FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout
Accounting for Exchange-Traded Digital Assets and Commodities
May 11, 2022

Meeting Purpose

1. The purpose of this decision-making meeting is to ask the Board whether to add a project to its technical agenda to address accounting for certain digital assets and commodities.

2. This handout is organized as follows:

    (a) Background

    (b) Information and research gathered

    (c) Agenda criteria.

Questions for the Board
1. Which of the following does the Board prefer to add to its technical agenda, if any: (a) A project to address the recognition and measurement of digital assets with corresponding presentation and disclosure considerations (b) A project to address the measurement of commodities with corresponding presentation and disclosure considerations (c) A project that addresses both (a) and (b) together? 2. If the Board adds a project to the technical agenda in Question 1, does the Board have any comments or questions about scope, feasible solutions, and the project's objective or planned next steps? 3. If the Board does not add a project on digital assets or commodities to its technical agenda, is there particular research that the Board would like the staff to perform?

Background

3. The Background section provides an overview of the current financial reporting guidance and practice for digital assets and commodities.

4. For the purposes of this handout, the staff will use the term *digital assets* unless those providing feedback or the sources for the research performed used a different term.

Accounting for Digital Assets

5. Assuming that an entity does not apply specialized industry accounting guidance or hold digital assets that are within the scope of other accounting guidance (as described further below), holders of digital assets generally account for them as indefinite-lived intangible assets. In December 2019, the AICPA's Digital Assets Working Group released a Practice Aid, *Accounting for and Auditing of Digital Assets* (Digital Asset Practice Aid).[1] The Digital Asset Practice Aid serves as nonauthoritative guidance on how to account for and audit digital assets under generally accepted accounting principles (GAAP) and generally accepted auditing standards, respectively. The Digital Asset Practice Aid stated that crypto assets (a subset of digital assets) generally would be accounted for under Topic 350, Intangibles—Goodwill and Other, and asserted that cryptocurrencies did not meet the Master Glossary definitions of *cash* and *cash equivalents, financial instruments, financial assets,* and *inventory.* In the guide, the Working Group lays out its reasoning for its conclusions, as follows:

    (a) Crypto assets will not meet the definition of *cash* or *cash equivalents* (as defined in the Master Glossary) if they are not considered legal tender and are not backed by sovereign governments. In addition, these crypto assets typically do not have a maturity date and have traditionally experienced significant price volatility.

    (b) Crypto assets will not meet the definition of *financial instruments* or *financial assets* (as defined in the Master Glossary) if they are not cash (see previous discussion) or an ownership interest in an entity and if they do not represent a contractual right to receive cash or another financial instrument.

    (c) Although these crypto assets may be held for sale in the ordinary course of business, they are not tangible assets and, therefore, may not meet the definition of *inventory* (as defined in the Master Glossary).

6. As intangible assets, digital assets are initially measured at cost. They are treated as indefinite-lived intangible assets in accordance with paragraph 350-30-35-4, which states

[1] The Digital Assets Practice Aid was updated in January 2022.

that if no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset to the reporting entity, the useful life of the asset should be considered indefinite. As a result, the indefinite-lived intangible asset should not be amortized and should be tested for impairment annually or more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired. In practice, this impairment testing has been interpreted to mean that digital assets should be impaired to the lowest fair value observable within a period. Impairment losses are presented in net income and not reversed.

7. Investment companies apply industry-specific guidance in Topic 946, Financial Services—Investment Companies. An investment company is an entity that meets the assessment described in paragraphs 946-10-15-4 through 15-9. Entities within the scope of that guidance account for all assets, including digital assets, at fair value.

8. Broker-dealers apply industry-specific guidance in Topic 940, Financial Services—Brokers and Dealers, and the interpretive guidance in the AICPA Accounting and Auditing Guide for Broker Dealers (Broker-Dealer Guide). While there is no specific guidance for those entities to carry digital assets at fair value, industry practice has been to measure "inventory," including digital assets, at fair value, based on interpretation of a paragraph 5.02 in the Broker-Dealer Guide, which states that "A broker-dealer accounts for *inventory* and derivative positions (such as futures, forwards, swaps, and options) at fair value" (emphasis added).

9. The Securities and Exchange Commission (SEC) issued a Spotlight on Initial Coin Offerings[2] (ICOs), which are digital assets used to raise capital or allow entities to participate in investment opportunities. The SEC has stated that digital assets may be securities under the Securities Exchange Act of 1934. Securities must be registered with the Commission or must qualify for an exemption from registration requirements. Items, including digital assets, that the SEC deems to be a security have established GAAP depending on the nature of those items.

10. On March 31, 2022, the SEC issued Staff Accounting Bulletin No. 121 (SAB 121), which states that in the fact pattern described in that SAB, a crypto platform should present a liability on its balance sheet measured at an amount equal to the fair value of the "crypto-assets" that an entity is responsible for holding on its platform. That liability represents the platform's "obligation to safeguard the crypto-assets held for its platform users." The liability is offset by an asset measured at the same amount. SAB 121 also details disclosures that an entity should make.

