October 21, 2024

Mr. Jackson M. Day
Technical Director
Financial Accounting Standards Board
801 Main Avenue, PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2024-ED100

Dear Mr. Day,

This letter is submitted by Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) in response to the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update—Derivatives and Hedging (Topic 815) and Revenue from Contracts with Customers (Topic 606): Derivatives Scope Refinements and Scope Clarification for a Share-Based Payment from a Customer in a Revenue Contract (Exposure Draft or proposed Update).

FEI is a leading international organization comprised of members who hold positions as Chief Financial Officers, Chief Accounting Officers, Controllers, Treasurers, and Tax Executives at companies in every major industry. CCR is FEI's technical committee of approximately 50 Chief Accounting Officers and Corporate Controllers from Fortune 100 and other large public companies, representing more than $16 trillion in market capitalization. CCR reviews and responds to pronouncements, proposed rules and regulations, pending legislation, and other documents issued by domestic and international regulators and organizations such as the U.S. SEC, PCAOB, FASB, and IASB.

This letter represents the views of CCR and not necessarily the views of FEI or its members individually.

Executive Summary
We commend the Board's responsiveness to stakeholder requests to address the broad interpretation of the definition of derivatives, especially its application to transactions such as funded research and development (R&D) arrangements in the life sciences industry and emerging transactions with payments based on environment, social, and governance (ESG)-linked metrics. CCR believes the proposed scope exception in Topic 815 and clarifying amendments in Topic 815 and Topic 606 will reduce diversity in practice, drive accounting that better reflects the economics of the transactions, and provide more decision-useful information to investors. In our letter, we offer broad support for the amendments in the proposed Update and provide a few recommendations to improve clarity.

CCR strongly supports the scope exception proposed in ASC 815-10-15-59(e); however, we believe the Board should further clarify how to apply the proposed scope exception to arrangements with underlyings based on financial metrics in the financial services industry. While CCR companies generally believe the updated predominance test is operable, we acknowledge that there will be judgment involved in its application, especially in situations where underlyings are dependent upon each other. We also provide a recommendation to clarify when the predominance assessment is required.

In addition, CCR supports the amendments to clarify that an entity should apply the guidance in Topic 606 to share-based payments received from a customer and that an entity should not apply Topic 815

and Topic 321 unless and until the share-based payment that is consideration for the transfer of goods or services is recognized as an asset under Topic 606. We also support similar amendments to Subtopic 610-20, Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20) and recommend the Board consider whether similar amendments to Topic 323, Investments – Equity Method and Joint Ventures (Topic 323) might also be necessary. Lastly, we recommend clarifying the application of the guidance in situations where a performance obligation is recognized over time and the entity performs before or after the entity's right to receive or retain a share-based payment is no longer contingent on satisfaction of the performance obligation.

We are supportive of the transition methods proposed for the scope exception and other clarifying amendments in Topic 815 and Topic 606 and believe it would be beneficial to provide preparers 18 months to implement.

Issue 1: Derivatives Scope Refinements

Scope Exception

CCR is strongly supportive of the proposed scope exception in paragraph 815-10-15-59(e) which will exclude certain contracts from derivative accounting with underlyings that are based on the operations or activities of one of the parties to the contract. We believe the proposed scope exception is generally operable and will scope out contracts we do not believe should be accounted for as derivatives – primarily R&D funding arrangements with payments based on regulatory approval for life sciences companies, instruments with payments based on ESG-linked metrics, and litigation funding settlements. We believe there is existing guidance in U.S. GAAP to account for these contracts that better reflects the economics of these transactions.

However, we suggest the Board further clarify how to apply the proposed scope exception to arrangements with underlyings based on financial metrics in the financial services industry. The proposed guidance in paragraph 815-10-15-59(e)(1) states that the scope exception applies to contracts with underlyings based on, *"the **financial statement metrics** of one of the parties to the contract. The financial statement metrics include metrics derived from amounts presented in the financial statements and components of amounts included in financial statements (e.g., earnings before interest, taxes, depreciation, and amortization; net income; expenses; or total equity of one of the parties to the contract)."* However, paragraph 815-10-15-59(e) goes on to state, *"this scope exception does not apply to variables based on a market rate, market price, or market index (including those in paragraph 815-10-15-88(a) through (f)) or the price or performance (including default) **of a financial asset or financial liability** of one of the parties to the contract."* We recommend the Board clarify how these two concepts interact.

Specifically, we believe the Board could further clarify the intended application of the scope exception to arrangements with underlyings based on financial metrics where those metrics are ultimately based on the performance of financial assets or financial liabilities. For example, financial services companies may enter into arrangements where the underlying is based on a single financial metric, which is partially based on the performance of a financial asset or financial liability (e.g., interest income, interest expense, or credit losses). In this situation, it is unclear if the scope exception in 815-10-15-59(e) would apply or if a company would have to conduct an additional assessment to determine whether the single financial metric was predominantly based on the performance of a financial asset or financial liability.

