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October 21, 2024

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

Via Email to director@fasb.org

Re: File Reference No. 2024-ED100

Dear Mr. Day:

Grant Thornton LLP appreciates the opportunity to comment on Proposed Accounting Standards Update (ASU), *Derivatives and Hedging (Topic 815) and Revenue from Contracts with Customers (Topic 606): Derivatives Scope Refinements and Scope Clarification for a Share-Based Payment from a Customer in a Revenue Contract*.

Overview of our comments

Issue 1: Derivatives scope refinements

We support the addition of a scope exception to ASC 815 that would exclude from derivative accounting contracts with underlyings based on operations or activities specific to one of the parties to the contract, although we believe that certain clarifications are necessary to ensure this scope exception is operable.

We do not believe the proposed predominant characteristics assessment for contracts with multiple underlyings is operable, and we encourage the Board to reconsider an alternative approach whereby a contract would be accounted for as a derivative if any individual underlying does not qualify for any of the scope exceptions in ASC 815-10-15-59.

It is not clear to us how other guidance in the Codification would apply to certain contracts that would be newly excluded from the scope of ASC 815 based on application of the proposed guidance, and we believe the Board should consider

whether there are additional implementation issues, particularly related to non-derivative accounting for certain R&D funding and litigation funding arrangements.

Issue 2: Scope clarification for a share-based payment from a customer in a revenue contract

We support the proposed amendments to ASC 606 clarifying that an entity receiving a share-based payment from a customer under a revenue contract should recognize the share-based payment once the entity's right to receive or retain the share-based payment is no longer contingent on satisfaction of a performance obligation.

However, in practice we observe that it is not uncommon for noncash consideration to include a combination of the following four complexities – the noncash consideration (1) is variable, (2) is accumulating (tranche-based), (3) vests upon something other than the entity's satisfaction of its performance obligation and/or (4) vests only upon the entity satisfying its performance obligation, but, the pattern of vesting differs from the pattern of revenue recognition. It remains unclear how the proposed amendments will apply to these common features included in revenue contracts.

We have included two common examples observed in practice and identified various interpretations that we observe in trying to apply the proposed guidance as presently written. We encourage the Board to update the proposed amendments to ensure the proposed amendments address fact patterns such as these with sufficient clarity so as to limit diversity in practice.

Our responses to the questions in the proposed ASU

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

We believe the proposed scope exception is responsive to stakeholder feedback indicating that financial statement users do not benefit from entities reporting as derivatives arrangements such as contracts to fund research and development (R&D) and litigation, and certain features embedded in hybrid financial instruments such as environmental, social and governance (ESG) -based payment provisions.

We agree with the Board's decision to amend the scope of ASC 815 based on a principle – underlyings based on operations or activities specific to one of the parties to the contract – rather than attempting to exclude from the scope of ASC 815 specific types of contracts or features.

We believe that the proposed scope exception, combined with the proposed amendments to the predominant characteristics assessment, will exclude from the scope of ASC 815 certain embedded conversion and redemption (put and call) features, as described in paragraphs BC16 and BC17, that are contingent on events specific to one of the parties to the host contract, such as a change in control. We are

not aware of stakeholder concerns with current practice that requires such features to be separated from the host contract and accounted for as derivatives, provided that the features are not clearly and closely related to the host contract and do not qualify for an existing scope exception from ASC 815.

We are concerned that excluding all such features from the scope of ASC 815 might change practice in a way that goes beyond the feedback from stakeholders regarding ESG-linked payment provisions and funding arrangements with contingent payoffs. As described further in our responses to Questions 3 and 4, we believe that the alternative approach described in BC31, whereby a contract would be accounted for as a derivative if any individual underlying does not qualify for any of the scope exceptions in ASC 815-10-15-59, will likely alleviate this concern.

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

We believe the proposed scope exception is clear and operable, although in our view certain elements of the proposed guidance should be clarified.

First, we note that the proposed scope exception encompasses underlyings based on financial metrics, including those derived from amounts presented in the financial statements and components of those amounts. On the other hand, the proposed scope exception excludes variables based on the price or performance of a financial asset or financial liability of one of the parties to the contract.