[2] https://www.sec.gov/ICO

Accounting for Commodities

11. Most entities generally carry commodities at the lower of cost or market. *Commodity* is not defined in the Master Glossary. There is no specific guidance in the Codification for accounting for commodities. Topic 330, Inventory, provides guidance allowing inventories to be carried above cost "only in exceptional cases." Paragraph 330-10-35-15 states:

> Only in exceptional cases may inventories properly be stated above cost. For example, precious metals having a fixed monetary value with no substantial cost of marketing may be stated at such monetary value; any other exceptions must be justifiable by inability to determine appropriate approximate costs, immediate marketability at quoted market price, and the characteristic of unit interchangeability.

12. A speech by the SEC staff at the AICPA SEC Conference in 2006[3] stated that, in most situations, registrants would have the ability to determine approximate cost of commodity inventory and thus not be able to carry it above cost.

13. Past projects have attempted to provide fair value accounting for commodities. EITF Issue No. 06-12, "Application of AICPA Audit and Accounting Guide, *Brokers and Dealers in Securities,* to Entities That Engage in Commodity Trading Activities and Related Issues," was issued in 2007. The EITF discussed determining whether an entity is included within the scope of the Broker-Dealer Guide and whether entities within the scope could measure physical commodity inventory at fair value. That EITF guidance did not change the accounting for commodities. Instead, the EITF recommended that the accounting for traded physical commodity inventory be addressed through the issuance of an FASB Staff Position. On May 1, 2008, the FASB issued proposed FASB Staff Position ARB 43-a (proposed FSP) that would have amended ARB No. 43, Chapter 4 *Inventory Pricing,* to require that inventories included in an entity's trading activities with a readily determinable fair value be initially and subsequently measured at fair value with changes recognized in earnings. The project was originally added to deal with diversity in practice regarding how broker dealers were accounting for physical commodity inventory. Subsequently, there were requests from major broker-dealers and banks to expand the scope of the proposed FSP beyond inventory to items like energy and transportation contracts. Ultimately, the proposed FSP was met with opposition in comment letters and not finalized, in part because it failed to define *trading activities* and received opposition from some entities in the energy industry because of complexity. One complexity highlighted by stakeholders

[3] https://www.sec.gov/news/speech/2006/spch121106jdm.html

was that it can be difficult to determine how inventory is expected to be used and intent can change over time.

14. In exceptional cases (when determining the appropriate cost basis for the inventory is not practicable), agricultural inventory may be measured on a market basis (realizable value less direct costs of disposal). Animals and harvested crops may subsequently be measured at net realizable value if all of the following conditions exist:

    (a) The product has a reliable, readily determinable, and realizable market price.

    (b) The product has relatively insignificant and predictable costs of disposal.

    (c) The product is available for immediate delivery.

15. As noted in the digital assets section, there is no explicit guidance that allows measurement of physical commodities at fair value for broker-dealers who carry security positions resulting from proprietary trading at fair value under Subtopic 940-320, Financial Services—Brokers and Dealers—Investments—Debt and Equity Securities. However, industry practice has been to measure inventory (including commodities) at fair value, based on interpretation of a paragraph 5.02 in the Broker-Dealer Guide, as noted above.

Information and Research Gathered

16. At its October 21, 2020 Board meeting, the Board decided not to add this topic to its technical agenda. However, the Board directed the staff to continuing monitoring developments and the pervasiveness of this area.

17. Following the Board's consideration of agenda requests related to digital assets in October 2020, the staff has monitored and gathered information from a variety of sources. Additionally, stakeholders requested that the Board consider standard setting in this area in recent agenda requests and through the feedback received in response to the 2021 FASB Invitation to Comment, *Agenda Prioritization* (2021 ITC).

Agenda Requests Since the Previous Agenda Prioritization Meeting on Digital Assets

18. Since October 2020, the Board has received three agenda requests on digital assets, all of which encourage the Board to address the financial reporting for digital assets. Those agenda requests are summarized as follows:

    (a) On May 21, 2021, the Board received an agenda request from seven members of Congress to add a project to address the accounting for digital assets. Those members noted that the "growth of digital assets has been staggering and will likely continue." The letter further notes that that "U.S. financial regulators are also recognizing the enormous potential of digital assets." It highlights that the Office of the Comptroller and Currency issued statements on allowing national banks to provide custody services for digital assets. Those members noted that a "lack of thoughtful and carefully developed authoritative guidance from the FASB threatens the ability to create accurate and consistent financial reporting of a large and fast-growing financial asset class." The letter also states that because "companies hold digital currencies for varying purposes, we believe the FASB should take into consideration how a company intends to use its bitcoin holdings when determining the appropriate accounting method."

