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

File Reference No. 2024-ED100

Dear Mr. Day:

RSM US LLP is pleased to provide feedback on the Financial Accounting Standards Board's (FASB or Board) proposed Accounting Standards Update (ASU), *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 (*proposed Update).

We support the Board's efforts to address stakeholders' concerns about the application of derivative accounting to contracts with features based on the operations or activities of one of the parties to the contract and the diversity in accounting for a share-based payment that a reporting entity receives from a customer as consideration for the transfer of goods or services.

Overall, we agree with the proposed amendments to exclude contracts with underlyings that are based on the operations or activities specific to one of the parties to the contract from derivative accounting. We also generally agree with the proposed amendments to clarify that an entity should apply Topic 606 when it receives a share-based payment from a customer as consideration for the transfer of goods or services and should not apply Topic 815 or Topic 321, *Investments – Equity Securities*, unless and until the share-based payment is recognized as an asset under Topic 606. In general, we believe that the proposed amendments would lead to more intuitive accounting results by allowing an entity to better reflect the economics of the contracts, thereby providing more decision-useful information to investors. However, we believe that additional clarification and implementation guidance is needed to achieve some of the Board's stated objectives.

As explained more fully in our response to Question 1, we believe that some of the wording of the proposed guidance in paragraph 815-10-15-59(e) that is intended to exclude default-based credit derivatives and financial guarantees from the proposed scope exception for certain non-exchange-traded contracts is internally inconsistent with some of the other proposed guidance in that paragraph. We suggest some revisions to that guidance to avoid any confusion and unintended consequences. We also believe further enhancements are needed to clarify the proposed guidance in paragraph 606-10-15-3A that explains the threshold for recognizing a share-based payment from a customer as an asset under Topic 606, including when the guidance in Topic 815 or Topic 321 should be applied. Our observations and recommendations with respect to these comments are more fully explained in our responses to Questions 8 and 10.

Our responses to the questions posed in the proposed Update, other than those specifically directed solely at investors or preparers, are included in the remainder of this letter.

Responses to Questions for Respondents

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?

Except as noted below, we generally believe the proposed scope exception in paragraph 815-10-15-59(e) captures the population of contracts with entity-specific payment provisions that should not be accounted for as derivatives and appropriately excludes those contracts that should continue to be accounted for as derivatives in accordance with Topic 815.

We believe that the proposed scope exception would capture financial instruments that entitle the instrument holder to interest payments that vary based on environmental, social and governance-linked metrics specific to one of the parties to the contract. We also believe that the proposed scope exception would capture research and development funding arrangements and litigation funding arrangements that are based on operations or activities specific to one of the parties to the contract.

We agree with the Board's decision to exclude non-exchange-traded contracts from the proposed scope exception in paragraph 815-10-15-59(e) if settlement of the underlying is based on a market rate, market price or market index. Without that guidance, financial instruments such as interest rate swaps and certain forward contracts would no longer be treated as derivatives under Topic 815, which would be contrary to what is commonly understood in practice.

However, we have concerns with the wording in paragraph 815-10-15-59(e) that indicates that the proposed scope exception would not apply to non-exchange-traded contracts if settlement of the underlying is based on "the price or performance (including default) of a financial asset or financial liability of one of the parties to a contract." We believe this guidance conflicts with the wording in paragraph 815-10-15-59(e)(1) that indicates that the scope exception would apply to contracts with an underlying based on financial statement "metrics derived from amounts presented in financial statements and components of amounts included in financial statements." We believe there is conflicting guidance because amounts included in financial statements may be comprised in part of financial assets and financial liabilities.

We understand the proposed exclusion for non-exchange-traded contracts with underlyings based on "price or performance" is meant to prevent default-based credit derivatives and financial guarantees that do not qualify for the scope exception in paragraph 815-10-15-58 from qualifying for the proposed scope exception (and we support that decision). To avoid any confusion and unintended consequences, we suggest that the Board strike the words "the price or performance (including default) of a financial asset or financial liability of one of the parties to a contract" and replace that guidance with an additional sentence that states, "The scope exception does not apply to default-based credit derivatives and financial guarantees that do not qualify for the scope exception in paragraph 815-10-15-58."

