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Via email to director@fasb.org

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

Re: 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 (File Reference No. 2024-ED100)

Dear Mr. Day:

We appreciate the opportunity to respond to the Board's exposure draft. Overall, we support the proposals to refine the derivatives scope exception and to clarify that an entity should apply the guidance in Topic 606, including the noncash consideration guidance, to a share-based payment from a customer as consideration in a revenue contract. However, we believe the Board should consider certain alternatives to its proposed guidance for assessing a derivative's predominant characteristics. We also recommend clarifying the revenue amendments to reduce complexity and the potential for diversity in practice.

Our suggestions for the proposed amendments in Topic 815 include expanding the derivative scope exception by adding the term "achieving a production target" to capture certain lending activities based on loan production volumes, as well as considering alternatives to the proposed predominant characteristics assessment. We believe the Board's proposed requirement to analyze future changes in fair value could lead to costly and complex analyses when applied to common embedded features.

Additionally, we suggest clarifying the exception related to share-based payments from customers to indicate the proposed revisions in Topics 606, 321, and 815 have no impact on the existing guidance for recognizing contract assets and receivables, and therefore the timing of revenue recognition. We also believe the final ASU should address whether and how to apply the proposed guidance to cash-settled share-based payments from customers.

We have responded to the Questions for Respondents in the attached Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Roscelle Holgado at (312) 233-1825, Jennifer Kimmel at (203) 905-6284 or Adam Brown at (214) 665-0673.

Very truly yours,

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Appendix

Issue 1: Derivatives Scope Refinements

Question 1: Does the proposed scope exception in paragraph 815-10-15-59(e) capture the population of contracts with entity-specific payment provisions that, in your view, should not be accounted for as a derivative and, instead, should be accounted for under other Topics? Conversely, does the proposed scope exception capture any types of contracts that, in your view, should continue to be accounted for as a derivative under Topic 815? Please explain why or why not. If not, what changes would you suggest?

We agree the proposed scope exception in paragraph 815-10-15-59(e) generally captures the population of contracts the Board intends to exclude from derivative accounting. However, we believe some contracts that have an underlying based on metrics that are similar in nature to those in paragraph 815-10-15-59(d) or 815-10-15-59(e)(1) should also qualify for exemption.

For example, some capital or subordinated debt instruments issued by private companies under certain loan programs from the U.S. Treasury department have terms that lower the dividend or interest yield based on achieving specific loan production volumes.¹ Paragraph 815-10-15-59(d) currently does not capture those instruments because the metric is based on loan production targets, which although similar in nature to, are not the same as, the volume of sales or service revenues. We believe those instruments (and other instruments with a similar underlying) are not intended to be derivatives and can be excluded from derivative accounting by expanding the examples in paragraph 815-10-15-59(e)(2) to include “achieving a production target”, which would reduce diversity in practice for those contracts.

We do not believe the proposed scope exception would capture a significant number of contracts that should continue to be accounted for as derivatives under Topic 815.

Question 2: Is the proposed scope exception in paragraph 815-10-15-59(e) clear and operable? Please explain why or why not. If not, what changes would you suggest?

We generally believe the proposed scope exception in paragraph 815-10-15-59(e) is operable. However, we believe certain clarifications are needed.

Historically, paragraph 815-10-15-59(d) has been applied in practice to underlyings based on volumes of sales or revenues (measured in units or in currency) as well as to other related performance metrics of the parties to the contract (such as net earnings or operating cash flows as cited in paragraph 815-15-55-10). We suggest clarifying that the scope exception in paragraph 815-10-15-59(d) applies to volumes of sales or revenues measured in units, if that is what the Board intends, and to include sales or revenues measured in currency as an example of financial statement metrics in paragraph 815-10-15-59(e)(1). Otherwise, it is not clear which paragraph applies to sales or revenues measured in currency. Also, we recommend replacing the reference in paragraph 815-15-55-10 (which currently refers to paragraph 815-10-15-59(d)) to cite paragraph 815-10-15-59(e).