(b) On June 7, 2021, the Board received an agenda request from the International Swaps and Derivatives Association (ISDA) to add a project to address the accounting for cryptocurrencies. The request highlighted the increase in pervasiveness since the October 2020 Board meeting. The ISDA stated that the current accounting for digital assets as intangible assets under Topic 350 does not reflect the economics and is misleading and not a faithful representation of the assets to users of financial statements. The request states that "a framework should be developed that will allow all entities, and not just investment companies and broker dealers, to account for crypto assets at fair value."

(c) On September 2, 2021, the Board received an agenda request from Mark Zashin, a member of CFANY. In his agenda request, Mr. Zashin states that fair market value of certain digital assets should be communicated, with cost and fair market value explained in detail.

19. The Board also received an agenda request encouraging the Board to consider the financial reporting for commodities. On June 8, 2021, the ISDA submitted an agenda request that asked the Board to expand the scope of the fair value option under Topic 825, Financial Instruments, to include physical commodities inventories and executory contracts related to physical commodities. The reasons given for its request include the following:

(a) Entities assess their economic exposures of commodities using fair value.

(b) Entities incur costs and there are complexities related to the fair value hedging model, which would be alleviated by allowing entities to account for commodities at fair value.

(c) Entities experience volatility in earnings that results from the measurement mismatch that exists when commodity-related assets are carried at cost and derivative contracts are measured at fair value. The mismatch exists because an entity's assessment of the derivative contracts related to physical commodities under GAAP generally do not meet the “normal purchases and sales” scope exception. Therefore, commodity-related contracts generally are accounted for as derivatives at fair value.

20. The agenda request details similar considerations for executory contracts; however, executory contracts are not within the scope of this research project. The preferred solution in the request is to provide entities with an option to measure physical commodities at fair value. Another approach described in the request is for the Board to consider changes to the application of fair value hedge accounting.

Feedback Received on the 2021 ITC

21. In June 2021 the Board issued an ITC to solicit broad stakeholder feedback about the future the Board’s standard-setting agenda. Chapter 2 of the ITC contains three questions on digital assets:

    (a) Investors—How significant are holdings in digital assets, such as crypto assets, in the companies you analyze? What type of financial reporting information about holdings in digital assets do you use in your analysis of a company? How does that information influence your decisions and behaviors? If there is other financial reporting information about digital assets that would be decision useful, what is that information and why would it be decision useful?

    (b) 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?

    (c) 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?

22. Overall, the Board received 522 responses from a variety of stakeholders. Seventy-seven respondents addressed multiple topics in response to the in the 2021 ITC, of which 47 discussed digital assets, making it the most frequently identified top priority for respondents. Among broad respondents to the ITC, digital assets was not the most frequently identified top priority for respondents that are users or investors.

23. Of the 522 ITC responses, 445 solely relate to digital assets. Of those 445 responses, 309 respondents specifically support the recommendation of 1 respondent that recommends accounting for digital assets at fair value.

24. The response to the ITC broadly favored the Board taking on a project to explore accounting for digital assets (and particularly bitcoin) at fair value. Nearly all respondents,

across all stakeholder types, agreed that adding a project that would permit or require entities to account for certain digital assets at fair value should be the Board's top priority going forward. Many respondents stated that the current accounting for digital assets as intangible assets, carried at cost and evaluated for impairment each period, does not reflect the economic reality of those assets or provide users with decision-useful information, and that fair value would provide a more relevant measure.

25. Furthermore, many respondents, including users, noted that because of the continued growth and change in the digital asset space, and the rate of adoption of digital assets by more and more entities, the trajectory of the pervasiveness of digital assets should be accounted for along with the current state.

26. Although the ITC did not include a specific question about accounting for commodities, six respondents provided comments on this area: three practitioners, two preparers, and one individual. Two practitioners noted that it could be beneficial for the Board to explore a fair value option for commodities, especially those that are exchange traded. One practitioner did not support including commodities in a digital assets project, stating that digital assets are unique in the way they are typically used compared with other assets. One preparer noted the diversity in accounting for commodities under the broker-dealer guidance. Another preparer stated that exchange-traded commodities should be provided with the fair value option because they are marketable. The individual respondent supported the Board looking at commodities as part of a digital assets project.

Additional Discussions with Stakeholders

27. The following section summarizes other staff discussions with stakeholders on digital assets.

Investor and Other User Outreach

28. The staff spoke with 13 users from 6 companies that included a rating agency and entities that specialize in investment management and investment banking. Those investors/users support the Board undertaking a project. Those users generally favored improvements to the recognition and measurement (with accompanying presentation and disclosure requirements) of digital assets with one user specifically favoring a disclosure-only project and noted that if entities were required to provide units held or fair value information on their top five digital asset holdings, that information would be adequate for their analyses.

29. Although there was limited user outreach concerning a fair value option, two users noted that they did not favor an option.

