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Invitation to Comment, *Agenda Consultation* (File Reference No. 2021-004)

Dear Ms. Salo:

We appreciate the opportunity to provide feedback on the Invitation to Comment (ITC), *Agenda Consultation*, and commend the Financial Accounting Standards Board (FASB or Board) for its thorough and thoughtful approach in deciding which financial reporting topics to add to its technical agenda. We believe that a transparent process is critical to provide investors and other marketplace participants with confidence in how the Board continues to allocate its limited resources to achievable standard-setting projects. A public process to solicit input on the technical agenda helps the Board fulfill its mission to improve financial accounting and reporting standards and address the topics that are the highest priority of its stakeholders.

Now that the Board has completed many of its major standard-setting projects, we believe it has an opportunity to consider its direction for the next few years and recommend that it focus its efforts on:

- ▶ Completing critical projects already on the FASB technical agenda
- ▶ Monitoring implementation of recently completed major standard-setting projects¹
- ▶ Addressing key areas identified through the ITC process with targeted and achievable standard-setting projects
- ▶ Continuing to prioritize outreach initiatives and enhancing the communication of feedback received

Since the Board has a limited number of resources to allocate to standard-setting activities, we recommend that it strike the right balance when deciding which projects to undertake. We encourage the Board to prioritize the completion of critical projects currently on its technical agenda and then take on some of the topics identified in the ITC to address stakeholder concerns over complexities that exist in the application of GAAP, accounting for transactions in emerging areas and disaggregation of financial information. We also support enhancing the Board's internal processes.

¹ These projects include Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, ASC 842, *Leases* and ASC 326, *Financial Instruments – Credit Losses*.

Completing critical projects

There are currently a number of projects on the technical agenda, some of which have been active for several years. We believe completing certain projects is more critical than completing others because there are pervasive practice issues that need to be resolved through standard setting that will also increase the decision usefulness of information. For example, we believe the FASB's current projects on Distinguishing Liabilities from Equity Phase 2 and Identifiable Intangible Assets and Subsequent Accounting for Goodwill should remain a top priority.

Monitoring implementation of recently completed major projects

The FASB's recently completed projects on revenue recognition, leases and credit losses have had significant effects on the financial accounting and reporting by all companies. We believe that the FASB's post-implementation review (PIR) process² is a critical aspect of its overall standard-setting process. The Board should continue to devote adequate resources to monitor the implementation of these major standards to determine whether their objectives are being met and identify areas of diversity in practice and implementation issues.

To date the PIR process has been effective in meeting its three main objectives of determining whether the standard has accomplished its purpose; evaluating implementation, including compliance costs and related benefits; and providing feedback to improve the standard-setting process. We recommend that implementation issues identified be assessed to determine whether immediate standard setting is required. Since it may take several years to complete all three stages of the PIR process, we believe that, depending on the nature of the issues identified, recommendations for potential areas of standard setting should be raised to the Board on a more timely basis. In the Appendix, we highlight two issues related to the revenue standard (principal versus agent considerations and accounting for licenses of intellectual property (IP)) that should be a top priority and addressed in the near term.

Addressing key areas identified through the ITC process with targeted standard setting

While the ITC highlights several topics on which the Board is requesting feedback, we believe that the addition of the following two topics to the technical agenda should be a top priority:

- ▶ *Definition of a derivative* – We recommend adding a project to address practice issues stemming from the application of the definition of a derivative in Accounting Standards Codification (ASC or Codification) 815-10, *Derivatives and Hedging – Overall*. We believe that either the current definition should be revised to narrow the applicability of the guidance or the list of scope exceptions should be expanded to include contracts where derivative accounting may not result in the best financial reporting.

² We support the decision of the Financial Accounting Foundation's Board of Trustees to embed the PIR process in the FASB's standard-setting process. Because the FASB is more directly involved in the development of each new standard and has engaged in outreach initiatives with stakeholders throughout the standard-setting process, we believe that it not only has the technical expertise but also the perspective necessary to perform such reviews.

- ▶ *Consolidation* – We recommend adding a project to simplify the guidance in ASC 810, *Consolidation*, by creating a single, comprehensive model. We believe that the current guidance is unnecessarily complex and requires entities to consider two different models to reach a conclusion regarding consolidation.

In the Appendix, we provide our responses to the applicable topic-specific questions the Board raised in the ITC and our recommendations on each of the potential areas of focus outlined therein.

Continuing outreach and enhancing communication

We commend the FASB for continuing to prioritize outreach initiatives with key stakeholder groups, including investors. We believe the Board's focus on obtaining stakeholder input during each stage of the standard-setting process, including the agenda decision process, has enhanced the quality of standard-setting initiatives by providing users of the financial statements with better, more decision-useful information. Therefore, we encourage the Board to continue to seek feedback from user and preparer groups to gain greater insights into the types of information that are needed but aren't currently presented.

We also encourage the Board to consider how to better communicate the results of outreach initiatives, particularly its outreach to investors. The FASB recently published an investor outreach report and established a FASB investor web portal. While these are positive steps, we believe more can be done. For example, the Board could include a more robust discussion of user input in the Background Information and Basis for Conclusions sections of future Accounting Standards Updates. We believe that stakeholders would benefit from this information, and it would lead to greater transparency in the standard-setting process and specifically, in the cost-benefit analyses.

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We would be pleased to discuss our comments with the Board or its staff at its 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. Lender
 10. Long-only focus
 11. Long/short focus
 12. Other
- c. NFP organization preparer
- d. Practitioner/auditor
- 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 should be a top priority for the Board? Please explain your rationale, 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 potential project scope, objective, potential solutions, and the expected costs and benefits of those solutions)
- c. What the urgency is of the Board completing a project on this topic (that is, how quickly the issues need to be addressed).