Paragraph 815-10-15-59(e)(2) states that the term “party to the contract” refers to any entity within a consolidated group. Further, Case C in paragraph 815-10-15-55-143E illustrates that the

¹ See [Emergency Capital Investment Program | U.S. Department of the Treasury](#).

term includes the parent's activity when evaluating the exception in the subsidiary's standalone financial statements. We suggest clarifying whether that concept is applicable only to the scope exception in paragraph 815-10-15-59(e)(2) and should not be used in the application of other guidance by analogy. For example, we believe that approach is inconsistent with how practice currently views contracts indexed to a parent's stock in the subsidiary's stand-alone financial statements. Those contracts are generally considered not indexed to the subsidiary's own stock in evaluating whether they pass the indexation guidance in ASC 815-40-15. Further, we suggest that the Board clarify whether the term applies to the immediate parent only or to entities further up in the consolidation chain.

Question 3: Is the proposed predominant characteristics assessment in paragraph 815-10-15-60 operable, including for contracts with multiple underlyings that are dependent on each other? Please explain why or why not. If not, what changes would you suggest?

We are concerned both about the cost and the operability of the proposed revisions for assessing a contract's predominant characteristics.

The proposal requires entities to determine which underlying has the "largest expected effect on changes in fair value." This suggests entities may be required to develop quantitative models (valuations) that isolate the effect of individual variables in a contract, and further, how that effect changes over the life of the contract. In practice, those variables often include changes of control, future private placements, security price thresholds, IPOs, regulatory milestones, and sales volumes. Developing quantitative assumptions about the likelihood of those triggers (including their correlation) and how they could change over the life of the contract could be quite subjective. If our understanding is accurate, that could impose significant costs, including third-party valuation fees.

In light of those difficulties, we suggest two alternatives for the Board's consideration:

- Specify that, at inception, an entity would identify the predominant underlying as the one with the greatest expected effect on the derivative's fair value upon settlement rather than the greatest expected effect on changes in fair value over the contract's life. This would simplify the predominance assessment because it would not require entities to make assumptions about changes in multiple underlyings over the life of the contract. Depending on the facts and circumstances, the analysis may be qualitative or quantitative.
- Specify that, at inception, the scope exception in paragraph 815-10-15-59 applies as long as the derivative contains at least one underlying that meets the scope exception and that underlying is substantive.

While both alternatives require the application of judgment, we believe they draw upon concepts similar to the assessment of predominance in paragraph 480-10-25-14, as well as the requirement in ASC 470-20 to determine whether a conversion feature is substantive. Therefore, preparers and auditors would be able to make a similar type of determination in paragraph 815-10-15-60.

If the Board does not adopt either of the approaches above, we would also support retaining the current language in paragraph 815-10-15-60 rather than adopting the proposed amendments.

However, if paragraph 815-10-15-60 is amended as proposed, we suggest expanding the proposed examples to illustrate how the predominant characteristics assessment should be performed as follows:

- Expand Case B in paragraph 815-10-55-143D to include a substantial premium or discount to illustrate that the contingent put feature is not clearly and closely related to the host contract under paragraph 815-15-25-42. Adding that fact would highlight that the predominant characteristics assessment is only required if the instrument is not clearly and closely related to the host.

Further, we suggest expanding the example to illustrate how the predominant characteristics assessment would be performed for a contingent embedded feature where the contingency serves as an on/off switch to settlement. Some may consider the contingency (the IPO) to be predominant in those cases because there would be no settlement until the contingency occurs and therefore, the market price underlying is disregarded in the predominance test. Alternatively, others may consider the likelihood of the contingency in determining whether it is predominant and therefore, further evaluation of the effect of the market price underlying on the derivative's fair value is necessary. We also suggest that the Board clarify whether the predominant characteristics assessment can be qualitative in those cases.

- Expand Case A in paragraph 815-10-55-143B through 55-143C to include an additional underlying that may not be in the scope of paragraph 815-10-15-59(b)(2). Specifically, assume that the contract in Case A requires additional consideration payable to Entity B if Entity A subsequently sells the drug compound to another party. In that case, the example would need to address which entity benefits "under the contract" – whether Entity A because it is permitted under the agreement to monetize a successful drug candidate or Entity B because it is entitled to receive contingent consideration in that situation.