We believe the proposed scope exception could produce inconsistent outcomes when the underlying is a financial metric that incorporates, without being exclusively based upon, the price of a financial asset or financial liability of one of the parties to the contract. For example, the financial statement metric “total liabilities” would incorporate the fair value of a financial liability measured at fair value on the statement of financial position, as could other metrics such as current or noncurrent assets or liabilities. This would be of particular concern in situations where a financial statement metric is substantially comprised of the price (that is, fair value) of a financial asset or financial liability.

We do not believe that the proposed predominant characteristics assessment would address this issue, since the proposed guidance in ASC 815-10-15-59(e)(1) indicates that a financial statement metric is itself a single underlying. If that is the case, then it is unclear how or whether that underlying could be disaggregated into multiple underlyings for purposes of applying the predominant characteristics assessment.

Second, we note that the proposed examples at ASC 815-10-55-143D and 55-143G refer to an IPO “to obtain funding to expand ... operations” and a reduction of “greenhouse gas emissions from ... operations,” respectively. This suggests that there are underlyings based on the occurrence of an IPO or the reduction of greenhouse gas emissions of one of the parties to the contract that would not qualify for the proposed scope exception because they would not be deemed to relate to the operations or activities of one of the parties to the contract.

We do not believe the intended use of IPO proceeds should be determinative regarding whether an IPO-based underlying qualifies for the proposed scope exception. Likewise, we do not believe the source of greenhouse gas emissions subject to a reduction target should be determinative regarding whether a greenhouse gas reduction-based underlying qualifies for the proposed scope exception. If it is the Board's intent for events such as an IPO and achieving a greenhouse gas emissions target to be considered based on an entity's operations or activities, we recommend that these examples be updated to remove references to the intended use of proceeds and the source of emissions, respectively. If that is not the Board's intent, then we recommend adding examples that illustrate IPO and greenhouse gas emissions underlyings that would not qualify for the proposed scope exception in ASC 815-10-15-59(e).

Third, the proposed example in ASC 815-10-55-143E describes a bond in which the fixed interest rate is increased by a fixed percentage if the borrower fails to meet a specified greenhouse gas emissions reduction target. The example presumes that the interest rate adjustment feature has a single underlying – the failure to meet the greenhouse gas emissions reduction target. However, since the feature would adjust the fixed interest rate on the bond, we believe the Board should consider whether in practice this feature might be deemed to also have an interest rate underlying, in which case the predominant characteristics assessment guidance would need to be considered. If the feature described in this example is deemed to have a single underlying, then we recommend that this be explicitly stated in the example.

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

We do not believe that the proposed predominant characteristics assessment is operable.

First, we believe that applying the proposed predominant characteristics assessment will in many cases require highly judgmental valuation inputs and assistance from valuation professionals, which will challenge preparers and auditors and detract from benefits associated with avoiding derivative accounting for the arrangements identified by stakeholders that prompted this project.

Second, we believe that in many cases the multiple underlyings prompting application of the proposed predominant characteristics assessment will be interrelated, and that evaluating the impact of each underlying on the fair value of the contract or feature in isolation could produce results that are divorced from the economic substance of the arrangement.

Third, since the proposed predominant characteristics assessment requires an entity to consider only reasonably possible changes in fair value, it effectively establishes a "remote" threshold for identifying a contract or feature's predominant underlying.

According to the ASC Master Glossary, "reasonably possible" means "the chance of the future event or events occurring is more than remote but less than likely."

The Board previously considered adding a “remote” threshold to the guidance in ASC 815-40 regarding contracts in an entity’s own equity, and decided not to do so, as described in the following paragraphs from ASU 2020-06:

[Respondents] had mixed views about whether remote would be an operable and/or auditable threshold and whether the Board went far enough to effectively improve the derivatives scope exception guidance. Additionally, auditing standard setters observed that operability concerns are often accompanied by or are the basis for auditability concerns. They noted that while there are situations in which qualitative thresholds are both operable and auditable, the operability concerns about applying the remote threshold and the number and variety of potential settlement features may lead to complexity in management judgments, which could, in turn, give rise to complexity in auditing those judgments and related management controls. Additionally, some stakeholders noted that the length of time to which the assessment relates (the term of the contract) may add to the difficulty of the assessment.

We believe that the same operability concerns about adding a “remote” threshold to ASC 815-40 exist for the Board’s proposal to add a remote threshold to the predominant characteristics assessment.