We recommend that the Board continue to prioritize the following projects on its current technical agenda:

► Distinguishing Liabilities from Equity Phase 2

We believe that the Board should prioritize the Phase 2 project on Distinguishing Liabilities from Equity and other targeted improvements to the liabilities and equity guidance. There is an urgent need for the Board to make targeted improvements in certain areas of the liabilities and equity accounting framework to increase the decision usefulness and relevance of information about equity-linked financial instruments and at the same time reduce the complexity in applying the accounting literature. The challenges that have been encountered in applying the guidance in ASC 815-40, *Derivatives and Hedging – Contracts in Entity's Own Equity*, to issuances of equity-linked financial instruments have highlighted the need for such improvements.³

For example, to determine the appropriate classification of these instruments, preparers and practitioners not only need to interpret complex and extensive accounting guidance, they also need to understand valuation principles to (1) determine whether settlement amounts paid in certain specified scenarios would represent the fair value of the instrument and (2) understand whether settlement amounts paid in other settlement scenarios appropriately compensate the holder for lost time value. Also, due to the complexity of the guidance in ASC 815-40, the application of which is driven by the legal form of an instrument rather than its substance, legal counsel is often necessary to interpret complex agreements.

In addition, many of the provisions in these instruments that caused them to be classified as liabilities are only triggered in scenarios that have a low or remote likelihood of occurrence. Reporting these instruments as liabilities and measuring them at fair value on an ongoing basis does not reflect the economics of the instruments and the likely settlement amounts or form of settlement (i.e., cash or shares).

More importantly, we understand based on discussion with Board members and staff that financial statement users find it difficult to understand what drives one instrument to be classified in equity versus another to be classified as a liability. The complexity in the accounting model and the resulting financial reporting of these instruments call into question the usefulness of the information provided and highlight the need for simplification.

As a result, we urge the Board to prioritize targeted improvements in the liabilities and equity guidance, in particular the Board's Phase 2 project on Distinguishing Liabilities from Equity, which should be completed in the near term. Refer to our response to Question 23 for a further discussion of potential solutions.

³ An example of the challenges in applying the guidance in ASC 815-40 relates to its application to certain warrants issued by special purpose acquisition companies (SPACs), which has resulted in a number of restatements after the Securities and Exchange Commission (SEC) staff issued a statement on 12 April 2021 calling into question the classification of these warrants as equity rather than a liability. This example highlights the complexities and judgment involved in applying the accounting guidance in ASC 815-40 to various types of instruments.

► Fair Value Hedging – Portfolio Layer Method

We believe the FASB's current project on Fair Value Hedging – Portfolio Layer Method is a priority project that should remain on the technical agenda. As noted in our comment letter on the proposed Accounting Standards Update (ASU), *Derivatives and Hedging (Topic 815): Fair Value Hedging – Portfolio Layer Method* (File Reference No. 2021-002), we support the Board's proposal to expand the existing last-of-layer fair value method from a single-layer model to a multiple-layer model and to clarify the accounting for and disclosure of basis adjustments associated with these hedges.

We believe this proposal is consistent with the FASB's efforts to improve its hedge accounting model by enabling entities to better portray the economics of their risk management activities in their financial statements. Allowing entities to apply hedge accounting to multiple layers in a closed portfolio, rather than just a single layer, is more consistent with the risk management strategies that would be employed by most entities, particularly financial institutions that routinely seek to hedge portfolios of financial instruments.

In addition, we believe this project should be completed in the near term. Many financial institutions have delayed applying the last-of-layer method introduced in ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, until various issues associated with this approach have been addressed by the FASB, including the ability to apply hedge accounting to multiple layers in a closed portfolio and the effect of fair value hedge basis adjustments when considering the impairment of financial assets within the closed portfolio.

► Identifiable Intangible Assets and Subsequent Accounting for Goodwill

We believe that completion of the FASB's current project on Identifiable Intangible Assets and Subsequent Accounting for Goodwill should remain a priority. As noted in our comment letter,⁴ we question the relevance of the information provided by the current goodwill impairment model because we believe that acquired goodwill diminishes in value over time. In addition, the subsequent accounting for goodwill is often a complex and time-consuming exercise that begs the question of whether the benefits of the current model justify the cost. We support a model that (1) requires goodwill amortization over a default period, since this would capture the diminution of value over time, and (2) only requires goodwill impairment testing upon a triggering event.

We encourage the Board to continue deliberations and outreach in this area as part of its effort to develop a model that will reduce complexity, while maintaining the usefulness of information provided to users of financial statements.

⁴ See Ernst & Young LLP Comment Letter, *Identifiable Intangible Assets and Subsequent Accounting for Goodwill* (File Reference No. 2019-720), for more detail on our views on this topic.

► Post-Implementation Review: Credit Losses, Leases, Revenue Recognition

We believe that the PIR process is an important quality control mechanism within the overall standard-setting process that provides an efficient and effective way to monitor the ongoing application of new standards and identify the need for additional standard setting or implementation guidance to improve operability, reduce cost and address unintended consequences.

While we encourage the Board to continue its PIR processes for the credit losses, leases and revenue recognition standards, we believe that there are two specific aspects of the revenue recognition guidance that should be prioritized and addressed before the completion of the PIR process. These include the guidance in ASC 606 on principal versus agent considerations and accounting for licenses of IP.

Principal versus agent considerations

Determining whether an entity is a principal or an agent in a revenue transaction continues to be challenging as entities apply ASC 606, especially when two or more parties are involved in providing services to a customer. Recently, we have observed many of these transactions in emerging e-commerce business models and in the health care industry. We believe the FASB and its staff should reevaluate the principal versus agent guidance in light of these market changes. This guidance at times is not clear about how to apply the judgment required by the standard, and as a result, companies with the same or similar fact patterns can reach different conclusions.

We acknowledge that the complexity of determining whether an entity is acting as a principal or agent already existed in legacy revenue guidance and continues to exist in ASC 606. The FASB, regulators and other stakeholders have engaged in a robust effort to provide implementation and interpretive guidance for ASC 606 to address potential diversity in practice. Despite the significant effort to promote common application of the standard, we note that entities may not always be applying the control principle consistently to services, which may compromise the quality of revenue information provided to investors.