30. Members from the FASB's Investor Advisory Committee also provided their individual views about potential improvements and prioritization. One Committee member noted that current

impairment accounting does not make sense given the volatility of the digital asset markets. Some Committee members also noted that it would be useful in the notes to have detailed information on the type of holdings, units held, and the cost and fair value of those holdings. Some Committee members would prefer disclosure because fair value measurement of digital assets would introduce volatility to the income statement. However, generally, improving the accounting for digital assets was not noted as a major area of concern by those members.[4]

Preparer, Practitioner, and Other: Outreach Discussions

31. Since October 2020, as part of the pre-agenda monitoring activities, the staff has had more than 40 different interactions with preparers, accounting firms, regulators, other standard setters, and others. Recurring themes throughout the outreach performed are as follows:

    (a) Accounting for digital assets at cost less impairment does not reflect the economics of digital assets.

    (b) The impairment model is costly for preparers because entities are required to identify the lowest price and estimate fair value for their digital asset holdings throughout the entire reporting period. This process requires that consider prices across multiple exchanges and to seek information that often is not readily available.

    (c) Prior concerns regarding the ability to audit holdings in this space have decreased because many audit firms have developed new processes and additional expertise in verification of the existence and valuation of digital assets.

    (d) Either a requirement or an option to account for digital assets at fair value would improve the existing financial reporting.

    (e) Entities are becoming more interested in decentralized finance activities that create potential for mismatches between the measurement of an entity's digital assets holdings and related liabilities associated with those activities.

    (f) Digital assets are becoming more prevalent.

32. On March 9, 2022, members from the FASB's Financial Accounting Standards Advisory Council provided their views about potential improvements and prioritization. Council members noted that they were not seeing a lot of entities investing in digital assets at the time. Nonetheless, they indicated that the current accounting treatment as an intangible asset does not make sense and should be improved. One council member noted that an entity that has material digital asset holdings accounted for as intangible assets was having

[4] Comments were provided by individual IAC members as part of an internal Agenda Consultation meeting on February 28, 2022.

to include extensive non-GAAP disclosures to the financial statements to convey an entity's value to its investors. Some members suggested that the accounting should be based on how the entity intends to use the digital assets, that is, either as an investment or as inventory. Council members noted that even if the Board does not address recognition or measurement, digital assets should be presented separately on the balance sheet with disclosures on the quantity held and cost basis.

33. The staff solicited feedback from the Not-for-Profit Advisory Committee (NAC) members through a survey and at the March 31, 2022 NAC meeting. Feedback from the survey and NAC meeting indicated that some not-for-profits (NFPs) have received donations of digital assets. Many indicated that NFPs were liquidating those donations upon receipt, similar to what they would do when equity securities are gifted. Some NFPs that have yet to receive a gift of digital assets are in the process of reviewing their gift acceptance policies and establishing relationships with third parties to assist with liquidation of digital assets received. One NAC member also noted that its organization is in the process of reviewing its policies to determine when using digital assets might be acceptable, for example, in the event of a ransomware attack. NAC members were unaware of NFPs currently investing in or intentionally holding digital assets. One NAC member stated that it would support accounting for exchange traded digital assets at fair value.

Financial Reporting in Other Jurisdictions

34. In November 2018, the IASB decided against adding a project on the holdings of cryptocurrencies or initial coin offerings. In June 2019, the IFRS Interpretations Committee discussed how IFRS Standards apply to holdings of cryptocurrencies. The Committee observed that a holding of cryptocurrency meets the definition of *intangible asset* in IAS 38, *Intangible Assets,* because "(a) it is capable of being separated from the holder and sold or transferred individually; and (b) it does not give the holder a right to receive a fixed or determinable number of units of currency." Paragraphs 72 and 75 of IAS 38 permits fair value revaluation if there is an active market at the end of each reporting period. Paragraphs 85 and 86 of IAS 38 state that if the intangible asset's carrying amount increases as a result of the revaluation, the increase should be recognized in other comprehensive income to the extent that losses were not previously recognized in profit and loss for the same intangible asset. A decrease in fair value should be recognized in profit and loss. However, the decrease should be recognized in other comprehensive income to the extent that there is a credit balance in the revaluation of the particular intangible asset.

35. In addition to IAS 38, the IFRS Interpretations Committee also concluded that IAS 2, *Inventories,* applies to cryptocurrencies held for sale in the ordinary course of business.

Unlike Topic 330, IAS 2 does not require that inventory be tangible. Paragraph 9 of IAS 2 requires that inventories be measured at the lower of cost and net realizable value. If an entity is a broker-trader[5] that measures inventory at fair value less the cost to sell, then that inventory is not measured at the lower of cost and net realizable value in accordance with IAS 2 (paragraph 3(b)).