Additionally, for binary contingent event-type underlyings, we believe the consideration of only reasonably possible outcomes will place significant pressure on the determination of whether an outcome is remote or reasonably possible. For example, assume a bond has a contingent put option that’s exercisable only if the issuer does not complete an IPO by a certain date. If the issuer determines that there is a remote likelihood of it completing an IPO by the prescribed date, then it appears only one outcome (non-occurrence of an IPO) would be considered in the predominant characteristics assessment. In this case the other underlying (the security price of the bond) would by default have the largest effect on the change in fair value of the embedded put option, and the put option could be separated from the host contract. On the other hand, if the likelihood of an IPO by the prescribed date moved over the remote threshold to reasonably possible, then the IPO-based underlying might be considered predominant, and therefore exclude the embedded put option from the scope of ASC 815.

As described in our response to Question 4, we support the alternative to the proposed amendments to the predominant characteristics assessment, such that the existence of any underlying that does not qualify for the scope exception in ASC 815-10-15-59 would preclude that exception’s application.

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

We believe the Board should reconsider the alternative approach that would preclude application of the scope exception if the contract or feature includes a non-qualifying underlying. We believe the alternative approach would be more operable, less complex, and responsive to stakeholder concerns.

As described in our response to Question 1, we believe that the proposed guidance, including the amendments to the predominant characteristics assessment, could exclude contingent conversion and contingent put and call options from the scope of ASC 815, provided the contingency is based on the operations or activities of one of the parties to the contract and is deemed to be the predominant underlying. We are concerned that excluding such features from the scope of ASC 815 might go beyond the stakeholder feedback that prompted this project, which appears to have focused on ESG-linked features as well as arrangements designed to fund R&D and litigation activities. Implementing the alternative approach would alleviate this concern, as the existence of a security price underlying for an embedded conversion or redemption (put or call) feature would preclude application of the scope exception in ASC 815-10-15-59(e).

We believe that the proposed scope exception in ASC 815-10-15-59(e), without the proposed amendments to the predominant characteristics assessment, would be responsive to stakeholder concerns regarding the accounting for R&D and litigation funding arrangements as well as many ESG-linked features embedded in hybrid financial instruments. In our experience, litigation and R&D funding arrangement underlyings relate to operations or activities of one of the parties to the contract, as would fixed payment provisions in a hybrid financial instrument contingent on meeting or failing to meet an ESG target.

We understand there are concerns that removing the predominant characteristics assessment from ASC 815 might cause contracts or features that previously have been scoped out of ASC 815 pursuant to application of the guidance in ASC 815-10-15-60 being deemed within the scope of ASC 815. We do not often see the existing predominant characteristics guidance applied in practice, and we believe the situations in which it most often applies – arrangements involving contingent royalty-type payments – would continue to be scoped out of ASC 815 based on the proposed amendments to ASC 815-10-15-59.

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

We believe the proposed transition method is operable. We defer to users to address whether the proposed transition disclosures are decision useful.

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

We defer to preparers to address how much time is needed to implement the proposed amendments and whether a deferred effective date should be provided for entities other than public business entities.

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

As noted in our responses to the previous questions, we are concerned that the costs associated with applying the proposed predominant characteristics assessment would outweigh the expected benefits of the proposed guidance, and support the alternative approach described in paragraph BC31 of the proposed ASU.

We also believe that it is not clear what accounting guidance applies to certain contracts that are currently accounted for as derivatives, or hybrid instruments containing features currently accounted for as derivatives, that under the proposed guidance are excluded from the scope of ASC 815. Uncertainty about the applicable guidance outside of ASC 815 could increase the costs of implementing the proposed guidance. While the Board did provide some insight into its thinking regarding these instruments in BC15, we believe that paragraph raises questions that could affect entities adopting the proposed guidance, particularly with regard to R&D funding and litigation funding arrangements.

R&D funding arrangements

The Board specifies in BC15 that R&D funding arrangements not accounted for as derivatives should be accounted for under ASC 730-20, *Research and Development – Research and Development Arrangements*.

Subtopic 730-20 was written to address arrangements in which multiple parties share in the financial risks of R&D activities, and also share in the intellectual property resulting from the R&D activities (see ASC 730-20-15-2). However, many R&D funding arrangements that would cease to be accounted for as derivatives under the proposed amendments are purely financial transactions in which the funding party (“investor”) transfers cash or other assets to the R&D partner (“investee”) in exchange for a right to a future, contingent payment (typically in cash or securities of the investee). If the underlying contingency (typically related to either regulatory approval, commercialization of the underlying technology, or a subsequent qualifying capital raise) fails to occur, the investee has no obligation to make a payment to the investor.