We observe that valuation methods commonly use revenue-based metrics to value entities operating in the emerging technology industry, including e-commerce platform companies. Metrics used to value these entities, or support the valuation of these entities, may include peer group revenue multiples, average revenue per user, monthly recurring revenue, revenue run rate and average order value. As such, inconsistencies in the application of the control principle between entities may result in differences in presentation of revenues and could affect valuations of entities with emerging business models.

Examples of entities for which the existing guidance is difficult to apply include e-commerce platform companies, financial technology (Fin-Tech) companies and managed health care companies. In these examples, an entity provides a service to a customer but requires the involvement of other parties to provide that service. In addition, there are often complex relationships between the parties, and not all of the rights and obligations of the parties are evidenced by contractual arrangements. Therefore, an entity's evaluation of whether it controls the specified service may be unclear or complex.

In addition, while the indicators of control in ASC 606-10-55-39 are designed to assist with the evaluation, they are not determinative because the services may be provided instantaneously (inventory risk assessment) and involve multiple parties and contracts present in many of these transactions (primary responsibility for fulfillment). Further, the identification of an entity's customer or customers can be complex in these arrangements and potentially different between entities with seemingly similar fact patterns. We also observe that platform companies may encounter challenges in appropriately classifying their incentive payments to end consumers (i.e., as contra revenue or sales and marketing expense), particularly when the end consumers are not customers.

Accounting for licenses of IP

We have observed continuing challenges in the accounting for term-based software licenses in the technology industry. The application of ASC 606 generally results in term-based software licenses being considered functional IP,⁵ which grants a right to use the entity's IP, and revenue is generally recognized at the point in time when the IP is made available for the customer's use and benefit. The restriction of time is generally determined to be an attribute of a license of IP that does not affect the recognition of revenue for the license granted. We have observed that the licensing guidance in ASC 606 is complex and can be costly for preparers in the technology industry to apply. This is because term-based software licenses are generally sold with post-contract customer support (referred to as PCS or support) and may also be sold with promises to provide software as a service (SaaS or cloud services).

The cost and complexity of applying the guidance in ASC 606 primarily relates to identifying performance obligations, allocating the transaction price to the identified performance obligations and accounting for contract modifications. We believe that the Board should consider whether term-based software licenses should be considered a right to access the license over the license term rather than a right to use functional IP. We believe this would reduce the cost and complexity of applying the guidance and increase comparability between similar term-based software licensing contracts, since software licenses would be recognized over time rather than at a point in time. We have not observed challenges in the accounting for perpetual software licenses; therefore, our observations are limited to the accounting for term-based software licenses.

We believe that projects related to the following topics should be added to the technical agenda:

- ▶ Definition of a derivative: scope exceptions

We believe that the Board should add a project to address practice issues related to the application of the definition of a derivative in ASC 815-10, including the application of its various scope exceptions. An instrument or arrangement that meets the definition of a derivative in ASC 815-10 and does not qualify for a scope exception is required to be subsequently measured each reporting period at fair value, with changes in fair value reported in earnings, unless the instrument or arrangement qualifies and is designated as a hedging instrument.

⁵ Paragraph BC56 of ASU 2016-10.

As further discussed in our response to Question 9, given the broad definition of what qualifies as a derivative instrument in ASC 815, we have observed many arrangements that seem to meet the definition of a derivative, where subsequent measurement at fair value may not be the best financial reporting for those arrangements. The application of the definition of a derivative and the available scope exceptions to these arrangements are complex and have resulted in diverse views on how the guidance should be applied.

Refer to our response to Question 9 for further discussion of how we believe the Board can address these issues. We believe there is a need for guidance in the near term because these transactions occur frequently.

► Simplification of consolidation guidance

We believe that the Board should prioritize a project to simplify the consolidation guidance in ASC 810. We acknowledge that the Board issued a proposed ASU, *Consolidation (Topic 812): Reorganization*, to reorder the guidance in ASC 810 into separate subtopics on the variable interest entity (VIE) and voting models. However, we do not believe the Board should move forward with the proposal because its benefits would not outweigh its costs, and the proposal does not address the complexity within the VIE model.

We continue to believe that the FASB should create a single comprehensive consolidation model to reduce the cost and complexity of applying the guidance for all entities.⁶ We believe that today's guidance is challenging to apply because ASC 810 requires entities to consider both the VIE model and the voting model to determine whether a reporting entity has a controlling financial interest.

The current model requires all entities in scope to first be evaluated for consolidation as potential VIEs before determining the primary beneficiary, which is identified based on power and benefits. This is unlike IFRS 10, *Consolidated Financial Statements*, which requires all entities to be evaluated for consolidation based on a single control model and also focuses on power and benefits. That is, IFRS 10 does not first require identification of a VIE or structured entity to determine whether a reporting entity should consolidate another entity.

We believe that IFRS 10 could be a starting point for a new model (i.e., a single control model), but the Board would need to address certain aspects of the IFRS 10 model that may not work well in the US environment (e.g., potential voting rights, *de facto* control, related party considerations). We also believe the Board should address the complexity that arises in US GAAP when there are different requirements depending on whether a legal entity is a VIE, such as determining the accounting acquirer, or measuring the net assets upon initial consolidation of a VIE that represents an asset acquisition.

If there were a single model for identifying a controlling financial interest (i.e., if the concept of a VIE were eliminated), we would recommend that the Board perform outreach with investors to determine whether the required disclosures that exist today for VIEs should continue to be required.

⁶ See Ernst & Young LLP Comment Letter, *Consolidation (Topic 810): Principal versus Agent Analysis* (File Reference No. 2011-220), for more detail on our views on this topic.

Question 3: Are there topics in this ITC that the Board should not address as part of its future standard-setting efforts? Please explain your rationale, 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 that the Board should pursue a project to create a model for the recognition and measurement of government grants for business entities. Stakeholder feedback summarized in the ITC indicates that there is diversity in practice due to the lack of guidance for business entities. In our experience, business entities typically analogize to IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, rather than other accounting models, such as ASC 958-605, *Not-for-Profit Entities – Revenue Recognition*. This is likely because IAS 20 was created for government assistance and provides a reasonable, easily understood accounting model with disclosure requirements. It also includes guidance on the accounting for forgivable loans, a common form of government assistance.