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?

Except as noted in our response to Question 1, we believe that the proposed scope exception is generally clear and operable.

We also believe the example beginning in paragraph 815-10-55-143B should be clarified. That example describes a scenario in which a lender provides $50 million of funding to a borrower under a funding arrangement so that the borrower can develop and commercialize a drug. Upon regulatory approval of the drug, the borrower pays $20 million to the lender. The borrower also pays an additional $80 million to the creditor upon sales of the drug exceeding $500 million.

Paragraph 815-10-55-143C indicates that this underlying (i.e., the occurrence or nonoccurrence of achieving $500 million of sales) qualifies for the proposed scope exception in paragraph 815-10-15-59(e). The guidance is not clear as to why the potential obligation to pay $80 million would not be considered tied to the performance of the borrower's financial liability, causing the contract to fail to qualify for the proposed scope exception. We recommend that the Board clarify why the occurrence or nonoccurrence of achieving $500 million of sales qualifies for the proposed scope exception.

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?

Yes, we believe that the proposed predominant characteristics assessment in paragraph 815-10-15-60 is operable, including for contracts with multiple underlyings that are interdependent.

In some cases, it may be obvious which underlying would have the greatest impact on the fair value of the contract. While the proposed fair value assessment may be challenging to perform when a contract has multiple underlyings where one underlying depends on another, we expect that the fair value assessment would be more operable than the current correlation assessment. We further believe that the requirement that the fair value assessment be performed only at inception partially mitigates the operational challenges. We believe the fair value assessment is more intuitive than the current correlation assessment, which is applied inconsistently.

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 to replace the predominant characteristics assessment 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. Preventing a contract with multiple underlyings from meeting the scope exception in paragraph 815-10-15-59 because it has one underlying that does not qualify would be more operable and less complex; however, it would likely result in a greater number of contracts being subject to Topic 815. Because such results may lead to unintuitive accounting outcomes and may not properly reflect the economics of those contracts, we agree with the Board that the alternative approach that was rejected would have resulted in less decision-useful information to investors.

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.

Yes, we believe the proposed transition requirements would be operable because the proposed amendments would be applied prospectively to contracts entered into after the adoption date, unless entities elect to apply the guidance to contracts that exist as of the beginning of the fiscal year of adoption through a cumulative-effect adjustment. We do not foresee any issues with being able to audit the application of the proposed transition guidance. We defer to users of financial statements to determine whether the proposed transition disclosures are decision useful.

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 defer to the preparers of financial statements as to how much time would be needed to implement the proposed amendments, including whether the effective date for entities other than public business entities should be different from the effective date for public business entities. However, in our experience, providing nonpublic business entities with additional time to learn from the transition experiences and interpretations of public business entities is helpful for those other entities.

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 defer to the preparers and users of financial statements as to whether the expected benefits of the proposed amendments justify the expected costs.

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?

Yes, we agree that an entity should apply the guidance in Topic 606, including the guidance on noncash consideration in paragraph 606-10-32-21 through 32-24, to a share-based payment it receives from a customer as consideration for the transfer of goods or services in a revenue contract. We believe that applying Topic 606 to determine the revenue recognized, and the timing of the recognition, best reflects the economics of these transactions.

However, we believe the threshold for recognizing a share-based payment as an asset under Topic 606 should be further clarified before issuing a final standard. The proposed guidance in paragraph 606-10-15-3A indicates that a share-based payment would be recognized as an asset when it is no longer contingent on the satisfaction of a performance obligation. We believe that an entity should recognize the share-based payment as an asset under Topic 606 when both:

1. Its right to receive or retain the share-based payment from a customer is no longer contingent on the satisfaction of a performance obligation.
2. It is probable that recognition of the revenue would not result in a significant reversal of that revenue in the future (i.e., an entity should apply the guidance in paragraph 606-10-32-11 when considering the timing of recognizing revenue and an associated asset).