36. The term *commodity* is not defined in IFRS. IAS 2 states that physical *inventories* are generally carried at cost, while inventories of broker-traders are measured at fair value less costs to sell. In accordance with IAS 41, *Agriculture,* inventories comprising agricultural produce that an entity has harvested from its biological assets (living animals or plants) are measured on initial recognition at their fair value less costs to sell at the point of harvest.

37. At the April 2022 meeting, the IASB voted on which projects should be added to its work plan. The IASB staff recommended not adding a project on cryptocurrencies and related transactions and the IASB voted in agreement. The IASB staff memo[6] noted that a project to comprehensively consider the accounting for different types of crypto assets and liabilities "would be complex and maybe premature, given [that] such crypto-assets and liabilities are part of a new and rapidly evolving ecosystem." At that meeting, the IASB voted to add to the research pipeline a project on IAS 38, *Intangible Assets.* It was noted in the IASB staff memo that the project on IAS 38 would be comprehensive and could consider if cryptocurrencies are within the scope of IAS 38.

Agenda Criteria

38. In order to assist the Board in deciding whether to add a project to its technical agenda, the staff considered a potential project to improve the financial reporting for holders of commodities and for digital assets against the Board's agenda decision criteria. The Board's agenda decision criteria are as follows:

    (a) Identifiable and sufficiently pervasive need to improve GAAP

    (b) Identifiable scope

    (c) Technically feasible solutions and the perceived benefits of those solutions are likely to justify the expected costs of change.

39. Since the project on exchange-traded digital assets and commodities was added to the Board's research agenda, the research conducted has not focused on the underlying

[5] Paragraph 5 of IAS 2 describes broker-traders as "those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard."

[6] https://www.ifrs.org/content/dam/ifrs/meetings/2022/april/iasb/ap24a-projects-to-add-to-the-work-plan.pdf

technology (blockchain technology), issuers of digital assets (for example, ICOs) or those traditional assets that may come in digitized form (for example, securities) or digital assets when they are accounted for within the scope of other guidance (for example, digital assets held by investment companies). Although NFTs were not initially contemplated as part of the research, it is the staff's understanding that the NFT space is evolving and that some NFTs may have close links to fungible digital assets.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout
Targeted Improvements to Income Tax Disclosures
May 11, 2022

Meeting Purpose

1. The purpose of the May 11, 2022 Board meeting is to discuss the potential improvements to the existing disclosure requirements in Topic 740, Income Taxes, on income taxes paid and rate reconciliation and seek the Board's direction on the next steps for the project.

Questions for the Board
Issue 1: Income Taxes Paid
1. Which of the following disaggregation approaches (or combination of approaches) would the Board like to explore? For each disaggregation approach or approaches that the Board would like to explore, which alternative(s) would the Board like to consider?
(a) Jurisdiction Approach
(i) Alternative 1A—Top Jurisdictions
(ii) Alternative 1B—Quantitative Threshold.
(b) Time Period Approach.
(c) Payment Nature Approach
(i) Alternative 1C—By Type
(ii) Alternative 1D—By Frequency of Occurrence.
Issue 2: Rate Reconciliation
2. Which of the following approaches (or combination of approaches) would the Board like to explore? For each approach or approaches that the Board would like to explore, which alternative(s) or specific category (or categories) would the Board like to consider?

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

(a) Quantitative Threshold Approach

(i) Alternative 2A—A Measure Aligned with the Existing SEC Guidance

(ii) Alternative 2B—A Measure Other Than the Existing SEC Guidance.

(b) Specific Categories Approach

(i) Category A—Foreign Tax Rate Differential by Top Jurisdictions

(ii) Category B—State and Local Income Tax, Net of Federal Income Tax Effect, by Top Jurisdictions

(iii) Category C—Enactment of New Tax Laws

(iv) Category D—Effect of Cross-Border Tax Laws by Nature

(v) Category E—Tax Credits

(vi) Category F— Valuation Allowances

(vii) Category G—Nontaxable or Nondeductible Items by Nature

(viii) Category H—Tax Position Changes

(ix) Category I—Other Adjustments.

Next Steps

3. Does the Board have any feedback on the next steps?

Project Background

2. At its March 23, 2022 meeting, the Board discussed recent feedback received on income tax disclosures, including feedback on the June 2021 Invitation to Comment, *Agenda Consultation*, and agreed that the purpose of this project is to better meet the informational needs of financial statement users in making capital allocation decisions through incremental and achievable improvements to income tax disclosures. As a result, the Board revised the project objective to improve the transparency and decision usefulness of income tax disclosures and revised the project scope to primarily focus on income taxes paid and the rate reconciliation table. At that meeting, the Board directed the staff to perform research on the income tax information in the revised scope and come back to the Board at a future meeting to discuss potential improvements.

Issue 1: Income Taxes Paid

3. The staff has identified the following potential approaches to disaggregate information about income taxes paid and provide more transparent information to investors and other financial statement users. The approaches that the Board is interested in will be further explored and discussed at a future Board meeting. The Board also may choose to require a combination of the approaches listed below.

