

Mr. Jackson M. Day
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Financial Accounting Standards Board
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30 June 2025

Invitation to Comment, *Agenda Consultation* (File Reference No. 2025-ITC100)

Dear Mr. Day:

We appreciate the opportunity to provide feedback on the Invitation to Comment (ITC), *Agenda Consultation*, issued by the Financial Accounting Standards Board (FASB or Board).

We commend the Board for its thoughtful approach in determining which financial reporting topics to add to its technical agenda. We believe a transparent process is critical in providing confidence to investors and other marketplace participants in how the Board allocates its limited resources to achievable standard-setting projects. A public process soliciting input on the technical agenda helps the Board fulfill its mission to improve financial accounting and reporting standards and address topics that are of the highest priority for stakeholders.

Generally accepted accounting principles (GAAP) were established in the late 1930s, and the FASB was established in 1973. Since then, the FASB has completed many successful projects to create, improve and maintain financial accounting and reporting standards for its stakeholders. After several years of major standard-setting projects, the FASB has provided stakeholders with a comprehensive set of financial accounting and reporting standards that function as intended.

We believe the FASB now has an opportunity to evaluate its strategic direction and recommend that it focus its efforts on (1) addressing emerging and interpretive issues with targeted standard-setting projects, (2) prioritizing maintenance of and improvements to existing US GAAP and (3) monitoring the evolving regulatory environment for crypto assets. If the Board were to shift its priorities to these areas, the decision-making process for when a project is added to its technical agenda and the related resources required may change from current practice.

We also encourage the Board to prioritize completing the existing projects on its technical agenda, many of which are planned to be completed in 2025 or in the first half of 2026. Once these projects are done, we recommend the Board take on some of the topics identified in the ITC to address stakeholder concerns over complexities that exist in the application of US GAAP and the accounting for transactions in emerging areas.

Addressing emerging and interpretive issues with targeted standard-setting projects

We do not believe there is a need for major standard setting at this time. We recommend the Board focus its resources on more targeted standard setting for emerging and interpretive issues such as (1) research and development (R&D) funding arrangements and (2) guarantees. Refer to our responses to Questions 22 and 32 in our Appendix for details.

Prioritizing maintenance and improvements of existing US GAAP

One area we believe the Board should allocate its limited resources to is maintaining and improving the Accounting Standards Codification (ASC or Codification). The lack of planned major standard-setting projects in the near term should allow the FASB to quickly address areas in existing US GAAP that need improvement. We believe that the FASB should focus on (1) accounting changes and error corrections, (2) equity indexation and equity classification, (3) principal versus agent considerations and (4) consolidation. Refer to our responses to Questions 4, 13, 14, 38 and 50 in our Appendix for details.

Monitoring the evolving regulatory environment for crypto assets

We recommend that the Board closely monitor evolving regulation related to crypto assets. Based on recent statements by the Securities and Exchange Commission (SEC), we understand that regulatory changes are likely to decrease requirements related to crypto assets and may lead to increased activity in the industry. Accordingly, we recommend it closely monitor the SEC's activities and potentially congressional activities because there could be a need for standard setting as a result of possible shifts in the regulatory environment. We believe the FASB should be in a position to respond quickly to such changes. Refer to our response to Question 4 in our Appendix for details.

Statement of cash flows

While we are not suggesting a specific project on the statement of cash flows, we encourage the Board to address the presentation in the statement of cash flows as part of each standard-setting project. New guidance that affects recognition and measurement concepts generally includes additional disclosure guidance. However, additional guidance addressing the impact on financial statement presentation, particularly for the statement of cash flows presentation, is generally more limited.

We believe consideration of how the principles in ASC 230, *Statement of Cash Flows*, would be applied in each new ASU improves the decision usefulness of information by enhancing comparability and mitigating diversity in practice that often develops during and after an ASU's implementation period.

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We would be pleased to discuss our comments with the Board or its staff at their convenience.

Very truly yours,

Ernst & Young LLP

Appendix – Responses to questions for respondents

Question 1: Please describe what type of stakeholder you (or your organization) are from the list below, including a discussion of your background and what your point of view is when responding to this ITC:

- a. Academic
- b. Investor, other allocator of capital, or other financial statement user, such as:
 - 1. Equity analyst: buy side
 - 2. Equity analyst: sell side
 - 3. Credit-rating agency analyst
 - 4. Fixed-income analyst
 - 5. Accounting analyst
 - 6. Quantitative analyst
 - 7. Portfolio manager
 - 8. Private equity
 - 9. Individual investor
 - 10. Lender
 - 11. Long-only focus
 - 12. Long/short focus
 - 13. Other
- c. Practitioner/auditor
- d. Not-for-profit (NFP) organization preparer
- e. Private company preparer
- f. Public company preparer
- g. Regulator
- h. Standard setter
- i. Other.

