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November 14, 2024

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

RE: Proposed Accounting Standards Update, *Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606)* (File Reference No. 2024-ED300)

Dear Mr. Day:

We appreciate the opportunity to comment on the proposed ASU, *Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606)*. We support the Board's proposal and believe it will provide more consistent and operable results. The Appendix to this letter includes our detailed comments; the following is a summary of our key observations.

- We support the amendments to the definition of performance condition because it makes the definition more intuitive for customer awards. We also note that in the basis for conclusions the Board intends for the definition to be applied broadly and gives additional examples of what should be a performance condition. We recommend that the Board include those examples in the Codification rather than the basis for conclusions.
- We agree with the proposal to remove the accounting policy election for forfeitures for share-based consideration payable to a customer that includes a service condition. This will make the accounting more comparable for awards to customers with performance and service conditions.
- We believe it is important to allow grantors that have previously made an entity-wide policy election to estimate forfeitures to make a one-time change upon transition for other nonemployee awards. We are aware of companies that made their election solely because of the impact to their revenue accounting but otherwise would elect to account for forfeitures for nonemployee, noncustomer awards, as incurred.
- While the proposal would improve the understanding of the interaction of the variable consideration constraint and measurement of share-based consideration under Topic 718, we believe the interaction is still not sufficiently clear. We suggest the Board clarify in paragraph 606-10-55-88B that Topic 606 variable consideration guidance should apply when an estimate is required but the conditions to begin accounting for the grant under Topic 718 have not been met. See Question 5 for a more detailed proposal.
- We believe the Board should provide a practical expedient for the retrospective transition method that would allow use of either the actual amount of forfeitures if known or use the estimate at the date of adoption. This expedient would encourage retrospective application and result in more comparable reporting.

* * * * *

If you have questions about our comments or wish to discuss the matters addressed in this comment letter, please contact Nick Burgmeier at (212) 909-5455 or nburgmeier@kpmg.com or Kimber Bascom at (212) 909-5664 or kbascom@kpmg.com.

Sincerely,

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Appendix – Responses to Questions for Respondents

<u>**Definition of a Performance Condition**</u>

Question 1:

Do you agree with the amendments in this proposed Update that would incorporate performance targets based on customer purchases into the Master Glossary term performance condition for share-based consideration payable to a customer? Are the proposed amendments clear and operable? Would the revised definition improve the operability of the guidance and capture the complete population of share-based consideration that vests on the basis of customer purchases? Please explain why or why not.

We support the changes to the definition of performance condition to make the definition more intuitive for awards issued to customers. However, we believe the Board should consider making additional changes to make its intent clearer. For example, in paragraph BC14, the Board states the proposed definition is intended to be interpreted broadly and includes additional examples of what it believes should be included in the definition. We suggest that the Board include those examples in the proposed Codification amendments rather than the basis for conclusions, to make its intent clearer.

In addition, we have seen share-based consideration that vests upon an entity entering into a future Master Service Agreement (MSA), which is not, on its own, considered a customer contract in Topic 606. It is unclear whether this type of a condition would be considered related to a grantee's purchase, given that no purchase has occurred or is even required at that time. Therefore, we also suggest the following edits to the definition to be inclusive of MSAs and similar arrangements (additions <u>underlined</u>):

> For share-based consideration payable to a **customer** that is not in exchange for a distinct good or service (or that is in exchange for a distinct good or service and can result in a reduction of the transaction price in accordance with paragraph 606-10-32-26), a condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that relates to any of the following:
>
> a. Achieving a specified performance target that is defined solely by reference to the grantor's own operations (or activities) or by reference to the grantee's (the customer's) performance related to the grantor's own operations (or activities)
>
> b. The grantee's purchase <u>(or potential purchase)</u> of the grantor's goods or services from either the grantor or the grantor's customers
>
> c. A purchase of the grantor's goods or services from either the grantee or the grantee's customers.
>
> The performance targets listed in this definition for employee and nonemployee awards (for example, a change in control) are also examples of performance conditions for share-based consideration payable to a customer.

Question 2:

In addition to customer purchases, do you agree with the proposed amendments that would incorporate performance targets based on purchases by parties that purchase the grantor's goods or services (its customer's customers) into the Master Glossary term performance condition? Are the proposed amendments clear and operable? Please explain why or why not.