Jurisdiction Approach

4. The disclosure of income taxes paid could be disaggregated by jurisdictions, in addition to income taxes paid disaggregated between federal, state, and foreign.

    (a) **Alternative 1A—Top Jurisdictions**: An entity would be required to disclose the amount of income taxes paid to its top jurisdictions (such as top 5, top 10, or other number decided by the Board) on the basis of the amount of income taxes it paid to each jurisdiction during the reporting period.

    (b) **Alternative 1B—Quantitative Threshold**: An entity would be required to disclose the amount of income taxes paid for each of the jurisdictions identified on the basis of a quantitative threshold, such as 5 percent or 10 percent of the total amount of income taxes paid.

Time Period Approach

5. The disclosure of income taxes paid could be disaggregated by time period (the amount paid for the current period and the amounts paid for prior periods).

Payment Nature Approach

6. The disclosure of income taxes paid could be disaggregated by payment nature.

    (a) **Alternative 1C—By Type**: An entity would be required to disclose significant amounts of different types of income taxes paid, such as general corporate tax payments, payments of the base erosion and anti-abuse tax (BEAT) or the global intangible low-taxed income (GILTI), payments of interest and penalties related to income taxes, etc.

    (b) **Alternative 1D—By Frequency of Occurrence**: An entity would be required to disclose the amount of income taxes paid disaggregated between regular or recurring items and unusual or infrequently occurring items (such as payments of penalties or fines).

Issue 2: Rate Reconciliation

7. The staff has identified the following potential approaches that could improve the rate reconciliation table and provide more transparent information to investors and other financial statement users. The approaches that the Board is interested in will be further explored and discussed at a future Board meeting. The Board may choose to require a combination of the approaches listed below to provide more transparent information to investors and other financial statement users.

Quantitative Threshold Approach

8. A quantitative threshold could be established and any reconciling item greater than that threshold would need to be separately disclosed in the rate reconciliation table.

   (a) **Alternative 2A—A Measure Aligned with the Existing U.S. Securities and Exchange Commission (SEC) Guidance**: Establish the threshold as 5 percent of the amount computed by multiplying pre-tax income by the applicable statutory income tax rate. This alternative aligns with the existing SEC guidance.

   (b) **Alternative 2B—A Measure Other Than the Existing SEC Guidance:** Establish the threshold on a measure other than the existing SEC guidance, which could be a rate higher than the existing SEC guidance or a fixed-rate threshold based on pretax earnings.

Specific Categories Approach

9. A list of specific categories could be prescribed and required to be separately disclosed in the rate reconciliation table.

   (a) **Category A—Foreign Tax Rate Differential by Top Jurisdictions**: An entity would be required to include a separate category in its rate reconciliation table for the rate differential from its foreign operations. Within this category, an entity would be required to disclose the top jurisdictions (such as top 5, top 10, or other number determined by the Board) that contribute most (that could be either an increase or a decrease) to the foreign tax rate differential.

   (b) **Category B—State and Local Income Tax, Net of Federal Income Tax Effect, by Top Jurisdictions**: An entity would be required to include a separate category for the difference (between its statutory rate and effective tax rate) resulting from its state and local income tax. Within this category, an entity would be required to disclose the top jurisdictions (such as top five or other number determined by the Board) that contribute most (that could be either an increase or a decrease) to the state and local income tax differential.

(c) **Category C—Enactment of New Tax Laws**: An entity would be required to include a separate category for the difference resulting from the enactment of new tax laws. This category is intended to reflect the transitional effect of newly enacted tax laws.

(d) **Category D—Effect of Cross-Border Tax Laws by Nature**: An entity would be required to include a separate category for the difference resulting from the effect of cross-border tax laws on domestic or foreign earnings. This category is intended to reflect the impact under enacted cross-border tax laws driven by domestic initiatives or international initiatives. Within this category, an entity would be required to separately disclose by nature of the differentials, such as the differential related to GILTI, foreign derived intangible income (FDII), and BEAT.

(e) **Category E—Tax Credits**: An entity would be required to include a separate category for the difference resulting from the receipt of tax credits, such as domestic or foreign, research and development (R&D), etc.

(f) **Category F—Valuation Allowances**: An entity would be required to include a separate category for the differences resulting from changes in valuation allowances for deferred tax assets.

(g) **Category G—Nontaxable or Nondeductible Items by Nature**: An entity would be required to include a separate category for the permanent differences between its book basis and tax basis. Within this category, an entity would be required to disclose items of a different nature, such as the difference related to share-based compensation, amortization of goodwill, goodwill impairment, etc.

(h) **Category H—Tax Position Changes**: An entity would be required to include a separate category to disclose the changes in its tax positions, such as changes in uncertain tax positions, resolution of certain tax positions, and tax settlements.