Practitioner/auditor – Ernst & Young LLP is a member firm of one of the largest multinational professional services organizations that provides assurance, consulting, strategy and transaction, and tax services to both public and private entities across a variety of industries.

Question 2: Which topics in this ITC, including those related to current technical and research agenda projects, should be a top priority for the Board? Please explain, including the following:

- a. Why there is a pervasive need to change GAAP (for example, what is the reason for the change)
- b. How the Board should address this topic (that is, the scope, objective, potential solutions, and the expected benefits and expected costs of those solutions)
- c. Why is this topic a top priority and what is the urgency to complete standard setting on this topic (that is, how quickly the issues need to be addressed).

We recommend that the Board prioritize the completion of the current projects on its technical agenda, as many of those projects are already underway and will be completed within the next year. We also recommend that the Board concurrently begins its standard setting process for the projects raised in its ITC discussed below.

Equity indexation and equity classification

We believe the Board should prioritize efforts to simplify the liabilities and equity guidance with a focus on the indexation and settlement criteria in order to achieve financial reporting outcomes that are more consistent and relevant. The guidance in ASC 815-40, *Derivatives and Hedging – Contracts in Entity's Own Equity*, is complex and difficult to navigate, and the financial reporting outcomes are often not well-understood by users of financial statements. Refer to our responses to Questions 13 and 14.

Guarantees

We believe there is uncertainty about whether an entity applies ASC 460, *Guarantees*, when it issues a warranty or guarantee on outcomes related or partially related to the entities' activities. We recommend the Board address this uncertainty since business models with these types of guarantees are becoming more prevalent. Refer to our responses to Questions 4 and 32 for additional views on guarantees.

R&D funding arrangements

We have observed an increase in the complexity of R&D funding arrangements in the last several years. If the Board decides to pursue a project on R&D funding and sales of future revenue arrangements, we recommend that it consider focusing on the types of arrangements most commonly evaluated under ASC 730-20 and ASC 470-10. We believe there are operable solutions that would reduce diversity in practice in this area. Refer to our response to Question 22.

Principal versus agent

We believe the Board should prioritize a project to simplify and clarify the application of the control principle to determine whether an entity is a principal or agent. In some sectors there is inconsistency in the conclusions reached on whether an entity is a principal or agent in specific transactions. This will help drive more consistent conclusions for similar facts. This evaluation currently requires significant judgment, which makes it more difficult to evaluate control over specified services, especially when multiple parties are involved in providing services to a customer. Refer to our response to Question 38.

Consolidation

We recommend the Board consider simplifying the guidance in ASC 810, *Consolidation*, by improving the current framework to a model premised on power and benefits by leveraging the aspects of the existing variable interest model. Simplifying the consolidation guidance through the principles of power and benefits that already exist in ASC 810 would reduce the complexity associated with a two-model framework. Refer to our response to Question 50.

Question 3: Are there financial accounting and reporting topics in this ITC that the Board should not address as part of its future standard-setting efforts? Please explain why not, such as there is no pervasive need to change GAAP, the scope would not be identifiable, or the expected benefits of potential solutions would not justify the expected costs.

We do not believe there is a widespread need to significantly revise current US GAAP related to share-based payment awards. We do not believe the Board should add a project to its technical agenda on requiring the remeasurement of equity-classified, share-based payment awards at fair value as of each reporting period until settlement. Refer to our response to Question 37.

The Board recently issued two separate ITCs asking for feedback from stakeholders. We said in our comment letter for the ITC on the recognition of intangibles that we do not believe there is a widespread need to significantly revise US GAAP related to intangibles. Similarly, we said in our comment letter for the ITC on financial key performance indicators (KPIs) that we do not believe the Board should add a project to its technical agenda on the disclosure of financial KPIs for business entities. We believe the Board's resources would be better directed toward improving other areas of financial reporting, rather than undertaking either of these projects.

Question 4: Are there any financial accounting and reporting topics beyond those in this ITC that should be a top priority for the Board to address? Please explain, including the following:

- a. The nature of the topic
- b. The reason for the recommended change
- c. Whether the topic is specific to a subset of companies, such as public companies, private companies, or NFPs, or specific to a certain industry
- d. How the Board should address this topic (that is, the scope, objective, potential solutions, and the expected benefits and expected costs of those solutions)
- e. What is the urgency to complete standard setting on this topic (that is, how quickly the issue needs to be addressed).

We believe the Board should prioritize projects in the areas discussed below, which are beyond those included in the ITC.