With regard to the investee’s accounting, in many cases this type of R&D funding arrangement may support a conclusion that there has been a transfer of financial risk from the investee to the investor. As a result, the investee would recognize the proceeds received as a reduction in R&D expense and would only recognize an amount payable to the investor when such payment was probable and reasonably estimable. That accounting seems consistent with the intended outcomes in Subtopic 730-20.

However, with regard to the investor’s accounting, we believe the application of Subtopic 730-20 may result in accounting that does not faithfully represent to users the economic substance of the transaction. For instance, transactions such as those described above may require the investor to recognize the proceeds transferred to the investee as R&D “costs incurred” pursuant to paragraph 730-20-25-11, despite the

investor having no rights to the underlying intellectual property results of the R&D activity. Said differently, Subtopic 730-20 does not appear to have been written to address investor accounting in purely financial R&D funding arrangements. We believe presenting such arrangements as financial assets more faithfully represents the economic substance of these transactions from the perspective of the investor – although it is not clear what guidance the Board believes should apply if these transactions are financial assets. We believe the Board should consider whether investors should apply the guidance regarding financial assets subject to prepayment in ASC 310-10-35-45 to these arrangements.

Furthermore, if an R&D transaction is not determined to have transferred “the financial risk,” and is therefore a liability to the investee and asset to the investor, Subtopic 730-20 does not provide any subsequent measurement guidance, and it is unclear what subsequent measurement guidance should apply.

Litigation funding arrangements

The Board specifies in BC15 that litigation funding arrangements not accounted for as derivatives are commonly accounted for by the recipient of proceeds (“investee”) as reimbursement of litigation expenses with any obligation to share proceeds accounted for under ASC 450-20, *Contingencies – Loss Contingencies*. We are not aware of the basis for this accounting and believe that investees in litigation funding arrangements currently accounted for under ASC 815 may be challenged to identify relevant guidance for such arrangements under other Topics. One area of GAAP that we believe might more faithfully represent the substance of these arrangements is the guidance regarding sales of future revenues in ASC 470, *Debt*.

BC15 does not address the accounting by funding providers (investors) in litigation funding arrangements. We believe it is unclear what guidance applies to the investor in a litigation funding arrangement if the guidance in ASC 815 is not applicable. However, one might conclude based on the Board’s views in BC15 that the investor should account for the proceeds transferred as an expense, and not as a financial asset (since the investee would not recognize the proceeds received as a financial liability). We do not believe this faithfully represents the substance of this transaction and believe that investors should account for the proceeds transferred as a financial asset. We believe the Board should consider whether investors should apply the guidance regarding financial assets subject to prepayment in ASC 310-10-35-45 to these arrangements.

Potential hybrid financial instruments

Whether or not R&D funding and litigation funding arrangements are recognized as financial assets or liabilities, we believe it would be helpful if the Board clarified whether these arrangements are considered hybrid instruments subject to evaluation under the embedded derivatives guidance in ASC 815-15. If an R&D funding or litigation funding arrangement is not in its entirety a derivative based on the proposed scope exception, we believe there may be questions regarding whether any features within the funding arrangement require analysis under embedded derivatives guidance in ASC 815-15.

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

Question 8: Do you agree that an entity should apply the guidance in Topic 606, including the guidance on noncash consideration in paragraphs 606-10-32-21 through 32-24, to a share-based payment from a customer that is consideration for the transfer of goods or services in a revenue contract? Do you agree that the share-based payment should be recognized as an asset under Topic 606 when an entity's right to receive or retain the share-based payment from a customer is no longer contingent on the satisfaction of a performance obligation? Please explain why or why not for both questions. If not, what changes would you suggest?

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

We believe that for non-complex fact patterns, the proposed language in ASC 606-10-15-3A will be sufficient to address the current lack of clarity and diversity in practice.

However, in practice we observe that it is not uncommon for noncash consideration to include a combination of the following four complexities – the noncash consideration (1) is variable, (2) is accumulating (tranche-based), (3) vests upon something other than the entity's satisfaction of its performance obligation and/or (4) vests only upon the entity satisfying its performance obligation; however, the pattern of vesting differs from the pattern of revenue recognition.