In other words, if the share-based payment vests based on contingencies that will be resolved after satisfaction of the performance obligation, an entity should consider the probability of those contingencies occurring when determining the timing of revenue recognition. Only once the threshold for recognition of revenue has been met under Topic 606 should an entity recognize the share-based payment as an asset. This is because if an entity recognizes revenue based solely on when the performance obligation is satisfied, and the contingent event does not occur, the entity would either have to reverse revenue that it may have never considered probable of being realized, or it would recognize the entire amount as a loss on the financial instrument. For those reasons, we recommend that proposed paragraph 606-10-15-3A be revised and clarified as follows:

> *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. Accordingly, under this Topic, the share-based payment is recognized as an asset measured at the estimated fair value at contract inception when the 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* ***<u>and it is probable that recognition of the revenue would not result in a significant reversal of that revenue in the future (see paragraph 606-10-32-11)</u>****. 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 the share-based payment is recognized as an asset under this Topic.*

In addition, we recommend that the Board clarify the unit of account to which the guidance in paragraph 606-10-15-3A would apply. We have observed share-based awards that do not vest all at one time. As a hypothetical example, consider a reporting entity that received 52,000 shares as compensation for services performed and 1,000 shares vest for every week of services it provides. Assume that at the end of the reporting period, the reporting entity provided 30.5 weeks of services. This means that 30,000 would have vested at the end of the reporting period. It is not clear whether the reporting entity would record a share-based payment asset for 30,000 shares and a contract asset for the 500 additional shares, or only a contract asset for the entire 30,500 shares.

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?

Yes, we believe both Topic 815 and Topic 321 should be amended as proposed to clarify that the guidance in those Topics does not apply to a share-based payment received by the reporting entity as consideration for the transfer of goods or services unless and until the share-based payment is recognized as an asset under Topic 606.

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

As currently written, we believe it may be challenging to implement certain aspects of the proposed amendments.

In our opinion, the following sentences in paragraph 815-10-15-3A should be clarified:

> *"Accordingly, under this Topic, the share-based payment is recognized as an asset measured at the estimated fair value at contract inception when the 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. 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 the share-based payment is recognized as an asset under this Topic."*

It is not clear whether the proposed guidance means that an entity cannot recognize an asset of any kind (including a contract asset) until the performance obligation is satisfied. We believe another way of interpreting the proposed guidance is that an entity could recognize a contract asset, but not a share-based payment asset. That is, the entity would record the contract asset as the services are performed, but only when the contingency is resolved (as discussed in our response to Question 1) would the entity apply the guidance in Topic 815 or Topic 321. Also, the proposed Update is silent on the accounting in the situation where the share-based payment earned for satisfying the performance obligation only vests upon a future contingency not related to the performance obligation. Consequently, if the performance obligation is satisfied, but the share-based payment earned for satisfaction of the performance obligation is not vested, it is not clear as to the accounting guidance that should be followed between satisfaction of the performance obligation and vesting of the share-based payment earned. In these instances, should an entity apply the guidance in Topic 815 or Topic 321 after the share-based payment is vested or when the contract asset is recognized (even though the contingency related to something outside the performance of the entity may not have been resolved)? In addition, see the last paragraph to our response to Question 8.

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.

Yes, we believe that Subtopic 610-20 should be amended to be consistent with the proposed clarification of Topic 606. We do not foresee any unintended consequences from this clarification.

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 defer to the preparers of financial statements as to whether the proposed transition method is operable. We do not foresee any issues with being able to audit the application of the proposed transition guidance. We defer to users of financial statements to determine whether the proposed transition disclosures are decision useful.

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 defer to the preparers of financial statements as to how much time would be needed to implement the proposed amendments, including whether the effective date for entities other than public business entities should be different from the effective date for public business entities. However, in our experience, providing nonpublic business entities with additional time to learn from the transition experiences and interpretations of public business entities is helpful for those other entities.

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.

We defer to the preparers and users of financial statements as to whether the expected benefits of the proposed amendments justify the expected costs.

We appreciate this opportunity to provide feedback on the proposed Update and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Mike Gaiso at 212.372.1709 or Joseph Cascio at 212.372.1139.

Sincerely,

RSM US LLP

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