(i) **Category I—Other Adjustments**: An entity may need to disclose other significant reconciling items if they are not captured by the specific items listed above, such as noncontrolling interest, ownership restructuring activities, etc.

Board Meeting Handout

Accounting for Financial Instruments with Environmental, Social, and Governance (ESG)-Linked Features

May 11, 2022

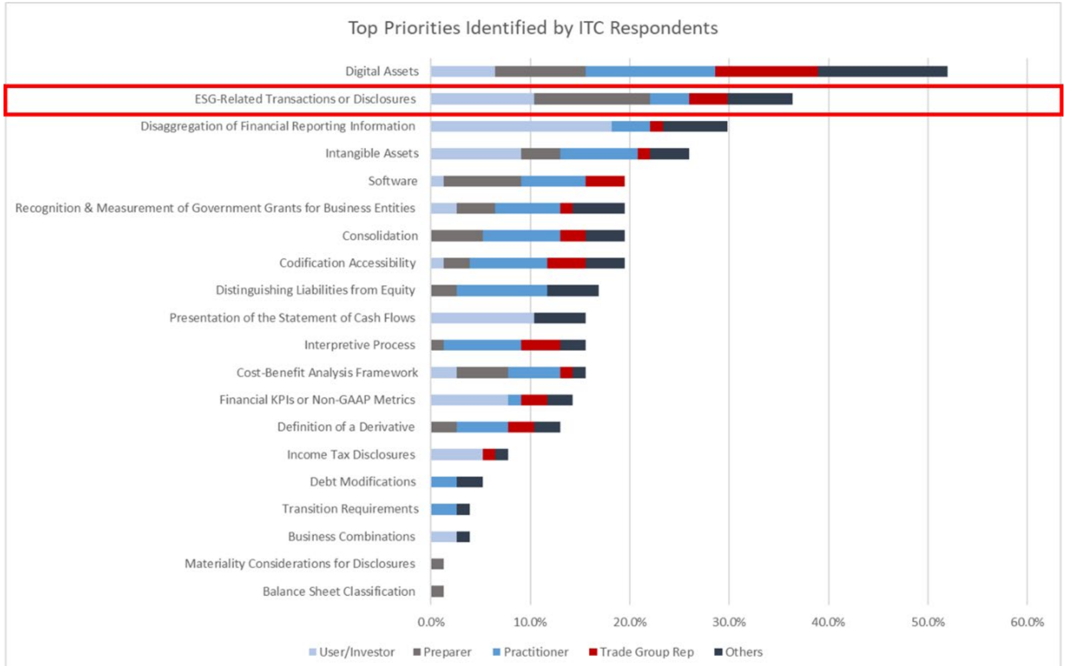
Meeting Purpose

1. The staff will update the Board on its initial research in preparation for a future agenda prioritization decision on whether to add a project related to the accounting for financial instruments with ESG-linked features to the Board's technical agenda.

Questions for the Board
1. What feedback does the Board have on the following issues identified by stakeholders related to ESG-linked financial instruments? (a) The accounting for ESG-linked features as derivatives (b) The disclosure of ESG-linked financial instrument provisions (c) The designation of ESG-linked derivative instruments as hedging instruments in net investment hedges. 2. Does the Board have any feedback for the staff to consider on the interaction with other projects? 3. What additional information will Board members need before making an agenda decision on whether to add this potential project to the technical agenda?

Background

2. In June 2021, the Board issued the Invitation to Comment, *Agenda Consultation* (ITC), to solicit broad stakeholder feedback about the future standard-setting agenda of the FASB. In the ITC feedback, ESG-related transactions or disclosures were identified as a top priority:



3. While ESG-related transactions or disclosures cover a broad range of topics, numerous respondents urged the Board to reevaluate the accounting for ESG-linked financial instruments. The most frequently cited challenge by respondents in applying the embedded derivative guidance and derivative scope exceptions was evaluating ESG-related provisions within financial instruments, such as bonds in which the interest payments vary on the basis of sustainability-linked metrics.

4. Furthermore, users that responded to the ITC generally encouraged the Board to consider expanding ESG disclosures in financial statements. The staff understands that ESG disclosures cover a broad range of topics including ESG-linked financial instruments.

Feedback from Stakeholders in the ITC

Issues Identified in the ITC

5. Overall, respondents expressed that applying the bifurcation criteria for an embedded derivative in Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives, to ESG-linked financial instruments and evaluating the derivative scope exceptions in Subtopic 815-10, Derivatives and Hedging—Overall, is costly and complex. If ESG-linked features are required to be bifurcated and accounted for as derivatives, ESG-linked features would be measured at fair value separately from the debt host contracts. One trade group expressed that estimating the fair value of ESG-linked features requires significant judgment and the fair value of such features may not provide decision-useful information to investors and other allocators of capital.