We have drafted our comments and suggestions with the following understanding:

- The Board did not intend to change the recognition guidance in ASC 606, including when an entity recognizes a contract asset.
- The Board did not intend to change the measurement guidance in ASC 606, including an entity's application of the constraint guidance.

Keeping these assumptions in mind, we encourage the Board to address the recognition and measurement observations below, as illustrated in the two examples that we believe would incorporate and address the common complexities identified above. We have added various interpretations that we observe in trying to apply the proposed guidance as presently written. We believe the Board should consider adding examples with fact patterns similar to those we have articulated below to clarify how the proposed guidance should apply in those and similar circumstances.

Recognition:

Paragraph BC49 says an entity recognizes the share-based payment under ASC 606 when an entity's right to receive or retain the share-based payment from a customer is no longer contingent on the satisfaction of the performance obligation. Further "The Board observes that this is generally consistent with the definition of *vest* in the Master Glossary and is expected to improve the symmetry with the grantor's accounting under Topic 718."

Acknowledging there may be timing differences between when a share-based payment is recognized under Topic 606 and when it is received or exercisable, “The Board concluded that if a share-based payment from a customer is consideration for the transfer of goods or services, it is appropriate to base the timing of the **recognition** [emphasis added] of the share-based payment under Topic 606 on when an entity’s right to receive or retain the share-based payment from a customer is no longer contingent on the satisfaction of a performance obligation.”

There are arrangements in which an entity’s pattern of vesting in noncash consideration may differ from its pattern of revenue recognition. For instance, the entity’s vesting pattern may be a cliff or stair-stepped pattern, whereas its revenue recognition pattern may be ratably over time or on a more granular/gradual stair-stepped pattern. In such situations (such as we have illustrated in Example 1 below), we believe the entity should recognize revenue in accordance with the existing guidance in ASC 606, unaffected by the proposed updates. However, we believe it may be unclear to some when an entity would recognize the noncash, share-based payment consideration, and when an entity would recognize a contract asset. That is, in arrangements in which the purchase price includes unvested share-based payments, and an entity has met the criteria to recognize a portion of the purchase price in revenue, but has not yet met the vesting criteria for a share-based payment to which it expects to be entitled, we are unclear when an entity should recognize a share-based payment asset and when (if ever) it should recognize a contract asset instead.

Furthermore, we believe it is unclear whether a share-based payment asset should be recognized when performance obligation(s) have been satisfied, but there remains an unresolved contingency relating to receipt or exercise of the noncash consideration, based upon a factor other than the entity’s performance (as illustrated in **Example 2** below).

Measurement:

We acknowledge the Board decided not to address measurement in BC53 as this is not a new issue. However, we believe the measurement questions remain unresolved and without the Board’s clarifications, further diversity in practice may result.

We observe that ASC 606-10-32-21 (unchanged by the proposed amendments) requires an entity to measure the estimated fair value of the noncash consideration at contract inception. In practice, this contract inception valuation assumes the entity will receive 100% of the noncash consideration.

Because it is not uncommon for share-based payment awards received as consideration from customers to contain vesting conditions unrelated to the entity’s satisfaction of its performance obligation, we believe without clarification, diversity in practice will exist in determining the contract inception date fair value of share-based payment awards with regard to inclusion in the estimate of fair value consideration of vesting or exercisability conditions based on factors or conditions *outside of the entity’s control*. In other words, for **Example 2** below, we believe some may include the 30% probability in the contract inception date fair value of the shares, while some may not.

Examples and interpretations using proposed guidance as presently drafted:

Example 1: Tranches earned at different times than the performance obligations are satisfied

- Vendor agrees to provide referrals to Customer from January 1, 2024 to December 31, 2024 in exchange for fixed consideration and up to 2,000 warrants in Customer B. This example ignores the fixed consideration for simplification.
- Vendor earns 0 warrants if it provides between 0-999 referrals to Customer; 1,000 warrants if it provides between 1,000 and 1,999 referrals to Customer; 2,000 warrants if it provides between 2000 or more referrals to Customer in the calendar year.
- Vendor estimates it is unlikely it will earn *any* warrants at March 31, 2024. By June 30, 2024, Vendor estimates it will earn 1,000 warrants. On December 31, 2024, Vendor earns 1,000 warrants.
- Actual referrals are: March 31, 2024 = 50; June 30, 2024 = 600; December 31, 2024 = 1,000.
- The inception date fair value of a single warrant is \$100 (ignores the probability of vesting).
- Vendor has concluded that the warrants constitute variable non-cash consideration.
- Vendor has further concluded that the referrals are individual performance obligations satisfied at a point in time.