Accounting changes and error corrections

There have been questions in practice about the application of ASC 250, *Accounting Changes and Error Corrections*, including (1) whether a change in financial presentation is a change in accounting principle for purposes of applying ASC 250 and (2) how to evaluate whether an allowable alternative accounting principle is preferable. We recommend the FASB provide implementation guidance for applying ASC 250 in these areas due to the diversity in practice and limited authoritative guidance. We believe such clarifications could reduce cost and complexity for all entities.

Whether a change in financial presentation is a change in accounting principle for purposes of applying ASC 250

ASC 250 defines a change in accounting principle as a “change from one generally accepted accounting principle to another generally accepted accounting principle when there are two or more generally accepted accounting principles that apply or when the accounting principle formerly used is no longer generally accepted.” The distinction between a voluntary change in accounting principle and a reclassification is important because although both require retrospective application, a voluntary change in accounting principle can only be made if an “entity can justify the use of an allowable alternative accounting principle on the basis that it is preferable” (ASC 250-10-45-2), and for SEC filers, if a preferability letter is issued by the independent auditor. A reclassification does not require such an evaluation or letter.

We understand practice generally considers a change in financial statement presentation a voluntary change in accounting principle only when an applicable Codification topic addresses the classification/presentation of the item. For example, under ASC 740-10-45-25, penalties associated with an uncertain tax position may be classified as either an income tax expense or another expense classification based on an accounting policy election. However, questions often have arisen about whether changes in the classification between two acceptable key financial statement sections (e.g., reclassification of items included in the cost of sales to selling, general and administrative expense) and between two acceptable statements of cash flows categories (e.g., between operating and financing activities) are considered changes in accounting principle that would require a preferability evaluation.

We recommend the FASB clarify the definition of a change in accounting principle and clarify when a change in the financial statement presentation would be considered a change in accounting principle.

How to evaluate whether an allowable alternative accounting principle is preferable

Although there is some, albeit limited, targeted authoritative guidance on considering justifications for a voluntary change in accounting principle¹, there is no general guidance on how to evaluate the preferability of such a change. In practice, entities and auditors often refer to the Public Company Accounting Oversight Board’s Auditing Standard No. 2820, *Evaluating Consistency of Financial Statements* (AS 2820).

¹ Examples of targeted guidance within the Codification is generally limited to ASC 330-10-30-14 and ASC 250-10-55-1 noted below.

AS 2820, which could be a helpful starting point for the FASB, states that “the auditor should evaluate a change in accounting principle to determine whether:

- a. The newly adopted accounting principle is a generally accepted accounting principle,
- b. The method of accounting for the effect of the change is in conformity with generally accepted accounting principles,
- c. The disclosures related to the accounting change are adequate, and
- d. The company has justified that the alternative accounting principle is preferable.”

For purposes of evaluating paragraph 7(d) in AS 2820, entities and auditors often look to the targeted guidance in the Codification. For example, ASC 330-10-30-14, which discusses methods of costing inventory and offers some general guidance on preferability, states that “although selection of the method should be made on the basis of the individual circumstances, financial statements will be more useful if uniform methods of inventory pricing are adopted by all entities within a given industry.” Further, ASC 250-10-55-1 states that “preferability among accounting principles shall be determined on the basis of whether the new principle constitutes an improvement in financial reporting and not on the basis of the income tax effect alone.” In addition, the Board has provided views on preferability on accounting policies it may prefer (e.g., ASC 230-10-45-25 states that “In reporting cash flows from operating activities, entities are encouraged to report major classes of gross cash receipts and gross cash payments and their arithmetic sum—the net cash flow from operating activities (the direct method)”). Providing options in accounting and then providing views (within the Codification or in non-authoritative communications) may indicate or infer one approach is preferable and therefore limit the benefits of providing the option. Additionally, other than when the Board clearly labels an alternative acceptable accounting approach as a practical expedient to apply specific guidance, such communications could increase the risk of adding confusion among financial statements preparers and practitioners regarding which and when such views are preferable in the circumstances.

We recommend the FASB consider expanding the existing criteria to include those used in practice when determining whether a change in an accounting principle is preferable. These criteria often focus on (1) the existence of authoritative and non-authoritative guidance supporting an accounting change, (2) rationality, which includes conformity with broad concepts of accounting, consistency among components of an entity, suitability in light of business circumstances, plans, policies and practicability and (3) industry practice.

We also recommend the FASB consider providing guidance on how entities and auditors should weigh any criteria developed. We currently observe that these non-authoritative criteria are not applied consistently in practice.

Guarantees

We have observed diversity in practice when determining (1) what an entity is guaranteeing and (2) how to measure such guarantee when the consideration to be received in the future is both variable and net settled. We recommend the Board address this diversity, which may be confusing to investors, since business models with these types of guarantees are becoming more prevalent.