Further, IAS 20 provides an appropriate level of judgment in how to present the financial statement impacts (e.g., between revenue and contra-expense for grants related to income) depending on the nature of the government assistance. While this level of judgment may contribute to the perception of diversity, it allows business entities to present government assistance in a manner that provides meaningful information to a user.

In addition to the above noted topic included in the ITC, there are projects on the technical agenda that we believe should be reconsidered.

Conceptual Framework

We believe the Conceptual Framework project continues to be important because the framework may inform the decisions the FASB makes in standard setting and will promote the consistent application of concepts within the standards. However, we recommend that the Board reassess the scale of this project and focus its efforts on alignment with the revised Conceptual Framework for Financial Reporting issued by the International Accounting Standards Board (IASB) rather than continuing to independently draft a conceptual framework. We believe that in addition to a better allocation of resources, alignment with the IASB's revised conceptual framework will significantly reduce the time to complete the project and promote increased comparability of accounting standards used internationally.

Improving the Accounting for Asset Acquisitions and Business Combinations

The objective of this project is to improve the accounting for asset acquisitions and business combinations by narrowing the differences in the accounting for the two types of transactions. Although the topic is broad and there are several differences between accounting for asset acquisitions and accounting for business combinations, the current scope of the project is fairly narrow. Areas currently covered by the project include the accounting for contingent consideration, transaction costs and the subsequent accounting for contingent consideration and in-process research and development (IPR&D) upon the initial consolidation of a VIE that is not a business under ASC 810.

Given the narrow scope of the project, we believe its completion should not remain a priority. As an alternative, the Board could expand the scope to include other topics related to asset acquisitions for which there is limited guidance in the Codification, as well as include acquired IPR&D in asset acquisitions once again in the scope.

Question 4: Are there any financial reporting topics beyond those in this ITC that should be a top priority for the Board to address? Please describe:

- a. The nature of the topic
- b. The reason for the 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 potential project scope, objective, potential solutions, and the expected costs and benefits of those solutions)
- e. What the urgency is of the Board completing a project on this topic (that is, how quickly the issues need to be addressed).

Refer to our response to Question 2 above.

Question 5: The objective of this ITC and the related 2021 Agenda Consultation process is to ensure that the FASB continues to allocate its finite resources to standard-setting activities that fulfill its primary mission of improving financial accounting and reporting standards and that are of the highest priority to its stakeholders. Therefore, feedback on the prioritization of projects on the FASB's technical agenda (see Appendix A) would be helpful.

Do you have any feedback on the FASB's technical agenda, including the following:

- a. Which projects on the FASB's agenda should the Board prioritize completing? Please explain.
- b. Which projects, if any, should the Board deprioritize or consider removing from the agenda? Please explain.
- c. Which projects, if any, need to be redefined to improve the objective and/or scope? Please explain.

We believe that the Board should prioritize completion of the following projects currently on the agenda (in alphabetical order):

- ▶ Distinguishing Liabilities from Equity Phase 2
- ▶ Fair Value Hedging – Portfolio Layer Method
- ▶ Identifiable Intangible Assets and Subsequent Accounting for Goodwill

In addition, we encourage the Board to continue its PIR processes for the credit losses, leases and revenue recognition standards. However, as noted in our response to Question 2, we recommend that the Board address principal versus agent considerations and accounting for licenses of IP before it completes its PIR process.

While there are other projects currently on the technical agenda that we believe are valuable and that the Board should work to complete, we have focused our comments on projects that we believe require more immediate attention, are new or emerging issues, or are projects we anticipate will require a significant amount of effort to complete. For further details, including a discussion of new projects that we believe should be added to the technical agenda, refer to our responses to Questions 2 and 3 above.

Question 6: Greater disaggregation and granularity of the types of financial reporting information described in Chapter 1 have been identified as decision useful to investors. The following insights would be helpful to the FASB when considering this area:

- a. Investors and other financial statement users—Which, if any, of the areas described in Chapter 1 should be a top priority for the FASB to consider requiring greater disaggregation—on the income statement, the statement of cash flows, or the notes to financial statements? Would this information be most useful in the financial statements or in the notes to financial statements? How would this information be used to analyze a company and make capital allocation decisions?
- b. Preparers—What requests or questions does your company receive from analysts on the areas described within Chapter 1? Please explain any requests or questions your company has received.

We commend the Board's responsiveness to stakeholders' request to consider standard-setting projects that address disaggregation of financial reporting information. We recommend that the Board focus on the needs cited by investors and other financial statement users in their responses to this ITC and continue outreach efforts with investors to gain a greater appreciation for their concerns and views on the type of disaggregated information that they believe should be included in the financial statements before initiating a project.

Question 7: Investors and other financial statement users—What cash flow information, if any, required for your analysis is missing in a statement of cash flows prepared using the indirect method? How would this information influence your decisions and behavior? Please explain.

We commend the Board's responsiveness to stakeholders' request to consider a project that would enable investors to gain greater insight from a company's statement of cash flows. Consistent with our response to Question 6, we recommend that the Board focus on the needs cited by investors and other financial statement users in their responses to this ITC and continue outreach efforts with investors to gain a greater understanding of their concerns and views on the type of improvements to the presentation that would be helpful before initiating a project.

Question 9: What challenges, if any, are there in applying the guidance on the definition of a derivative and the related derivative scope exceptions in Subtopic 815-10? Please explain the challenges and whether and how they could be addressed through standard setting.

While the FASB has made significant changes to simplify hedge accounting through the issuance of ASU 2017-12, it has not revisited the definition of derivative, including a comprehensive look at updating scope exceptions to derivative accounting, in many years. The last significant change in this area was made through Statement of Financial Accounting Standards (SFAS) 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, which, among other things, clarified the definition of an “underlying.” This guidance added the phrase “including the occurrence or nonoccurrence of a specified event such as a scheduled payment under a contract” to explain what was meant by the phrase “or other variable” in the first sentence of paragraph 7 of Statement 133, which is codified in ASC 815-10-20.