We have noted two interpretations of how Vendor may account for the transaction. While we believe interpretation A reflects the Board's intent, we have noted that interpretation B is another common interpretation of the proposed ASU language:

- A. At March 31, 2024, no contract asset or corresponding revenue should be recognized as any consideration is fully constrained due to Vendor's determination that it is unlikely it will earn any warrants. At June 30, 2024, Vendor should recognize a contract asset for $(600/1000 * 100,000)$ \$60,000 and revenue for \$60,000. At December 31, 2024, Vendor debits warrant asset for \$100,000, credits contract asset for \$60,000, and credits revenue for \$40,000, and this is when the warrant asset becomes subject to the subsequent measurement guidance in ASC 815 or ASC 321, as appropriate. At December 31, 2024, the warrant asset would be recognized at its current fair value and any difference between the current fair value and contract inception date fair value would be recognized as a gain or loss outside of revenue.
- B. At March 31, 2024, no contract asset or corresponding revenue should be recognized as any consideration is fully constrained due to Vendor's determination that it is unlikely it will earn any warrants. At June 30, 2024, Vendor should recognize warrant asset for $(600/1000 * 100,000)$ \$60,000 and revenue for \$60,000 as Vendor's right to receive or retain the share-based payment is no longer contingent on the satisfaction of a performance obligation (since Vendor

has satisfied 600 performance obligations). At December, 2024, Vendor recognizes warrant asset for \$40,000 and revenue for \$40,000, at which time the warrant asset becomes subject to the subsequent measurement guidance in ASC 815 or ASC 321, as appropriate. Consistent with view A, any difference between the current value and contract inception date fair value of the warrant asset would be recognized as a gain or loss outside of revenue.

Example 2: Vesting based on other than the entity's performance

Examples 2A and 2B are presented to compare the same contract with cash versus non-cash consideration.

Example 2A: Consideration payable in \$1M cash

- On January 1, 2024, Vendor agrees to provide drug candidate R&D services to Customer using Vendor's proprietary model to source drug candidates.
- Vendor concludes its contract contains a single performance obligation of providing a list of drug candidates satisfied at a point in time when it transfers control of the list of candidates to Customer.
- Vendor will earn \$1M cash consideration when and if both of the following have occurred: (1) all services are complete, and (2) the customer obtains FDA approval of a drug candidate provided by Vendor.
- At contract inception (January 1, 2024) and also at the date of completion of the vendor's services (June 30, 2024), there is an estimated 30% chance of FDA approval taking place. The uncertainty is likely to take 3-5 years to resolve.

Example 2B: Consideration payable in \$1M worth of Customer shares

Facts are consistent with Example 2A, except that:

- Vendor will earn a fixed number of shares (variable noncash consideration under Topic 606) when and if both of the following have occurred: (1) all services are complete, and (2) the customer obtains FDA approval of a drug candidate provided by Vendor. The shares' fair value at contract inception is \$1M.
- For simplicity, assume the Customer share price did not fluctuate from contract inception through satisfaction of the performance obligation on June 30, 2024.

Example 2A:

Based on existing ASC 606 guidance, as well as on ASC 606 with the proposed amendments adopted as drafted, no amounts are recognized as revenue after the transfer of control of the list of drug candidates on June 30, 2024 as the consideration is variable and would be fully constrained in accordance with paragraph ASC 606-10-32-11.

Example 2B:

If the proposed amendments are finalized as drafted, two interpretations of Example 2B may be:

View 1

View 1 is premised on the following perspectives:

- The proposed amendments **require** recognition of a share-based payment once the vendor's right to receive or retain it is no longer contingent on the satisfaction of a performance obligation. Other conditions that impact receipt or exercisability of the noncash consideration are not considered when determining the timing of recognition.
- There is no difference (economically or for accounting purposes) between (a) the right to contingently receive shares, and (b) currently holding a contingently exercisable warrant. As such, the form of the noncash consideration in this example should be considered to be contingently exercisable warrants. Once the vendor has satisfied the performance obligation, it has received the contingently exercisable warrants, and the remaining variability is due to the form of the consideration. As such, the constraint would not apply.