For example, an entity may provide certain services (in the scope of ASC 606, *Revenue from Contracts with Customers*) to a third party and guarantee a specified reduction to the customer's total operating costs. That is, the scope of the guarantee is broader than the guarantee of the entity's own performance under the provided services. Contractually, the guarantor is entitled to consideration for any savings relative to a benchmark based on historical total operating costs and is required to pay any costs in excess of the benchmark.

We observe some entities define and measure the fair value of the guarantee based on the view that the scope of the guarantee covers the total expected future operating costs (i.e., the guarantor is obligated to cover any costs incurred by the third party, even though a significant portion of that would be covered by the implied premium, which is net settled against the costs incurred). Other entities may define and measure the fair value of the guarantee based on the amount they expect to pay out, if any, in excess of the savings benchmark (i.e., the guarantee is identified and measured following the form of settlement).

The fair value of the guarantee in the latter approach would be significantly smaller than the former approach (and may be zero if there is an expectation the benchmark savings would be met). Additionally, any consideration the entity receives under the latter approach, if and upon achieving the cost savings against the benchmark, is often then allocated to the ASC 606 services (rather than to the ASC 460 related guarantee income).

The difference in the fair value described above results in the recognition of significantly different amounts of guarantee (and ASC 606) related income and costs associated with the guarantee. This may be confusing to investors.

Accounting for digital assets

We acknowledge the American Institute of Certified Public Accountants (AICPA) for its successful efforts to develop crypto asset accounting guidance through its Digital Assets Working Group. The nonauthoritative crypto asset accounting guidance in the AICPA's Practice Aid, *Accounting for and auditing of digital assets* (AICPA digital asset guide) is widely applied in areas of crypto asset accounting that US GAAP does not address.

We believe this AICPA guidance addresses critical accounting issues for crypto assets, as the market for crypto assets is evolving faster than the standard setting related to crypto assets. We recommend the FASB codify the AICPA digital asset guide so it has a starting point in the Codification to address these accounting areas. Codifying the AICPA digital asset guide would allow the FASB to quickly respond to the evolving regulation of crypto assets through its standard-setting process.

Question 13: If the FASB were to make targeted improvements to the liabilities and equity guidance in Subtopic 815-40, would you support those changes if they significantly changed current financial reporting outcomes? For example, would you support accounting for more contracts indexed to an entity's own equity as equity as compared with today? Please explain.

Question 14: What targeted improvements, if any, to the liabilities and equity guidance in Subtopic 815-40 should the FASB consider making? For example, should the improvements focus on the indexation guidance in the Scope and Scope Exceptions Section of Subtopic 815-40, the settlement guidance in the Recognition Section of Subtopic 815-40, or both? Please explain.

We support the FASB's continuous efforts to simplify its guidance on liabilities and equity, with a focus on indexation and settlement, which would result in more consistent and relevant financial reporting outcomes. The guidance in ASC 815-40 is complex and difficult to navigate, and the financial reporting outcomes are often not well understood by users of financial statements. In addition, this guidance is a primary driver of diversity in practice and frequent restatement issues and often results in liability and fair value measurement accounting for equity-linked instruments. As such, we believe the FASB should prioritize making targeted improvements to the liabilities and equity accounting framework in ASC 815-40 in order to address the most pervasive issues that cause challenges in practice.

As the Board continues to explore opportunities to improve the decision usefulness and relevance of information about contracts indexed to an entity's own stock, it is important that the Board focus on the needs of users of financial statements. Through the FASB's projects on distinguishing liabilities from equity and its stakeholder outreach over the years, we understand that users would prefer a simple accounting model for such contracts (often referred to as equity-linked instruments). They have said that accounting for these contracts as liabilities subject to fair value measurement on an ongoing basis creates unnecessary income statement volatility associated with changes in the value of an entity's own share price that is less relevant. They also indicated that the cash flow and dilution effects of those contracts would be more relevant information for their analyses.

Accordingly, we strongly urge the FASB to add separate projects to its agenda that would focus on making targeted improvements to (1) Step 2 of the indexation guidance under ASC 815-40-15 and (2) the equity classification guidance under ASC 815-40-25.

Step 2 of the indexation guidance in ASC 815-40-15

We have provided the FASB staff with a technically feasible solution for improving Step 2 of the indexation guidance that aligns with the FASB's agenda criteria and supports the goal of allowing more equity-linked instruments to qualify as indexed to an entity's own equity than those that are today. We believe a technically feasible solution would be to ignore adjustments in the evaluation unless the adjustments are extraneous to the instruments. We welcome the opportunity to discuss our recommended solution to Step 2 of the indexation guidance in more detail.