Yes, we agree with the proposed amendments that would incorporate performance targets based on purchases by parties that purchase the grantor's goods or services (its customer's customers) into the definition of a performance condition.

Elimination of the Forfeitures Election for Share-Based Consideration Payable to a Customer

Question 3:

Do you agree with the proposed amendments that would remove the accounting policy election for forfeitures in paragraph 718-10-35-1D for share-based consideration payable to a customer that includes a service condition? Are the proposed amendments clear and operable? Please explain why or why not.

Yes, we agree with removing the forfeiture election for share-based consideration payable to a customer that includes a service condition. We expect there will still be awards that include only service conditions and eliminating the policy election would reduce the financial reporting differences between customer awards with a service condition and customer awards with a performance condition. Requiring entities to estimate forfeitures will better align the accounting with the economics and revenue recognition principles.

Question 4:

Should grantors that have previously made an entity-wide policy election to estimate forfeitures for nonemployee share-based payment awards, including share-based payment awards granted to customers, be permitted to make a one-time change upon transition to account for forfeitures as they occur? Please explain why or why not.

Yes, we believe a one-time change upon transition should be permitted for these entities. We are aware of entities that have elected to estimate forfeitures for all nonemployee awards because of the implications to their revenue accounting. However, absent the requirement to elect the same policy for customer awards and other nonemployee awards, they would have elected to account for forfeitures as they occur for the other nonemployee awards.

Without the ability to make a one-time election on transition, those entities could only change their policy from estimating forfeitures to recognizing them as incurred if the as-incurred policy is preferable. However, the Board indicates in BC13 of ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, that it rejected requiring all entities to recognize forfeitures as incurred "because estimating forfeitures generally provides a more accurate reflection of periodic compensation cost." This may suggest that the Board believes estimating forfeitures is generally preferable. Even if estimating is considered preferable, we believe entities that elected to estimate forfeitures to better reflect the economics of their revenue contracts should not be disadvantaged compared to other entities that did not have customer awards. Therefore, we believe it is important to afford these entities the same opportunity as those that did not have customer awards.

Applicability of the Guidance on Constraining Estimates of Variable Consideration to Share-Based Consideration Payable to a Customer

Question 5:

Are the proposed amendments that would clarify that the guidance in Topic 606 on constraining estimates of variable consideration does not apply to share-based consideration payable to a customer clear and operable? Please explain why or why not.

We believe it is clear that the constraint would not apply to share-based consideration accounted for under Topic 718. However, we still believe the overall interaction between estimating variable consideration under Topic 606 and the accounting under Topic 718 is not clear and should be clarified in paragraph 606-10-55-88B for completeness of the model.

For example, paragraph 606-10-55-88B states in part:

> When an estimate of the fair value of share-based consideration is required before the grant date in accordance with the guidance on variable consideration in paragraph 606-10-32-7, the estimate should be based on the fair value of the award at the reporting dates that occur before the grant date.

The above paragraph indicates an estimate of the fair value of share-based consideration before the grant date should be made when required by Topic 606. It is unclear whether the fair value should be determined in accordance with Topic 718, Topic 820, Topic 606 or otherwise. As such, it is unclear in the period before the grant date whether the fair value measurement is subject to the constraint because it is unclear which Topic in GAAP applies to the measurement of the share-based consideration.

The following is an example of when this might occur:

> Entity X enters into a contract with a customer and issues warrants that vest upon the customer purchasing 10 widgets. The strike price of the warrants is not determined until the date the warrants vest.
>
> The lack of a strike price would prevent the customer from beginning to benefit from or be adversely affected by subsequent changes in the price of Entity X's equity until the strike price is set. Therefore, there would be no grant date until the 10 widgets are purchased by the customer. However, the requirements to have a service inception date under Topic 718 would be met because the award is approved, the service begins before the grant and the award has a performance condition (under the revised definition) that results in forfeiture if not met before the grant date.

In the above example, it appears that Topic 718 should apply before the grant date, which would result in a remeasurement each period using Topic 718 fair value measurements. We note that paragraph 55-88B also requires remeasurement but is unclear if Topic 718 measurements are supposed to be used or the fair value measured in a different manner. Further, a Topic 606 estimate and consideration of the constraint could be necessary if a Topic 718 measurement is not yet required. This situation would occur, for example, when the customer has a valid expectation to receive, or the entity intends to issue, share-based consideration of some amount in the future.