Accordingly, under View 1, upon the transfer of control of the list of drug candidates, there is no longer a contingency based upon satisfaction of a performance obligation. Therefore, on June 30, 2024, the vendor has earned contingently exercisable warrants (whose fair value at contract inception was \$300,000) and should debit Warrants \$300,000 and credit Revenue \$300,000. (Further changes in the value of the warrants or the probability of earning the warrants will not impact revenue prospectively, but rather are recognized through other applicable GAAP.)

If FDA approval is never obtained (most likely outcome), revenue will remain unchanged and a \$300,000 loss for the change in warrant value will be recorded through other applicable GAAP.

Note that this view results in differences in both (1) the amount of revenue recognized, and (2) the timing of revenue recognition as compared to Example 2A.

View 2

View 2 is premised on the perspective that the variable noncash consideration in the contract is the fixed number of shares. That is, the form of the noncash consideration is specified in the contract to be shares, and the variability related to FDA approval is not due to the form of the consideration. Therefore, variable noncash consideration should be subject to the constraint in Topic 606 (and not recognized) until the vendor determines it is probable there will not be a significant revenue reversal (which, in this case, would likely only occur once FDA approval is received). Proponents of View 2 believe this interpretation is consistent with the Board's views in BC252¹ from ASU 2014-09—*Revenue from Contracts with Customer*.

¹ BC252 says, in part, **(emphasis added)** "The Boards decided that it would be most appropriate to apply the guidance on constraining estimates of variable consideration to the same types of variability regardless of whether the amount that will be received will be in the form of cash or noncash consideration. Consequently, the Boards decided to constrain variability in the estimate of the fair value of the noncash consideration if that variability relates to changes in the fair value for reasons other than the form of the consideration (that is, for reasons other than changes in the price of the noncash consideration)."

Accordingly, under View 2, no contingently issuable share-based payment asset would be recognized at June 30, 2024 since the recognition of revenue is precluded via application of the constraint.

Note that this view results in recognizing revenue in the same timing and amount as Example 2A. However, some believe it violates the proposed guidance regarding the recognition of noncash consideration once the vendor has satisfied its performance obligations necessary to be entitled to the noncash consideration. Proponents of View 2 might solve this potential problem by recognizing a share-based payment asset and a corresponding contract liability at the time the performance obligation was satisfied. However, subsequent measurement of the contract liability is unclear and could result in unintended mismatches in income statement impact.

Question 9: Should Topic 815 and Topic 321 be amended as proposed to clarify that the guidance in those Topics does not apply to a share-based payment from a customer that is consideration for the transfer of goods or services unless and until the share-based payment is recognized as an asset under Topic 606? Please explain why or why not. If not, what changes would you suggest?

Yes. We support the proposed language being included in ASC 815 and ASC 321. We believe the Board should clarify that “recognized as an asset” does not mean “recognized as a contract-asset” if that is its intention. In other words, the guidance in ASC 815 and ASC 321 applies only when the entity recognizes the share-based payment asset under ASC 606.

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

From a scoping perspective, we have observed an increasing prevalence of payments in *cash* that are wholly or in part variable based on the value of the customer’s shares, share options, or other equity instruments.

As presently written, we believe the proposed amendments would not include these cash payments as only *noncash* payments are scoped into this proposal.

We encourage the Board to clarify whether this equity-based variable cash payment exclusion is intended or whether the Board wishes to align the scope of share-based payments in this proposed ASU with that in ASC 718-10-15-3.

For example, we believe the Board should clarify whether an embedded derivative in a revenue contract with an underlying based on the customer’s stock price would be treated in the same manner under the proposed guidance as a freestanding warrant on the customer’s stock.

See Question 8 for the rest of our comments on operability.

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

Yes, we believe the Board should amend Subtopic 610-20 to make it consistent with the proposed clarifications in Topic 606 as we believe the same questions giving rise to the need for this proposed amendment are applicable to the sales of non-financial assets. We are not able to think of any unintended consequences at this time.

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

Yes.

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

We defer to preparers on this question.

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

We defer to preparers on this question.



We would be pleased to discuss our comments with you. If you have any questions, please contact Ryan Brady (ryan.brady@us.gt.com) or Susan Mercier (susan.mercier@us.gt.com).

Sincerely,

/s/ Grant Thornton LLP