Although the Board did not anticipate that this change would have a significant impact on the definition of a derivative, in practice it has led to contracts that are not traditionally considered to be derivative instruments meeting the definition, where initial and subsequent measurement at fair value may not be the best financial reporting for those contracts. Some of these examples include:

- ▶ Guarantees of nonfinancial items (there is a specific scope exception in ASC 815 for financial guarantees)
- ▶ Guarantees provided by platform companies for transactions that occur on the platform (e.g., a platform where buyers and sellers come together and the platform company provides a performance guarantee to the buyer even if the buyer is not its customer as defined in ASC 606)
- ▶ Research and development funding arrangements primarily in the pharmaceutical industry, where contract payoff is based on the occurrence or non-occurrence of an event (such as Food and Drug Administration approval)⁷
- ▶ Litigation funding arrangements where contract payoff is based on monetary compensation received as a result of litigation

SFAS 133 (codified in ASC 815) initially had provided a long list of scope exceptions where the Board either did not believe fair value accounting would be appropriate (e.g., normal purchase normal sales contracts) or where other applicable guidance for these contracts existed (e.g., share-based payments, insurance contracts).

In a potential project, the Board could address the issues surrounding the definition of derivative in a variety of ways. It could revisit the definition by focusing on aspects of the definition of a derivative, such as the definition of an underlying, or when a notional or payment provision would be considered determinable at the inception of the contract.

⁷ Similar provisions also exist in contingent consideration arrangements for the sale of assets.

If the Board believes a project to change the definition of a derivative is too broad in nature, it could instead revisit the list of scope exceptions for contracts where derivative accounting may not be the best financial reporting. The Board has done this in the past when it has been made aware of contracts that technically meet the definition of a derivative, but the Board believes other guidance may better reflect these transactions (e.g., the scope exception provided for certain fixed-odds wagering contracts).⁸ If the Board considers the scope-exception approach, we believe it should consider various contract types, such as those noted above, and determine whether a different accounting model would be more appropriate.

Question 11: Preparers and practitioners—Does your company (or companies that you are involved with) hold significant digital assets, such as crypto assets? What is the purpose of those holdings?

In recent years, we have observed that a small but increasing number of clients hold or transact in digital assets. These transactions primarily occur in the form of crypto assets (e.g., bitcoin). Most of these entities hold crypto assets as an investment rather than use them in their ongoing operations. Other entities may engage in crypto-asset transactions such as trading, borrowing or lending crypto assets, maintaining custody of crypto assets, or facilitating purchases or sales of crypto assets by others through trading platforms.

Question 12: If the Board were to pursue a project on digital assets, which improvements are most important, what types of digital assets should be included within the scope, and should this guidance apply to other nonfinancial assets?

We believe the Board's outreach to users to understand the nature of information they need on digital assets and related activities would be an important step to set the objectives for the project and develop a standard that accomplishes the desired objectives. We encourage the Board as part of its outreach effort to ask users what information they need and better understand (1) how the users will use the information and (2) what effect that information would have on users' behavior.

If the Board were to pursue a project on digital assets, we believe it could consider a narrow-scope project or a series of projects to address the accounting for a subset of issues associated with digital assets. The Board could address three to five of the most critical issues that users believe are important. A broad-based digital asset project would take too long to complete. Given that the digital asset market continues to evolve, identifying the scope for a broad-based project would be challenging. In addition, extensive stakeholder outreach would be needed throughout the standard-setting process to develop a broad-based digital asset project that responds to investor needs and is feasible for preparers to apply.

We understand that some stakeholders would support a narrow-scope project to provide an option to apply a fair value measurement for digital assets that have certain characteristics and are traded in active markets. We believe such a project would be achievable in the near term and meet the needs of users. It would also give the Board an opportunity to seek input on whether additional disclosures are necessary for entities that invest in digital assets.

⁸ ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*.

Question 13: Are there common ESG-related transactions in which there is a lack of clarity or a need to improve the associated accounting requirements? Please describe the specific transactions and why standard setting is needed.

Our firm has been a strong supporter of private-sector efforts to help companies meet the growing needs of their investors and other stakeholders for decision-useful environmental, social and governance (ESG) information. While the primary focus of these efforts has been on the reporting of ESG metrics, we recognize that there is currently a lack of specific guidance on the accounting for certain environmental transactions (e.g., emissions credits), which has led to diversity in practice.

Although we have not experienced a significant increase in the number of inquiries on the accounting for any one type of ESG-related transaction, we support the Board's effort to seek input from users as a critical first step in understanding the challenges of accounting for these types of transactions and the nature of the financial statement disclosures that would be informative.

Question 14: Are there common financial KPIs or metrics—either widely applicable to all companies or industry specific—that would provide decision-useful information if they were defined by the FASB? Please explain.

Non-GAAP financial measures, including financial key performance indicators (KPIs), provide an alternative source of information, and management may disclose them to help investors better understand a company's operating performance, cash flows or financial position. Common non-GAAP measures include earnings before interest, taxes, depreciation and amortization (EBITDA); free cash flow (FCF); and, for real estate investment trusts, funds from operations. Companies also may adjust other GAAP measures or further adjust common non-GAAP measures to exclude, for example, nonoperating gains and losses, restructuring charges, integration costs, share-based payment expense, impairment charges, or gains and losses from asset dispositions.

While non-GAAP measures are commonly included in filings with the Securities and Exchange Commission (SEC) and in earnings releases to highlight how management measures performance of an entity, we do not believe the FASB should pursue a project to define these measures.

If the purpose of a project to define certain non-GAAP measures is to address a lack of consistency in adjustments to common KPIs, undertaking standard setting in this area would not prevent a company from disclosing adjustments to those defined metrics to accomplish the same disclosure objective. For example, if the Board were to define EBITDA, a company could still disclose adjusted EBITDA, as long as its communications complied with the SEC rules. Conversely, we note that we have not observed significant diversity in these calculations that would warrant standard setting.

