Quarterly Financial Reporting Update- September 2024

Teaser Video Transcript

Discussion on emerging issues in derivative scope exceptions

So moving ahead, the fast be released an exposure draft on its project that clarifies the scope for a couple of types of transactions, derivatives and share based payments from a customer and a revenue contract. And you know, in practice, often times scope issues or figuring out which guidance to apply can really be the toughest part of working through a question. Once you know which direction to go, it's often smooth sailing from there. So let's take a look at our derivative scope issue. First, the guidance to figure out whether or not something is a derivative to be accounted for under Topic 815, Derivatives and Hedging can be reasons. So the proposed standard would add a new scope exception to those that already exist.

Graham, can you tell us a little bit about what's being proposed here? Yeah, happy to Carolyn. And first of all, you know, the scoping guidance is complex. I mean, just within topic 8:15, there's more than 150 scoping paragraphs. So that just tells you just how difficult it is to figure this out. But what the proposed amendments would do is address sort of an emerging issue in applying the derivative scope exceptions that apply to not exchange traded contracts in paragraph 1559. So that's where in particular the contractual payments are linked to the entity's own performance.

So for example, let's take an ESG linked bond, where the amount of interest an entity has to pay could vary based on the entities either achieving a certain ESG performance metric or failing to achieve it. Another example is a long term research and development funding arrangement, where the payment that the entity could receive is based on whether the research is approved or successful. These provisions are all underlying to the contract, and there's been a lack of clarity as to whether those underlines qualify for some of the existing scope exceptions. Yeah. So, Graham, as we out here, the scope exception would exclude contracts where the underlying contains a variable that's based on operations or activities specific to one of the parties to the contract. So for example, if a payment is based on financial statement metrics of one of the parties to the contract such as EBITDA, net income, expenses or total equity