Question 4: The Board rejected an alternative to the proposed amendments to the predominant characteristics assessment in paragraph 815-10-15-60 that would have eliminated that assessment and replaced it with a requirement that if any underlying does not qualify for a scope exception in paragraph 815-10-15-59, the entire contract would not qualify for the scope exception (see paragraphs BC31 through BC32). Do you have any views on the alternative rejected by the Board and whether it would be more operable, be less complex, or provide more decision-useful information?

We agree with the Board's decision to reject the alternative that would cause a derivative to not qualify for the scope exception if it has any underlying that does not meet the requirements in paragraph 815-10-15-59. Although the alternative may be less complex and more operable, we agree it would significantly reduce the number of instruments that would qualify for that scope exception.

Question 5: Is the proposed transition method operable? If not, why not, and what transition method would be more appropriate and why? Would the proposed transition disclosure be decision useful? Please explain why or why not.

We agree with the proposed transition requirements and support the prospective method for new contracts and the option to apply a cumulative-effect adjustment approach for existing

contracts. We believe it is operable, however we defer to investors and other financial statement users on whether the required disclosures will provide decision-useful information.

Question 6: In evaluating the effective date, how much time would be needed to implement the proposed amendments? Should the effective date for entities other than public business entities be different from the effective date for public business entities? Please explain why or why not.

We believe adopting the proposed amendments would require considerable time for entities to transition, especially if the Board finalizes its proposed predominant characteristics assessment. We recommend giving one year for public entities and two years for private entities to adopt the amendments.

Question 7: Would the expected benefits of the proposed amendments justify the expected costs? If not, please describe the nature and magnitude of those costs, differentiating between one-time costs and recurring costs.

We believe the Board should consider replacing or clarifying the proposed predominance characteristics assessment in paragraph 815-10-15-60 – refer to our response to Question 3. The potential valuation work and use of specialists to assist in performing the predominance test could be costly because instruments with multiple underlyings are common in practice.

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

Question 8: Do you 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? Do you agree that the share-based payment should be recognized as an asset under Topic 606 when an entity's right to receive or retain the share-based payment from a customer is no longer contingent on the satisfaction of a performance obligation? Please explain why or why not for both questions. If not, what changes would you suggest?

We generally 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 when the share-based payment takes the form of a share, share option, or other equity instrument (that is, the payment constitutes noncash consideration). The approach is consistent with the guidance in superseded paragraph 505-50-05-2A.

We believe clarifying the proposed amendments in two respects would improve its operability – refer to our response to Question 10.

Question 9: Should Topic 815 and Topic 321 be amended as proposed to clarify that 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? Please explain why or why not. If not, what changes would you suggest?

We agree Topics 815 and 321 should be amended. We suggest revising proposed paragraphs 321-10-15-7 and 815-10-25-16A to state the guidance in those Topics is only applicable when the receipt of the consideration is no longer contingent on the satisfaction of a performance obligation (that is, a financial asset is recognized) as follows:

- 321-10-15-7 The guidance in this Topic does not apply to a share-based payment from a customer that is consideration for the transfer of goods or services under Topic 606 unless and until the share-based payment is recognized as an asset under Topic 606 on revenue from contracts with customers the receipt of the consideration is no longer contingent on the satisfaction of a performance obligation and revenue has been recognized in accordance with that Topic.
- 815-10-25-16A The guidance in this Topic does not apply to a share-based payment from a customer that is consideration for the transfer of goods or services under Topic 606 unless and until the share-based payment is recognized as an asset under Topic 606 on revenue from contracts with customers the receipt of the consideration is no longer contingent on the satisfaction of a performance obligation and revenue has been recognized in accordance with that Topic.

The proposed revisions above are in line with our recommendations for clarity in response to Question 10.

Further, the discussion in paragraph BC52 indicates that meeting the definition of a financial instrument does not automatically or necessarily lead to asset or liability recognition. We suggest clarifying whether that observation relates only to the application of paragraphs 321-10-15-7 and 815-10-25-16A and should not be applied by analogy in other Topics. For example, paragraph 815-40-15-6 states that outstanding instruments within the scope of paragraphs 815-40-15-5 through 15-8 are always considered issued for accounting purposes. Generally, the application of that paragraph results in recognizing a financial instrument under ASC 815-40 as soon as it meets the definition of financial instrument, which may be before the instrument is issued.

Question 10: Are the proposed amendments clear and operable? Please explain why or why not. If not, what changes would you suggest?