Under Item 10(e) of Regulation S-K, when a company presents a non-GAAP measure in an SEC filing, including an earnings release furnished on Form 8-K, it is required to present, with equal or greater prominence, the most directly comparable financial measure calculated and presented in accordance with GAAP and numerically reconcile the non-GAAP financial measure to the most directly comparable GAAP measure. Regulation G requires these same criteria to be met when a non-GAAP measure is made public orally, telephonically, by webcast or by other means. In addition, under Item 10(e), management is required to disclose why it believes the non-GAAP measure is useful to investors.

Question 15: If the FASB were to define certain financial KPIs or metrics, should all companies be required to provide those metrics or should providing those metrics be optional?

See response to Question 14.

However, if the Board decides it is necessary to define a common financial KPI, disclosure of that metric should be optional.

Question 16: If the Board were to pursue a project on the recognition and measurement of government grants, should the FASB leverage an existing grant or contribution model (such as the models in IAS 20 or Subtopic 958-605) or develop a new model? If you prefer leveraging an existing model, which would be most appropriate and why? If the FASB were to develop a new model, what should the model be?

We do not believe that the Board should pursue a project to create a model for the recognition and measurement of government grants for business entities. Refer to our response to Question 3 for more information.

Question 17: The FASB has encountered challenges in identifying a project scope that can be sufficiently described for government grants. If the Board were to pursue a project on the recognition and measurement of government grants, what types of government grants should be included within the scope and why (for example, narrow or broad scope)?

While we don't recommend the Board do so, if it were to pursue a project on the recognition and measurement of government grants for business entities, we believe that the scope should be broad and include all forms of government grants that are not already in the scope of other ASC topics (e.g., cash grants, forgivable loans, non-income tax credits). We do not agree with the stakeholder feedback summarized in the ITC that tackling only a subset of government assistance, such as cash grants, would "represent an incremental improvement." Creating partial models for differing types of government grants would only add confusion and complexity to this topic. For example, business entities would still need to determine an accounting policy for non-cash government grants and may continue to apply IAS 20 to other forms of government assistance.

Question 18: The FASB has encountered challenges in identifying a project scope that can be sufficiently described for intangible assets. If the Board were to pursue a project on intangible assets, what types of intangible assets should be included within the scope and why? Within that scope, should a project on intangible assets be primarily focused on improvements to recognition and measurement or to disclosure?

As noted in our comment letter on the 2016 Invitation to Comment, *Agenda Consultation* (File Reference No. 2016-290), we believe that a project on the accounting for intangible assets is not necessary and that pursuing such a project and making significant changes to the guidance could be challenging. However, with respect to digital assets that are accounted for as intangible assets, please see our responses to Questions 11 and 12.

If the Board decides to focus on improvements to intangible asset disclosures, we encourage it to seek further feedback on what additional disclosures, if any, would be helpful to financial statement users and how such disclosures would be used. Understanding how investors and other users of the financial statements would use this information could help the Board consider whether to proceed with any new disclosure requirements.

Question 19: What challenges, if any, exist in applying the capitalization thresholds in Subtopics 350-40 and 985-20? What improvements, if any, could be made to the software capitalization guidance to overcome those challenges? Should there continue to be a capitalization threshold when accounting for software depending on whether it is for internal use or whether it is to be sold, leased, or otherwise marketed? Please explain.

Changes to software development practices have made the guidance in ASC 350-40 and ASC 985-20 more challenging for some entities to apply. For example, many entities apply an “agile” development approach, which typically involves breaking down software development into a focused set of objectives (e.g., a new feature or elements of a new feature) that are developed simultaneously in a series of short, time-bound development iterations (or sprints). Under an agile approach, activities such as planning, coding, development and testing are iterative and often occur very quickly within each sprint (as opposed to the traditional linear waterfall approach that typically consists of well-defined, consecutive phases).

Under ASC 350-40, the preliminary project stage activities typically do not take place as a separate stage or activity under an agile development approach. Rather, the preliminary project stage efforts are often integrated into a series of sprints, meaning that these activities often occur simultaneously with coding and development. Similarly, under ASC 985-20, the planning and design work necessary to establish a comprehensive product design and a detail program design are often performed concurrently with coding and development throughout a series of sprints.

For entities applying an agile development approach, determining when the capitalization threshold is met for software developed for internal use or when technological feasibility is established for software to be sold or licensed can be difficult. This is further complicated by the iterative nature of the development. Significant judgment and detailed tracking are often necessary to determine whether a sprint or series of sprints (e.g., if there are functional interdependencies between sprints) results in the capitalization of costs (under either standard).

We believe the Board should consider whether targeted updates to the guidance are necessary to clarify when capitalization thresholds are met. For example, the Board could consider whether the stages of computer software development under ASC 350-40 should be revised to better reflect the software development life cycle and when the threshold for capitalization is achieved. Since significant judgment is often required to determine when the preliminary project stage is complete, the Board may consider whether the criteria in ASC 350-40-25-12 are sufficient to determine when to begin capitalization (or if updates to the criteria are necessary).

Alternatively, the Board could consider adding implementation guidance (to each standard) to provide examples of how to apply the current guidance when the costs are incurred in an iterative or agile development environment. Added examples could also address some of the considerations applicable to the agile development environment (e.g., evaluating whether interdependencies between sprints

exist to identify the appropriate unit of account). Additional outreach with preparers may be necessary to further understand the complexities of current software development methods beyond determining when costs qualify for capitalization.

In general, we believe that there should continue to be a capitalization threshold in each of the standards. However, updating the guidance to align better with current software development practices would reduce complexity in applying the current guidance and promote consistency in determining when capitalization thresholds have been achieved. We do not believe that eliminating the capitalization thresholds (i.e., requiring all costs to be capitalized) would result in a significant improvement to financial reporting. Although eliminating the threshold to capitalize costs may reduce complexity, it would likely result in other costs to preparers, including challenges related to subsequent measurement (e.g., impairment, amortization).