Equity classification in ASC 815-40-25

ASC 815-40-25 provides guidance to determine whether an instrument that is indexed to the issuer's own stock should be classified in equity. That determination depends heavily on how the instrument settles and whether an acceptable form of settlement is entirely within the control of the issuing entity. The guidance is applied without regard to the probability of events occurring that require the issuer to net cash settle an instrument, which often result in accounting that is counterintuitive. We believe there are technically feasible solutions that could address the complexity in financial reporting by adding a threshold to the evaluation (e.g., disregard a settlement provision unless the contingency that triggers the settlement provision is "more-likely-than-not") or disregard certain common settlement provisions that trigger net cash settlement (e.g., cash settlement upon a change of control transaction or a business combination). We welcome the opportunity to provide practical suggestions for refining the equity classification framework.

We suggest the FASB consider enhancing its guidance on redeemable equity instruments, currently addressed in ASC 480 and the SEC guidance (codified in ASC 480-10-S99). One practical solution could be for the FASB to codify the SEC's redeemable equity guidance, which would make sure all entities consistently apply a model that is well understood and has been applied in practice for a long time. As part of this process, the FASB could also consider making targeted improvements to this guidance, as there are aspects of the guidance that could be improved and better aligned with the existing codification.

Question 15: Should the FASB consider revising the hedge accounting model? If so, what core aspects of the hedge accounting model should be amended or removed to allow hedge accounting to more accurately reflect the economics of an entity's risk management activities? Please describe why and how those core aspects should be amended or why they should be removed.

We are supportive of the FASB considering revisions to its hedge accounting model. While its targeted improvements to the guidance in recent years (through ASU 2017-12 and the imminent ASU on hedge accounting improvements) serve to better align the hedging model with the entities' risk management activities, the application of hedge accounting for certain economically viable hedge strategies remains challenging. In addition, as acknowledged during the FASB's 26 March 2025 meeting, the Board's ability to achieve certain desired outcomes through targeted improvements is often limited due to the restrictive nature of certain key principles in the hedge accounting model.

As such, we agree with the FASB Chair's recent decision to add a project on hedge accounting to the research agenda and are supportive of the FASB developing a preliminary views document to outline the parameters of a revised hedge accounting model. We believe the FASB staff should identify, as part of this process, what they believe the primary objectives of such a model to be. This would provide direction on the nature and extent of changes that may be needed to certain existing principles in the current guidance.

As part of the FASB's research project, we believe the FASB staff should research alternatives such as eliminating many of the existing limitations on what can be designated as an eligible hedged item. This would increase the types of risk mitigation strategies that qualify for hedge accounting, allowing entities to more accurately reflect the economics of their risk management activities in the financial statements, without the need for non-GAAP measures.

Question 17: How often is the TDR guidance in Subtopic 470-60, Debt–Troubled Debt Restructurings by Debtors, applied? Does the TDR guidance for borrowers continue to be relevant and provide decision-useful information to investors? Is it possible for borrowers to determine the fair value of restructured debt in a TDR? Do you foresee any challenges in determining the fair value of restructured debt when a borrower’s financial difficulty results in other market participants being unwilling to lend to that borrower under the terms of the restructured debt? Are there other alternatives to improve the TDR guidance for borrowers that should be considered? Please explain.

Question 18: If borrowers were required to measure restructured debt at fair value, should interest expense be recognized? If yes, when should it be recognized and how should it be calculated? Please explain.

The troubled debt restructuring (TDR) guidance in ASC 470-60 is the first step in the accounting framework that is required for debtors to analyze debt restructurings. Upon assessment, debt restructurings typically would not be subject to the recognition and measurement requirements in the TDR guidance. However, when this guidance is applicable, it is difficult to apply because it is outdated for many debt instruments that exist today. In addition, we suspect that the information provided when the TDR guidance is applied is not overly relevant or clearly understood by users of financial statements.

The Board recently amended the accounting for TDRs by creditors through the issuance of ASU 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*. ASU 2022-22 eliminated the recognition and measurement guidance for TDRs by the creditors but retained and enhanced related disclosure requirements.

We believe it is important for the Board to seek investor feedback as it considers enhancements to the financial reporting of TDRs by borrowers. Accordingly, we recommend the FASB Chair add a project to the research agenda to solicit investor input on potential changes to this guidance, including whether enhanced disclosures would meet investors’ information needs. If the Board decides to undertake a project, one approach it could consider, based on investor feedback, would be to align the accounting models for debtors and creditors in TDRs by eliminating the recognition and measurement guidance in ASC 470-60 and requiring debtors to apply the guidance in ASC 470-50, *Debt–Modifications and Extinguishments*, to all debt restructurings.

We believe having a single model would potentially simplify the accounting for debt restructurings, reduce complexity and address practice issues that have arisen under the current TDR model, which has not been updated or kept pace with the development of instruments subject to its requirements.

