the obligation, to purchase a specified quantity or amount of common stock from the issuing entity at a specified price. An issuer may consider modifying outstanding warrants for various reasons, including, but not limited to, raising cash and capital, inducing additional financing, compensating for goods or services, or substituting dividend distributions.

Stakeholders have raised concerns that U.S. GAAP guidance does not address the accounting for warrant modifications from the issuer’s perspective. Such stakeholders have indicated that diversity in practice exists because entities analogize to various Codification topics and SEC guidance to reflect the economics of the warrant modification and therefore achieve different accounting outcomes for economically similar transactions. Accordingly, stakeholders have asked the Board to provide guidance on whether the effect of a warrant modification should be (1) recognized through earnings immediately, (2) amortized into earnings as a debt issuance cost, or (3) recognized as a deemed dividend or other equity transaction.

At its September 18, 2019, meeting, the FASB decided to add a project on warrant modifications to the EITF’s technical agenda. The scope of the project, when it was added to the technical agenda, was limited to modifications of equity-classified warrants that remain equity-classified after modification.

At its September 3, 2020, meeting, the Task Force discussed the accounting for modifications and reached a consensus-for-exposure on this Issue.

In addition, the Task Force discussed whether the scope of the proposed guidance should be limited to equity-classified warrants and tentatively decided to expand the Issue’s scope to include all freestanding equity-classified derivative instruments.

Summary: At its March 11, 2021, meeting, the Task Force discussed feedback received on the FASB’s proposed ASU. Specifically, the feedback highlighted that expanding the Issue’s scope to include all freestanding equity-classified derivative instruments could result in potential unintended consequences. On the basis of that feedback, the Task Force decided to limit the Issue’s scope to an issuer’s accounting for modifications of written call options.

The Task Force affirmed its consensus-for-exposure on this Issue and made minor revisions when applicable as follows:

- The proposed guidance would prescribe the following principles-based framework for determining the issuer’s accounting for modifications on the basis of the economic substance of the transaction in the same manner as if the issuer had paid cash:
  - If the nature of the modification is a financing transaction to raise equity, an entity should account for the additional value as an equity issuance cost in accordance with ASC 340.
  - If the nature of the modification is a financing transaction to raise debt, an entity should account for the additional value as a debt discount or debt issuance cost in accordance with ASC 835.
  - If the nature of the modification is a financing transaction to modify debt, an entity should account for any change in value in accordance with ASC 470-50.

    - If the nature of the modification is compensation for goods or services, an entity should account for the additional value as compensation cost in accordance with ASC 718.

- If, after an entity evaluates the substance of the transaction, the modification is not related to financing transactions or compensation for goods or services as described above, the entity should account for the effect of the modification as a deemed dividend.
- In addition to the current modification-related disclosure and presentation requirements in ASC 505-10, ASC 815-40, ASC 260, and ASC 850, the proposed guidance would add specific modification-related disclosure requirements related to (1) information about the nature of the modification or exchange transaction, (2) the value of the effect of the modification or exchange, and (3) how the effect of the modification or exchange has been recognized.

Effective Date and Transition: The Task Force reached a final consensus that an entity would apply a prospective transition method when adopting the final guidance and decided not to provide any additional transition disclosure requirements apart from the disclosure requirements in ASC 250. The guidance in the final consensus will be effective for all entities for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years.

Next Steps: FASB ratification is expected at a future Board meeting, after which a final ASU will be issued.

Administrative Matters

The next EITF decision-making meeting is tentatively scheduled for June 10, 2021.

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