We believe the final ASU's operability would be improved by clarifying: 1) the interaction of the new guidance with the existing guidance on contract assets and receivables, and 2) whether and how to apply the new guidance to cash-settled share-based payments from customers.

Interaction with the guidance on contract assets and receivables

We believe the Board intended paragraph 606-10-15-3A only to address when a share-based payment should be recognized as a financial asset under Topics 815 and 321. We believe it was not intended to change revenue recognition or preclude recognizing contract assets and receivables under Topic 606, as evident in proposed paragraph 606-10-55-250A (which refers to the guidance on recognizing those assets under ASC 606-10-45). However, as proposed, paragraph 606-10-15-3A may be subject to misinterpretation because it states an asset cannot be recognized until the right to the share-based payment is no longer contingent on future performance. Consequently, we suggest the following clarifications:

- Revise proposed paragraph 606-10-15-3A to state:
606-10-15-3A An entity shall apply the guidance in this Topic, including the guidance on noncash consideration in paragraphs 606-10-32-21 through 32-24, to a contract with a share-based payment (for example, shares, share options, or other equity instruments) from a customer that is consideration for the transfer of goods or services. The guidance in Topic 815 and Topic 321 does not apply to a share-based payment from a customer that is consideration for the transfer of goods or services unless and until receipt of the consideration is no longer contingent on the satisfaction of a performance obligation and revenue has been recognized in accordance with this Topic.
- Move the remainder of proposed paragraph 606-10-15-3A to Section 606-10-32 > Noncash Consideration (for example, 606-10-32-21A) to clarify that the noncash consideration guidance applies to share-based payments from customers, and revise it as follows:
606-10-32-XX A share-based payment (for example, shares, share options, or other equity instruments) from a customer is measured at the estimated fair value at contract inception. The guidance in other Topics applies to the share-based payment once the receipt of the noncash consideration is no longer contingent on the satisfaction of a performance obligation and revenue has been recognized. If the guidance in other Topics requires the share-based payment to be initially and/or subsequently measured at fair value, an entity shall recognize a gain or loss (outside of revenue) upon receipt of the noncash consideration if the fair value increases or decreases after contract inception.
- Revise part of paragraph 606-10-55-249 to state:
606-10-55-249 ...The guidance in other Topics applies to the shares once the receipt of the consideration is no longer contingent on the satisfaction of a performance obligation (that is, 100 shares per completed week of service).
- Revise the discussion in BC49 and BC50 accordingly.
- Also, we suggest providing an example in Section 606-10-55 of a contract in which the timing of recognition of the share-based payment does not coincide with the timing of its payment or receipt. The example would illustrate a situation in which it is appropriate to recognize a contract asset even though the share-based payment is not yet recognized as a financial asset.

Consider the following example: Entity B agrees to construct a building for a customer for a fixed price. As an incentive, if the building is complete within one year of contract inception, Entity B will receive 1,000 options to purchase the customer's stock for \$15 per share. Upon assessment at inception under the variable consideration guidance, Entity B estimates it will complete the building within one year of contract inception. Entity B also determines it meets the criteria to recognize revenue for the building over time. The guidance in ASC 606-10-32 requires Entity B to measure the option on the grant date at fair value and include the amount in its estimate of transaction price at inception. Entity B also determines it meets the criteria to recognize revenue for the construction contract over time. At the end of the quarter, Entity B concludes the building is 35% complete and it is probable the building will meet the one-year deadline, so it recognizes 35% of the fair value of the options as revenue.

If Entity B has not yet reached a billing milestone, the progress would be reflected as a contract asset under existing guidance. While not intended, the last two sentences in proposed paragraph 606-10-15-3A, when read literally, appear to preclude the recognition of any type of asset until completion of the building while ASC 606 requires that the entity recognize 35% of the revenue. We believe a similar example, together with our suggested changes above, would clarify how the guidance should be applied to contracts in which it is appropriate to recognize an asset (such as a contract asset) under Topic 606 before the share-based payment is recognized as a financial asset under other Topics.