Applying ASC 470-50 to debt restructurings that would otherwise be accounted for under ASC 470-60 may result in more restructured debt being subject to extinguishment accounting. This would require entities to recognize the restructured debt at fair value on the restructuring date.

However, we are not aware of challenges in practice related to measuring restructured debt at fair value in a TDR. We generally believe it is feasible for borrowers to determine the fair value of the restructured debt in a reasonable manner, as fair value principles are well-understood and similar valuations are already required in other areas of financial reporting.

Question 22: Are there challenges in determining whether a funding arrangement should be accounted for as an R&D funding arrangement or a sale of future revenue? If the FASB were to pursue a project on R&D funding and sales of future revenue arrangements, what types of arrangements should be included in the scope of the project? Please explain.

R&D funding arrangements involve entities that provide funding in exchange for cash flows tied to the success of the R&D and those that seek alternative forms of funding for ongoing or planned R&D. We have observed an increase in the number and complexity of these arrangements in the last several years.

The guidance on R&D funding arrangements, issued as Financial Accounting Standards (FAS) No. 68 in 1982 and codified in ASC 730-20, and on the sale of future revenue in ASC 470-10 addresses a narrower set of facts than those of the arrangements that exist today.

The most common types of arrangements we see in practice today include (1) passive, alternative funding R&D arrangements where one party provides funding to the entity performing R&D activities related to its intellectual property (IP) and/or operations and (2) collaborative arrangements where the funding entity is actively involved in the R&D. Generally, repayment under these types of arrangements depends solely on the results of the R&D having a future economic benefit through sales-based royalties, regulatory milestones and/or sales-based milestones.

We have observed several accounting challenges associated with such arrangements, including:

- ▶ Identifying the applicable accounting topic for each party to the arrangement, including when more than one topic may apply (e.g., ASC 730-20, ASC 808, ASC 606, ASC 470-10, ASC 310)
- ▶ Accounting for subsequent milestone payments based on the results of the R&D when the recipient of the funds accounts for the arrangement as a contract to provide services
- ▶ Subsequently measuring and/or derecognizing a financial liability recognized by the recipient of the funds
- ▶ Determining the appropriate accounting model to apply to amounts paid and received by the funding entity when the arrangement is in the scope of ASC 730-20

In practice, if an arrangement is determined to be in the scope of ASC 730-20, the parties evaluate whether there has been a substantive and genuine transfer of the risk associated with the R&D activities to the funding entity. If it is determined that the arrangement is a financing (i.e., the risk has not substantively transferred to the funding entity), the recipient of the funds may apply other guidance to account for the financing (e.g., sale of future revenue in ASC 470) since ASC 730-20 does not provide recognition and measurement guidance for obligations to repay the funding party.

We have observed issues when these arrangements are accounted for by the entity receiving funding as debt or deferred income under ASC 470 because the current model lacks comprehensive guidance on initial recognition, subsequent measurement, derecognition and disclosures of the liability. This has led entities to apply more general guidance on debt (e.g., ASC 405 and ASC 835), which has resulted in diversity in practice such as when:

- ▶ Evaluating the “significant continuing involvement in the generation of the cash flows” factor in ASC 470-10-25-2 and determining what constitutes significant continuing involvement
- ▶ Using different interest methods when updating recurring estimates of the timing and amount of the cash flows payable to the financing party when accounted for as a financing, due to the lack of fixed contractual cash flows

The current model also lacks explicit derecognition principles. In practice, entities apply the general principles in ASC 405, under which derecognition occurs upon legal extinguishment. Determining the point of legal extinguishment for these arrangements is often unclear, resulting in liabilities reported on the balance sheet for years, even when there are no anticipated future cash flows due to the funding entity. For example, if an entity sold future royalties related to an in-process IP but the IP is not commercialized, the estimated future royalties are less than the initial funding because cash flows are no longer due to the funding entity.

We believe there are feasible solutions that would reduce diversity in practice. A project that limits the scope of the guidance to passive, alternative funding R&D arrangements may help address some diversity in outcomes. One approach could include developing a model for alternative funding arrangements separate from or as a replacement of the sale of future revenue guidance. If the FASB decides to pursue a project, we recommend that it consider a reciprocal model that would provide guidance for parties that receive or provide the funding.

We believe limiting the scope would better align practice for collaborative arrangements where the funding entity is actively involved in the R&D. Such arrangements are typically more akin to service contracts and should not be in scope of ASC 730-20.

Question 32: What are the types of guarantees, if any, that lead to uncertainty about whether to apply the guidance for guarantees or revenue recognition? How pervasive are these guarantees? How should an entity account for these guarantees? Please explain.