Question 20: Should the Board prioritize a potential project on current and noncurrent classification of assets and/or liabilities in a classified balance sheet? If yes, what should be the scope? Please explain.

We do not believe that the Board should prioritize a potential project on current and noncurrent classification of assets and/or liabilities in a classified balance sheet. We have not observed many practice issues relating to this topic, except for those relating to the guidance in ASC 470-10, *Debt – Overall*, on the classification of debt and with respect to derivatives.

Further, we note that the Board recently removed a project on simplifying the balance sheet classification of debt from its technical agenda because the proposed amendments would not achieve the objective of the project and would result in replacing current cost and complexity with new cost and complexity. While the complexity in ASC 470-10 remains, we believe that there are more pressing practice issues in other areas of GAAP (e.g., challenges in applying the liabilities and equity guidance) that should take priority.

Question 21: Should the Board prioritize a potential project to simplify the consolidation guidance in Topic 810? Please explain why or why not. If yes, should the approach focus on targeted improvements or a holistic review of Topic 810?

Refer to our response to Question 2.

Question 22: What challenges, if any, exist in accounting for debt modifications in accordance with the guidance in Subtopic 470-50, *Debt–Modifications and Extinguishments*? Please explain the challenges and how they could be overcome through standard setting.

We have observed several challenges in accounting for debt modifications in accordance with ASC 470-50, *Debt – Modifications and Extinguishments*, and ASC 470-60, *Debt – Troubled Debt Restructurings by Debtors*. In particular, we observe that the guidance in ASC 470-50 and ASC 470-60 has not kept pace with the development of instruments that are subject to them. Some of the practice challenges are:

- ▶ *Unit of analysis when there are multiple debt arrangements between the same debtor and creditor:* The guidance in ASC 470-50 and ASC 470-60 does not specify whether the analysis should be applied on an instrument-by-instrument basis or creditor-by-creditor basis. This determination requires judgment, resulting in diversity in practice.

- ▶ *Modifications or exchanges of credit facilities that contain both term loans and revolving lines of credit:* For example, whether a debtor should apply the 10% cash flow test under ASC 470-50-40-10 through 40-12A or compare the borrowing capacity of the original versus new arrangement under ASC 470-50-40-21 through 40-23 to evaluate the modification.
- ▶ *Modifications or exchanges of convertible debt with bifurcated conversion options:* The guidance in ASC 470-50 related to the change in fair value of a conversion option and the addition or deletion of a substantive conversion option is limited to modifications or exchanges of convertible debt instruments in circumstances in which the embedded conversion is not separately accounted for as a derivative before the modification, after the modification or both. There is no guidance for a modification or an exchange of a convertible debt instrument with an embedded conversion that is separately accounted for as a derivative under ASC 815 or as an equity component because, for example, the convertible debt instrument is issued at a substantial premium under ASC 470-20, *Debt – Debt with Conversion and Other Options*.
- ▶ *Modifications or exchanges involving public debt issuances:* ASC 470-50-55-3 states that for purposes of applying the debt modification guidance for a public debt issuance, the debt instrument is the individual security, and the creditor is the security holder. However, in many cases it may be difficult to identify the investors (lenders) in the old and/or new debt. For example, in a refinancing of public debt, there may be investors that both held the old debt and invested in the new debt, resulting in the contemporaneous exchange of cash between the same creditor and debtor as discussed in ASC 470-50-40-9. Determining this fact may be difficult given the number of potential investors involved.

Companies generally know how to apply the existing guidance on debt modifications or exchanges, including the 10% cash flow test. Therefore, we do not recommend a broad project to reconsider the principles in ASC 470-50 and ASC 470-60. However, the Board could pursue a narrow-scope project to address the practice issues identified above.

While we recognize the practice challenges in the accounting for debt modifications or exchanges mentioned above, other more pressing accounting issues (e.g., challenges in applying the liabilities and equity guidance) should take priority. Therefore, we would not recommend any standard setting in this area in the near term.

Question 23: Stakeholders noted many challenges in applying the liabilities and equity guidance, but they had mixed views on how the Board should improve the accounting for financial instruments with characteristics of equity. The Distinguishing Liabilities from Equity Phase 2 project is intended to align the two existing indexation models in Topic 480 and Subtopic 815-40. Should the Board continue pursuing this project in its current scope and objective, or does the Board need to reevaluate this project? Please explain why or why not and if the project scope and objective need to be reevaluated, what should the approach be?

As noted in our response to Question 2, we urge the Board to prioritize targeted improvements in the liabilities and equity guidance that would reduce complexity and increase the decision usefulness and relevance of information about equity-linked financial instruments. We would support the Board continuing to pursue its Phase 2 project on Distinguishing Liabilities from Equity, which aims to improve and align the existing indexation models in ASC 480, Distinguishing Liabilities from Equity, and ASC 815-40. The Board also should consider further simplifying the settlement guidance in ASC 815-40.

We continue to believe that the classification of an instrument should focus on the economic substance of transactions (rather than the form) and, therefore, encourage the Board to consider alternative approaches that would include a threshold for determining the effect of events or features that could adjust settlement amounts and/or require net cash settlement on the accounting for equity-linked instruments or features. In connection with its Phase 1 project on Distinguishing Liabilities from Equity, the Board considered a remote likelihood threshold to the indexation and equity classification guidance in ASC 815-40 in an effort to improve the guidance on the derivative scope exception. The Board had significant open questions about whether a “remote” threshold would be operable and, therefore, decided not to proceed with the proposed amendment.

However, if the Board continues on its path of targeted improvements, we recommend that it consider a “more-likely-than-not” threshold to prevent features that are not “more likely than not” to affect the settlement amount from affecting the classification of an instrument. While “more likely than not” and “remote” are both probability thresholds, we believe a “more-likely-than-not” threshold would be easier to apply than a “remote” threshold. This would still provide for classification that more appropriately reflects the economic substance of an instrument, and it would simplify the model.