Cash-settled share-based payments from customers

We also recommend clarifying whether and how the guidance in the proposed amendments applies to cash-settled share-based payments from customers. The definition of “share-based payment arrangement” in Topic 718 includes liabilities for which the amounts are based, at least in part, on the price of the issuer’s shares or other equity instruments. Those liabilities are typically cash-settled. We note that including the term “share-based payment” in proposed paragraph 606-10-15-3A and in Section 606-10-32 (as we’ve suggested above) could generate confusion about how the grantee should account for consideration from a customer that is in the form of cash but which is based, at least in part, on the price of the entity’s shares.

Consider the following example: Entity C provides business consulting services to a customer accounted for as a single performance obligation satisfied over time in accordance with the series guidance in paragraph 606-10-25-15. In exchange, the customer promises to pay cash consideration at various billing dates based on the fair value of a specified number of the customer’s equity shares at the billing date. Entity C must determine the transaction price at contract inception and begin recognizing revenue as the services are performed.

Entity C might conclude the arrangement contains an embedded derivative – the payment indexed to the value of the customer’s shares. If Entity C determines the derivative is not clearly and closely related to the host contract, it would bifurcate the derivative and account for it separately. In that case, Entity C would estimate the transaction price based on the fair value of the customer’s shares at contract inception. Any changes in the value of the customer’s shares after contract inception would not be included in revenue but would be presented elsewhere in the income statement.

Under the proposed guidance in paragraph 606-10-15-3A, Entity C might conclude instead that the promised consideration constitutes a share-based payment from the customer. In that case, it is unclear whether the customer should apply the variable consideration guidance or the noncash consideration guidance. The transaction price is a cash payment indexed to the customer’s equity. A strict application of the variable consideration guidance would require Entity C to update the estimate of the cash settlement amount (based on current customer share price) at the end of each reporting period and include a proportionate amount in revenue. However, that outcome is inconsistent with the concept in 606-10-32-23 which states that any variation in the value of the consideration due to the form of the consideration should be accounted for separately from revenue. In contrast, application of the noncash consideration guidance could result in accounting more in line with the approach described above for a bifurcated derivative.

As a result, we believe that diversity in practice may exist or may develop related to accounting for cash-settled share-based payments from customers. We recommend clarifying how to apply the guidance on transaction price in 606-10-32 to those types of arrangements.

Question 11: Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets, refers to the revenue recognition principles in Topic 606, including the recognition and measurement guidance. Should the scope of Subtopic 610-20 be amended to be consistent with the proposed clarification in Topic 606? That is, should the Board clarify that a share-based payment from a noncustomer that is consideration for the transfer of a nonfinancial asset (that is within the scope of Subtopic 610-20) should be accounted for under Subtopic 610-20? Please explain why or why not. Do you expect any unintended consequences of providing that clarification? If so, please explain what those unintended consequences would be.

We agree the proposed guidance in Topic 606 should also apply to Subtopic 610-20, however we do not believe it is necessary to amend the latter since paragraph 610-20-32-3 currently refers to and incorporates the guidance on transaction price in Section 606-10-32. To promote greater visibility and ease of application for practitioners, consistent with our response to Question 10, we suggest moving part of the proposed paragraph 606-10-15-3A to Section 606-10-32. Thus, its applicability to Subtopic 610-20 would be captured explicitly by the current reference in paragraph 610-20-32-3.

Question 12: Is the proposed transition method operable? If not, why not, and what transition method would be more appropriate and why? Would the proposed transition disclosures be decision useful? Please explain why or why not.

We agree the proposed transition method is operable, however we defer to investors and other financial statement users on whether the required disclosures will provide decision-useful information.

Question 13: In evaluating the effective date, how much time would be needed to implement the proposed amendments? Should the effective date for entities other than public business entities be different from the effective date for public business entities? Please explain why or why not.

We do not expect a significant amount of time to be required for most entities to adopt the proposed amendments. Consistent with recent ASUs with similarly narrow scopes, we recommend one year for public entities and two years for private entities if early adoption is permitted, since a private entity may require additional time to transition under the modified retrospective approach.

Question 14: Would the expected benefits of the proposed amendments justify the expected costs? If not, please describe the nature and magnitude of those costs, differentiating between one-time costs and recurring costs.

If the Board incorporates our recommendations in response to Questions 8-11, we believe the benefits outweigh the costs as the proposed amendments promote consistency among companies and should not be difficult to apply.