Uncertainty about whether to apply ASC 460 often arises when an entity issues a “warranty” or guarantee on outcomes related or partially related to activities performed by the entity. In these cases, the activities performed by the guarantor could be viewed as (1) mitigating its own risk under the guarantee it issued (i.e., it is not transferring a good or service to the customer), (2) guaranteeing its own performance under a service provided to the customer, which is a scope exception in ASC 460-10-15-7(i) or (3) a combination of both.

These guarantees are common when there are multiple parties involved in transferring a good or service to a customer (e.g., if the entity were to conclude it is in the scope of ASC 606, it would need to determine whether it is a principal or an agent), including for entities that provide payment or marketplace platforms, health care coordination services and verification services.

For example, an entity with a marketplace platform that is acting as an agent may verify the quality of a product sold on its website and take on the risk of loss of the value of the product for insufficient quality. As another example, a health care or health-care-focused technology entity may perform certain limited health care services and/or care coordination services but take on the risk of loss for all health care services (e.g., including emergency, specialty) related to a group of assigned patients.

However, these guarantees also exist in a two-party arrangement.

We recommend that the Board clarify what it means to guarantee an entity's own performance. This would help clarify whether the entity should account for these guarantees under ASC 460 or ASC 606.

Question 37: If the FASB were to pursue a project to align the initial and subsequent measurement of share-based payment awards, how should the awards be initially and subsequently measured? Please explain, including the objective of the measurement and whether and how changes to the subsequent measurement of share-based payment awards would improve the decision usefulness of the information provided to investors.

We believe a project to require the remeasurement of equity-classified, share-based payment awards at fair value as of each reporting period until settlement (i.e., aligning the initial and subsequent measurement for both equity-classified and liability-classified share-based payment awards) would result in significant increased cost and complexity for preparers.

For certain share-based payment awards, fair value measurement can be complex (e.g., when observable market prices of awards are not available, when awards include market conditions) and often require significant estimation and judgment. By requiring a fair value measurement at each reporting period, rather than only upon initial measurement, preparers would need to spend significant time and effort to update valuations each reporting period.

We do not believe the benefit of more decision-useful information being provided to investors would outweigh the additional cost to preparers in this case, especially given the significant level of disclosures related to share-based payment arrangements already required.

Question 38: What challenges, if any, do entities encounter in evaluating whether they are acting as a principal versus an agent? Are there instances where the accounting does not appropriately reflect the economics of the transactions? Please explain, including the pervasiveness of those challenges, the industries and transactions for which the accounting could be improved, and whether and how those challenges and improvements could be addressed through standard setting.

Determining whether an entity is a principal or an agent in a revenue transaction remains challenging as entities apply ASC 606, especially when multiple parties are involved in providing services to a customer. Despite significant efforts by the FASB, regulators and other stakeholders to provide interpretive guidance, the application of the control principle in ASC 606 to a principal versus agent evaluation requires substantial judgment because control is not as binary as the standard contemplates. Entities may arrive at inconsistent conclusions due to different interpretations of the same or similar facts.

This issue continues to be prominent in e-commerce business models, such as platform companies, financial technology companies and online marketplaces, as well as risk-based contracts involving multiple service providers in the health care industry. In these sectors, the relationships between multiple parties involved in providing the services are complex, and the contractual rights and obligations may not exist between all parties. This adds to the difficulty in evaluating control over specified services.

Simplifying the application of the control principle to determine whether an entity is a principal or agent would help drive more consistent conclusions for similar facts. Currently, nuances in facts may lead to different financial reporting results that may not be meaningful to users of financial statements. We believe there are different ways that are technically feasible for the Board to simplify the guidance to enhance consistency in applying the control principle. We believe that these solutions would improve financial reporting to investors and the costs to implement the changes would not be significant and therefore we recommend that it add a project to address these concerns.

Question 39: Should the FASB consider requiring entities to recognize variable consideration when the underlying triggers have been reached? If so, should that change apply to all entities or a subset of entities (for example, entities that earn commission-based revenue)? Would this provide better information for investors' analyses? Please explain.

We believe the Board should consider a narrow-scope project to address variable payments where the variability extends over multiple future years and is highly susceptible to factors outside the entity's influence. For example, an insurance broker may have contracts with an insurance carrier to broker policies under which it satisfies its performance obligation upon the initial sale of a policy, with a commission paid to the broker based on a percentage of the policy premium. The broker may also be entitled to an additional commission upon future policy renewals. In this scenario, the broker estimates this variable consideration and includes it in the transaction price upon the initial sale of the policy (subject to a constraint), resulting in the recognition of a portion of revenue related to anticipated trailing commissions at that time. While the broker may have experience with similar contracts, this experience may not be indicative of the future renewals, especially during periods of economic uncertainty.