To clarify and complete the model, we suggest clarifying paragraph 606-10-55-88B as follows (additions underlined and deletions struck through):

> **606-10-55-88B** Paragraph 606-10-32-25A requires that share-based consideration granted by an entity in conjunction with selling goods or services be measured and classified under Topic 718 at the **grant date** of the instrument~~When an estimate of the fair value of share-based consideration is required before the grant date in accordance with the guidance on variable consideration in paragraph 606-10-32-7, the estimate should be based on the fair value of the award at the reporting dates that occur before the grant date~~. If the service inception date precedes the grant date, ~~The~~ the grantor should measure the share-based consideration at fair-value under Topic 718 at each reporting date that occurs before the

> grant date. The grantor should change the transaction price for the cumulative effect of measuring the fair value at each reporting period after the initial estimate until the grant date occurs. In the period in which the grant date occurs, the grantor entity should change the transaction price for the cumulative effect of measuring the fair value at the grant date rather than the fair value previously used at any prior reporting date. When an estimate of the share-based consideration is required before the grant date or service inception date in accordance with the guidance on variable consideration in paragraph 606-10-32-7, the estimate should be measured similar to other variable consideration, including the guidance on constraining variable consideration.

This clarification would require entities to use Topic 718 when Topic 718 is applicable and Topic 606 if an estimate is required before Topic 718 is required.

Decision-Useful Information

Question 6:

Would the proposed amendments reduce diversity and improve the decision usefulness of a grantor's revenue information? Please explain why or why not.

Yes, the proposed amendments would reduce diversity and improve decision usefulness because they would better align the recognition of share-based consideration to a customer with the revenue recognition principles in Topic 606. Absent the proposal, an entity has the ability to recognize the forfeiture of customer awards when they occur, which can result in the counterintuitive accounting of an increase in revenue when performance under a revenue contract does not occur instead of when it does occur (e.g. revenue increases when a customer does not order, and the entity does not perform). The proposal would create more consistency in the accounting for share-based consideration to a customer with cash and other consideration payable to a customer. It would also create more consistency among entities and would create more consistency in outcomes for awards with service conditions and those with performance conditions.

Transition and Effective Date

Question 7:

The proposed transition requirements would allow grantors to apply the proposed amendments on either a modified retrospective basis or a retrospective basis (unless impracticable). Would the information required to be disclosed under each proposed transition method be decision useful? If not, why not and what transition method would be more appropriate and why? Are the proposed transition requirements operable? Please explain why or why not.

We believe the proposed disclosures are appropriate because they are consistent with the disclosure requirements of Topic 250.

We believe the proposed transition methods (retrospective or modified retrospective) are appropriate. However, we are concerned that a prohibition on using hindsight may discourage entities from adopting retrospectively because it would be difficult to prove that hindsight is not being used.

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To encourage entities to apply a retrospective method and make it more operable, we believe the Board should encourage the use of hindsight in transition. To not conflict with the general requirements of Topic 250 on the use of hindsight, we believe this could be done with a practical expedient to both:

1) allow entities to use actual amounts of forfeitures if known; or
2) use an estimate based on the information available upon transition.

This approach would reduce the burden associated with adoption while still providing comparable information. Using actual amounts if known is consistent with the practical expedient on variable consideration provided when Topic 606 was adopted. The ability to use a current estimate is similar to the practical expedient allowed in ASU 2021-08 on recognizing and measuring contract assets and liabilities in a business combination. In that ASU, the FASB allowed the use of the stand-alone selling price at the acquisition date rather than contract inception in order to not have to go back and analyze historical periods.

Question 8:

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? Should early adoption be permitted? Please explain why or why not.

Given the narrow scope of the proposed ASU we do not think it will, on its own, require a significant amount of time. However, we believe the Board should also consider other potential ASUs being issued around the same time and the overall transition impact to preparers at that time. We would also be supportive of the customary additional year to adopt for entities other than public business entities.

We support early adoption because the ASU will provide better information through more consistent outcomes.

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