If the Board determines that requiring a threshold in evaluating the classification of an equity-linked instrument or feature is operationally challenging, consistent with the view we expressed in our comment letter on the proposed ASU, *Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in Entity’s Own Equity* (File Reference No. 2019-730), we recommended that the Board require entities to disregard certain common triggering events that haven’t yet occurred, regardless of their probability of occurring.

That is, entities should be required to disregard, for purposes of classification, certain triggering events, such as a change of control, a business combination or a subsequent round of financing, until the event occurs. This approach is also consistent with the Board’s decision on down round features when it issued ASU 2017-11, *Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*.

Question 24: How helpful would it be in evaluating disclosure materiality if the materiality guidance in paragraph 105-10-05-06 that “the provisions of the Codification need not be applied to immaterial items” was repeated in the Disclosure Section of each Codification Subtopic? Please explain.

We believe that the materiality guidance in ASC 105-10-05-06 that states that the provisions of the Codification, which include disclosure requirements, do not need to be applied to immaterial items is generally understood by preparers and practitioners. Therefore, we do not believe it would be necessary or helpful for evaluating disclosure materiality to repeat that guidance in the disclosure section of each Codification subtopic.

Question 25: Which, if any, of the FASB processes described in Chapter 4 of this ITC could be improved? Please explain your rationale for each, including the following:

- a. Why that process needs improvement
- b. How the FASB should improve that process
- c. What the urgency is of that process improvement.

Codification accessibility

We believe that it is important that resources be widely and easily accessible to all stakeholders so the Board can fulfill its mission to “establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports and educate stakeholders about how to most effectively understand and implement those standards.”⁹

Currently, the functionality and navigability of the basic view of the Codification makes it difficult for many users, preparers and practitioners to easily access the information they need. Further, the annual subscription fee associated with the professional view of the Codification, which is the superior viewing option and allows users to filter for pending content, use “go to” navigation, and join and combine content, may be cost prohibitive for many stakeholders. Therefore, we recommend the Board make the professional view of the Codification available to all users free of charge.

In addition, it would be helpful, especially in today’s work environment, for users to be able to access the Codification in a user-friendly format regardless of their physical proximity to a computer. Therefore, we recommend that the FASB develop an app that would allow users to view content on their phones or tablets. Similarly, we believe this app should be free to download for all users.

Cost-benefit analysis framework

We believe that the FASB’s cost-benefit analysis is a key aspect of its standard-setting process and commend the Board’s commitment to issue new or amended standards only when the expected benefits of the change justify the costs, including costs to prepare, provide and understand that information.

While the due process activities undertaken throughout the various stages of a project are designed to generate feedback about the costs and benefits of the proposed guidance from stakeholders representing a broad range of capital market participants (including investors, analysts, donors to nonprofit organizations, financial statement preparers, auditors, academics and other interested parties), findings are discussed broadly, and often responses from preparers are grouped with those from practitioners.

To have an accurate representation of the cost-benefit analyses performed, we believe feedback should be assessed and discussed discretely for preparers and practitioners. Because feedback from these constituents may vary by stakeholder group, particularly feedback about costs expected to be

⁹ *Strategic Plan, April 2015* by the Financial Accounting Foundation, the FASB and the Governmental Accounting Standards Board.

incurred, we believe that breaking out cost-benefit considerations discretely for preparers and practitioners would promote transparency and provide stakeholders with better insight on how the Board analyzes this information.

Interpretive process

We recommend that the Board consider establishing an additional process to provide stakeholders with timely and transparent interpretations of GAAP. While both the Emerging Issues Task Force (EITF or Task Force) and the Technical Inquiry Service were designed to respond to time-sensitive matters, we believe that the EITF's reliance on standard setting slows the interpretive process and the lack of transparency in the technical inquiry process could lead to inconsistencies in responses and result in diversity in the application of the guidance by stakeholders.

We believe that if the Board decides to reconsider the EITF's operating procedures, it should consider using the Task Force in a capacity similar to that of the IFRS Interpretations Committee, which was established by the IASB to provide guidance on the application and interpretation of IFRS. Any stakeholder can submit to the IFRS Interpretations Committee an inquiry, which is subsequently considered at a public meeting. Submissions may result in the IFRS Interpretations Committee (1) developing an IFRIC Interpretation, which provides additional requirements to existing IFRS; (2) recommending that the IASB develop a narrow-scope amendment to the applicable IFRS standard(s); or (3) more commonly, issuing an agenda decision that explains how the applicable principle and requirements of the IFRS standards apply to the fact pattern and is subject to public comment before being finalized.

We believe that the IFRS Interpretation Committee's process of issuing agenda decisions is a more efficient way to assist stakeholders seeking interpretations, particularly in situations in which a stakeholder is requesting a confirmatory answer rather than a change to a current guidance. Further, the process promotes transparency and seeks input from stakeholders, including investors, before final decisions are issued. In the past five years, the IFRS Interpretations Committee has issued 84 agenda decisions addressing stakeholder concerns, while the EITF has reached a consensus on 11 issues.

If the Board were to pursue this path, we recommend that EITF decisions be maintained in the Codification, consistent with SEC materials, to allow for easy access by users. Further, if the Board has concerns about making EITF interpretations publicly available without going through the lengthier due process that is undertaken to issue new guidance, we believe that the decisions could be deemed non-authoritative, if necessary, and still be decision-useful for stakeholders.

Other

We recommend that the Board publish the memorandums (memos) prepared and distributed to Board members in advance of regularly scheduled meetings. Because these documents contain robust background on the issues or projects being discussed, as well as thoughtful analyses prepared by the staff, it would be helpful for stakeholders to be able to use them as reference materials either prior to or following Board meetings. Although meeting handouts are publicly available, they do not contain the same level of detail regarding the projects on the meeting agenda.

Further, memos are currently publicly available for any joint projects, projects undertaken by the Private Company Council and EITF projects. We believe that it would be equally beneficial to and helpful for stakeholders' understanding of complex issues if the memos prepared in connection with Board meetings were published.