Contracts with this type of variable consideration create significant challenges for entities applying ASC 606. Entities may prepare probability-weighted estimates of future cash flows for business purposes, which would not be recorded as revenue upon the satisfaction of the performance obligation if the entity cannot assert that it is probable that a significant reversal of cumulative revenue recognized will not occur once the uncertainties about the variable consideration are resolved.

The following are several factors in the insurance broker example described above that increase the likelihood and magnitude of a significant revenue reversal: (1) the amount of variable consideration may be highly susceptible to factors outside the broker's control, (2) the resolution of the uncertainty about the amount of consideration may not occur for a long period of time and (3) across a cohort of individual policies, there may be a large number of possible consideration amounts. In addition, the determination of what constitutes a significant revenue reversal will change over time, because cumulative revenue recognized at policy inception may be lower compared with subsequent periods.

The revenue recognized for variable payments with characteristics similar to those in the insurance broker example provides less relevant information to users of financial statements due to the inherent volatility in the estimates and level of subjectivity involved in applying the constraint over multiple years. A similar point was observed by the Board in ASU 2014-09² related to contracts to license intellectual property with consideration based on a customer's subsequent sales or usage. We believe that one possible solution can be to extend the exception for sales- and usage-based royalties on licenses of intellectual property to trailing commissions and other similar variable payments anticipated over multiple future periods. There are also other technically feasible solutions for the Board to consider.

Question 50: Should the FASB prioritize a project to develop a single consolidation model? If yes, should the FASB leverage the guidance in IFRS 10, the VIE model, or the voting interest entity model as a starting point? If the FASB should not prioritize a single consolidation model, should the FASB make targeted improvements to better align the current voting interest entity and VIE guidance, including simplifying the determination of whether an entity is a VIE or a voting interest entity? Please explain.

We believe that the Board should prioritize a project to simplify the consolidation guidance in ASC 810. The concept of a variable interest entity (VIE) was created in FIN 46³ in early 2003 to address consolidation considerations for highly structured entities. The notion of a variable interest is a concept introduced by the FASB and is only considered in the consolidation guidance in ASC 810 and is not referenced elsewhere in the application of US GAAP. Under FIN 46, the variable interest model was based on a mostly quantitative analysis to determine whether a reporting entity had a controlling financial interest. Since then, while certain aspects of the original variable interest model remain, it has evolved to a mostly qualitative analysis based on power and benefits to determine which party has a controlling financial interest.

We believe that today's consolidation guidance is challenging to apply because ASC 810 requires a reporting entity to consider both the variable interest model and the voting interest model to determine whether it has a controlling financial interest. The guidance requires a reporting entity to first evaluate whether the legal entity being evaluated for consolidation is a VIE in determining whether the VIE or voting interest model should be applied.

This evaluation can often be complex and require significant judgment, leading to increased costs of applying the guidance. We believe that the Board should simplify ASC 810 through an improvement to the current framework to a model premised on power and benefits by leveraging many of the aspects of the existing variable interest model. Such a change would significantly reduce the cost and complexity of applying the guidance for all reporting entities. For example, a simplified model could remove the requirement to identify a VIE before determining whether a reporting entity should consolidate another legal entity, removing the distinction between a VIE and voting interest entity.

² Paragraph BC415 of ASU 2014-09.

³ FASB Interpretation No. 46, *Consolidation of Variable Interest Entities – an interpretation of ARB No. 51*

We do not believe this would result in a pervasive change to consolidation conclusions, because a power and benefits model would not be expected to significantly change the consolidation conclusions for most voting interest entities. However, we acknowledge that in some circumstances conclusions may change since the model for evaluating a controlling financial interest under the variable interest model and voting interest model is different. For example, under the voting interest model, a reporting entity is precluded from consolidating another legal entity if the noncontrolling interest holder holds substantive participating rights (based on the voting interest entity definition). However, if the same legal entity were evaluated under the variable interest model, the reporting entity may conclude it has power over the entity's significant activities and therefore has a controlling financial interest.

As the FASB considers a cost-benefit analysis of potential changes, it will be important for the Board to not only consider adoption costs but also the reduction in ongoing costs associated with applying the current two-model framework. The adoption costs may be more limited for many entities, since it may be readily apparent that their consolidation conclusion will be the same under both the VIE model and voting interest model. In addition, this improvement would provide investors with a uniform framework, because consolidation would be premised on consistent principles (i.e., power and benefits) for determining a controlling financial interest. We believe a consistent framework would provide a cost benefit to investors because it enhances understandability and alleviates complexity associated with a two-model framework.

If the Board decides to prioritize a project on the consolidation model, we recommend that it also perform outreach with investors to determine whether the current disclosure requirements for VIEs provide decision-useful information and be maintained or be revised through targeted improvements.