Predominance Assessment
While we find the proposed amendments to the predominance assessment to be clear, we believe preparers would benefit from further clarification on when a predominance assessment is required to be performed and its interaction with the proposed scope exception. Specifically, Example 14A: Certain Contracts That Are Not Traded on an Exchange—Underlyings Based on Operations or Activities Specific to One of the Parties to the Contract (Example 14A), Case A, discusses a circumstance in which there are two underlyings and both underlyings qualify for a scope exception; therefore, a predominance assessment is not required. We recommend adding a sentence to the end of Example 14A, paragraph 815-10-55-143C, Case A, to clarify this fact. For example, an additional sentence might state, "*Because each of the underlyings qualifies for a scope exception in paragraph 815-10-15-59, the entity does not need to perform a predominance assessment; the arrangement is not in the scope of Topic 815 and not accounted for as a derivative.*"

A number of CCR companies, such as life science companies with R&D funding arrangements, do not expect to frequently apply the predominance assessment to material arrangements post-implementation of the Update as a result of the application of the proposed scope exception. While CCR companies generally believe the proposed predominance assessment based on expected changes in fair value is operable, we acknowledge that there will be judgment involved in its application, especially in situations where underlyings are interdependent – such as those based on a change in control and share price. In addition, it is difficult to assess the cost and complexity of applying the proposed predominance assessment to new types of transactions that may emerge that are not currently contemplated. To address these complexities, the Board could consider permitting companies to make a policy election on the methodology applied to determine predominance and include the fair value assessment as an example of an acceptable approach.

Effective Date and Transition
We support requiring entities to apply the amendments in the proposed Update prospectively, with an option to apply the guidance to contracts that exist as of the beginning of the fiscal year of adoption through a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the fiscal year of adoption. CCR also strongly agrees that companies should have the option to elect early adoption. While many companies impacted by this proposal believe they could implement within one year, we believe it would be beneficial to provide preparers with 18 months to implement. This will allow companies time to assess the new requirements, identify the portfolio of impacted contracts, develop new processes and controls, and for those companies electing to adopt the standard retrospectively, time to calculate an adjustment to retained earnings. Additional time is also needed given the expected concurrent implementation of other standards.

Issue 2: Scope Clarification for a Share-Based Payment from a Customer in a Revenue Contract

Scope Clarification
While the scope clarification on share-based payments from a customer is not broadly applicable to CCR companies, we are generally supportive of the Board's amendments and appreciate the Board's responsiveness to stakeholder feedback and efforts to align the guidance with current practice.

We agree that an entity should apply the guidance in Topic 606, including the guidance on noncash consideration in paragraphs 606-10-32-21 through 32-24, to a share-based payment from a customer that is consideration for the transfer of goods or services in a revenue contract. Additionally, we agree

that Topic 815 and Topic 321 should be amended as proposed to clarify the guidance in those Topics does not apply to a share-based payment from a customer that is consideration for the transfer of goods or services unless and until the share-based payment is recognized as an asset under Topic 606. We believe share-based payments are a form of noncash consideration and should be treated the same as other forms of noncash consideration in Topic 606. As stated above, the clarification is in line with existing practice for many companies and will effectively reduce any remaining diversity in practice.

We believe the Board should also amend the scope of Subtopic 610-20 to be consistent with the proposed clarification in Topic 606 and clarify a share-based payment from a noncustomer that is consideration for the transfer of a nonfinancial asset should be accounted for under Subtopic 610-20. We believe this amendment will reduce potential diversity in practice and promote consistency between Topic 606 and Subtopic 610-20, which we believe is the Board's intent.

In addition to the proposed amendments, we suggest the Board consider additional amendments to Topic 323, similar to those proposed for Topic 321, to address situations where shares received from a customer would give the entity greater than 20% of voting common stock, but not a controlling financial interest.

Clarity and Operability

Overall, we find the amendments to the proposed Update to be clear and operable and appreciate the Board's inclusion of and amendments to the implementation guidance and illustrations. However, we suggest the Board expand Example 31 – Entitlement to Noncash Consideration (Example 31) to illustrate the intended application of the guidance in situations where a performance obligation is recognized over time and the entity performs before or after the entity's right to receive or retain share-based payment is no longer contingent on satisfaction of the performance obligation.

As proposed, Example 31 describes a scenario in which an entity enters into a contract with a customer to provide a weekly service (which is satisfied over time) for one year in exchange for shares of common stock paid upon the successful completion of each week of service. The entity recognizes revenue and the corresponding shares as assets each week once the service is completed.

While Example 31 and the additional language in 606-10-55-250A referencing the guidance in Section 606-10-45 are helpful, we believe without an explicit illustration, there is potential for misinterpretation when the timing of the recognition of the shares does not coincide with the timing of the payment of the shares. For example, if all shares were paid by the customer at the end of the year instead of on a weekly basis, the proposed Update could be misinterpreted to mean an entity would wait to recognize revenue until the performance obligation was completely satisfied (after one year). We do not believe this was the Board's intent. As a result, we recommend the Board retain the current example in Example 31 (Case A) and add a scenario that would retain the same facts, but alter the timing of share payment from a weekly payment to one lump sum payment at the end of the year (Case B).

Transition and Effective Date

We support requiring entities to apply the amendments in the proposed Update to revenue contracts that exist as of the beginning of the fiscal year of adoption through a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the fiscal year of adoption. As highlighted above, many CCR companies are not significantly impacted by this issue, and the proposed Update is largely in line with current practice. While CCR companies who are impacted believe they

could likely implement the proposed Update within one year, we believe it would be beneficial to provide preparers with 18 months to implement. This will allow companies time to assess the new requirements, identify the portfolio of impacted contracts, and make any necessary business changes. Additional time is also needed given the expected concurrent implementation of other standards.

Conclusion

We appreciate this opportunity to provide feedback on the proposed Update related to derivative accounting. We thank the Board for its consideration of our comments and welcome further discussion with the Board or staff at your convenience.

Sincerely,

Alice L. Jolla

Alice L. Jolla
Chair, Committee on Corporate Reporting
Financial Executives International