6. The terms of ESG-linked features may vary depending on the issuer's business and its ESG goals. The most common ESG-linked feature is a provision that increases or decreases interest payments depending on whether greenhouse gas reduction targets are met. ESG-linked financial instruments are generally considered hybrid instruments that consist of a debt host contract and an embedded derivative. ESG-linked features within a debt or loan contract that affect the cash flows, such as interest payments, are generally considered to be embedded derivatives requiring bifurcation from the host contract if the bifurcation criteria are met. ESG-linked financial features generally meet all of the bifurcation criteria because (a) the economic characteristics and risks of ESG-linked features are not considered clearly and closely related to the economic characteristics and risks of the host contract, (b) the debt host contract is not accounted for at fair value, and (c) ESG-linked features meet the definition of a derivative on a stand-alone basis. A few practitioners, banks, and trade groups expressed that, generally, ESG-linked features that affect payment provisions based on sustainability metrics do not bear a close economic relationship to the host contract because they are not related to interest rates, creditworthiness, or inflation. However, some of those respondents also expressed that some ESG-linked features could be associated with the borrower's creditworthiness. For example, those respondents noted that an entity's failure to meet ESG requirements could affect their creditworthiness. Those respondents highlighted the interpretative complexity of applying the bifurcation criteria to each ESG-linked feature, which could lead to diversity in practice.

7. As part of evaluating the bifurcation criteria, two derivative scope exceptions for non-exchange-traded contracts in Subtopic 815-10 are commonly considered when evaluating whether ESG-linked features meet the definition of a derivative. Those scope exceptions apply if the underlying is (a) a climatic or geological variable or other physical variable or (b) related to specified volumes of sales or service revenues. Generally, respondents expressed that neither of those derivative scope exceptions apply to ESG-linked features. One trade group expressed that the first scope exception does not apply to ESG-linked features because the triggering events, such as meeting or failing to meet certain ESG metrics, are not related to a climatic or geological variable or physical variable (that are outside an entity's control). The trade group also mentioned that the second scope exception does not typically apply to ESG-linked features because those features are not specifically related to revenue.

8. One practitioner highlighted a question about the ability to designate an ESG-linked freestanding derivative, such as a cross-currency swap with an interest rate step-up feature based on ESG targets, as a hedging instrument in a hedge of the foreign currency exposure of a net investment in a foreign operation under Topic 815. The practitioner indicated that the inclusion of a step-up feature would prohibit the cross-currency swap from being designated in a net investment hedge because, generally, Topic 815 does not permit the use of a compound derivative that has multiple underlyings as the hedging instrument in a net investment hedge.

Potential Paths Identified in the ITC

9. The following potential paths were recommended by ITC respondents:

   (a) **Derivative Scope Exceptions**: Add a new or modify the existing derivative scope exception of non-exchange-traded derivative scope exceptions, including an introduction of certain contracts excluded under IFRS 9, *Financial Instruments*.

   (b) **Bifurcation Criterion for Embedded Derivatives**: Specify that ESG features embedded in financial instruments should not be bifurcated.

   (c) **Implementation Guidance**: Add examples to the implementation guidance on how to apply the bifurcation guidance for embedded derivatives to ESG-linked financial instruments.

   (d) **Disclosure**: Expand ESG disclosures in financial statements.

   (e) **Net Investment Hedge**: Amend the qualified hedging instrument criteria to allow a compound derivative to be designated as a hedging instrument in a net investment hedge.

Potential Cross-Cutting Issues

10. As part of its project on Improving the Accounting for Asset Acquisitions and Business Combinations (Phase 3 of the Definition of a Business Project), the Phase 3 project team is evaluating the accounting for contingent consideration arrangements under Topic 805, Business Combinations. The Phase 3 project team understands that the derivative scope exception for non-exchange-traded contracts in paragraph 815-10-15-59(d) is commonly considered when entities evaluate whether contingent consideration arrangements should be accounted for as derivatives. Amending the guidance in that paragraph was also identified by some stakeholders as a potential path in the ITC to address ESG-linked financial instruments.

11. There is a research project on (a) further aligning hedge accounting with risk management activities beyond the targeted improvements made to the hedge accounting model in Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, and (b) considering changes to the definition of a derivative. On the basis of ITC feedback in relation to the definition of a derivative, several respondents highlighted challenges in applying the derivative scope exceptions for contracts that are nonexchange traded. Research and development funding arrangements primarily in the pharmaceutical industry in which contract payoff is based on the occurrence or nonoccurrence of an event (such as Food and Drug Administration approval) are some examples cited by respondents that often are captured by the definition of a derivative that in their view were not originally intended to be accounted for as derivative instruments. There could be overlap between the Hedge Accounting—Phase 2 project and this project on phase

3 of the definition of a business. However, that path would not resolve various other issues raised by stakeholders pertaining to ESG-linked instruments, such as the disclosures requested by investors pertaining to specific provisions of those instruments.