FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout
Agenda Prioritization
December 20, 2023

Meeting Purpose

1. The December 20, 2023 agenda prioritization meeting is for the staff to provide the Board with information and staff research for several potential projects and, if applicable, for the Board to consider adding those projects to its technical agenda.

2. If applicable, the Board will evaluate the potential projects based on the following agenda-decision criteria:

   (a) Is there an identifiable and sufficiently pervasive need to improve generally accepted accounting principles (GAAP)?

   (b) Are there technically feasible solutions, and are the expected benefits of those solutions likely to justify the expected costs of change?

   (c) Does the issue have an identifiable scope?

3. The following table lists the potential projects that the Board will discuss:

	Potential Projects
A	Clarifying the Scope and Application of Topic 480, Distinguishing Liabilities from Equity, for Legal Form Debt Instruments
B	Accounting for Equity Securities
C	Accounting for Held-to-Maturity (HTM) Debt Securities
D	Topic 740, Income Taxes, Backwards Tracing
E	Research Agenda Project: Accounting For Commodities

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.

Clarifying the Scope and Application of Topic 480 for Legal Form Debt Instruments

4. The questions for the Board on this potential project are as follows:

Questions for the Board
1. Does the Board want to add a project to its technical agenda to clarify the scope of Topic 480 for legal-form debt instruments? 2. If the answer to Question 1 is yes, does the Board have feedback on the project's objective or scope and/or request additional information for the staff to research?

Issue Background

5. The Board received an agenda request asking for clarity on whether share-settled debt should be accounted for under Topic 480. The agenda request asserted there has been an increase in stock-settled (or share-settled) debt issuances and that the submitter believes the amendments in Accounting Standards Update No. 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*, indicate that debt instruments settleable in shares may be within the scope of Topic 480, which may raise interpretive issues around the application of Topic 480 to those instruments.

6. The primary question included in the agenda request is to clarify whether legal-form debt instruments are within the scope of Topic 480 (referred to as the scope of Topic 480 question). Additionally, if legal-form debt instruments are within the scope of Topic 480, there are two follow-on questions:

   (a) In applying the subsequent measurement guidance in paragraph 480-10-35-5[1], should stock-settled debt be subsequently measured at fair value with changes through net income or subsequently measured at another measurement attribute in accordance with another Subtopic, such as in accordance with paragraph 835-30-15-2[2] (interest method) (referred to as the subsequent measurement question)?

[1] **480-10-35-5** All other financial instruments recognized under the guidance in Section 480-10-25 shall be measured subsequently at fair value with changes in fair value recognized in earnings, unless either this Subtopic or another Subtopic specifies another measurement attribute.
[2] **835-30-15-2** The guidance in this Subtopic applies to receivables and payables that represent contractual rights to receive money or contractual obligations to pay money on fixed or determinable dates, whether or not there is any stated provision

(b) How should entities apply certain concepts in paragraph 480-10-25-14,[3] including interpretation of what is an obligation, what constitutes conditionality, and the meaning of predominance, to stock-settled debt (referred to as the application of paragraph 480-10-25-14 question)?

Current GAAP

Overall

7. Topic 480 provides guidance for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity in its statement of financial position. That guidance applies to any freestanding instrument that has one of the following attributes:

   (a) Comprises more than one option or forward contract

   (b) Has characteristics of both a liability and equity and, in some circumstances, also has characteristics of an asset (for example, a forward contract to purchase the issuer's equity shares that is to be net cash settled).

8. Topic 480 does not apply to a feature embedded in a financial instrument that is not a derivative instrument in its entirety.

Classification

9. Overall, Section 480-10-25, Distinguishing Liabilities from Equity—Overall—Recognition, requires that an issuer classify a financial instrument that embodies an obligation of the issuer as a liability (or an asset in some circumstances). Topic 480 requires that an issuer classify the following as a liability:

   (a) Mandatorily redeemable financial instruments

   (b) Obligations to repurchase issuer’s equity shares by transferring assets

   (c) Certain obligations to issue a variable number of shares.

10. Accordingly, the following guidance—which is the partial focus of the agenda request—states that certain obligations to issue a variable number of shares should be classified as a liability (or an asset in some circumstances):

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for interest, with certain exceptions noted below. Such receivables and payables are collectively referred to in this Subtopic as notes. Some examples are the following:
   a. Secured and unsecured notes
   b. Debentures
   c. Bonds
   d. Mortgage notes
   e. Equipment obligations
   f. Some accounts receivable and payable.

[3] See paragraph 10 of this handout.

> **480-10-25-14** A financial instrument that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares shall be classified as a liability (or an asset in some circumstances) if, at inception, the monetary value of the obligation is based solely or predominantly on any one of the following:
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> a. A fixed monetary amount known at inception (for example, a payable settleable with a variable number of the issuer's equity shares)
> b. Variations in something other than the fair value of the issuer's equity shares (for example, a financial instrument indexed to the Standard and Poor's S&P 500 Index and settleable with a variable number of the issuer's equity shares)
> c. Variations inversely related to changes in the fair value of the issuer's equity shares (for example, a written put option that could be net share settled).
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> See paragraph 480-10-55-21 for related implementation guidance.

11. The guidance in paragraph 480-10-25-14 is often referred to as “indexation” guidance because it evaluates whether an instrument is indexed to its own shares—that is, if the settlement amount depends on the fair value of the issuer’s shares. Any instrument that provides a holder with a fixed settlement amount (or monetary value) is not indexed to an entity’s own shares because the holder will always receive a fixed value. Conversely, an instrument that provides a holder with an option to purchase, for example, 10 shares at $10 per share by a fixed date, would be indexed to an entity’s own shares.

Initial Measurement

12. Topic 480 requires[4] financial instruments[5] recognized under the guidance in Section 480-10-25 to be initially measured at fair value.

Subsequent Measurement

13. Topic 480 requires[6] financial instruments[7] recognized under the guidance in Section 480-10-25 to be measured subsequently at fair value with changes in fair value recognized in earnings, unless either Topic 480 or another Subtopic specifies another measurement attribute.

[4] Paragraph 480-10-30-7
[5] Mandatorily redeemable financial instruments and certain physically settled forward purchase contracts have specific initial measurement guidance, as required by paragraphs 480-10-30-1 through 30-6.
[6] Paragraph 480-10-35-5
[7] Mandatorily redeemable financial instruments and certain physically settled forward purchase contracts have specific initial measurement guidance, as required by paragraphs 480-10-30-1 through 30-6.

14. The guidance also specifies[8] that financial instruments within the scope of Topic 815, Derivatives and Hedging, should be measured subsequently as required by that guidance.

15. Subtopic 835-30, Interest—Imputation of Interest—the interest method,[9] may be considered for subsequent measurement guidance[10] for stock-settled debt. The interest method requires the difference between the present value and the face amount of the debt to be treated as a discount or premium and amortized as interest expense or income over the life of the note in such a way as to result in a constant rate of interest when applied to the amount outstanding at the beginning of any given period. The guidance[11] in Subtopic 835-30, Interest—Imputation of Interest, applies to receivables and payables that represent contractual rights to receive money or contractual obligations to pay money on fixed or determinable dates, whether or not there is any stated provision for interest, including secured and unsecured notes, debentures, bonds, mortgage notes, equipment obligations, and some accounts receivable and payable.

Accounting for Equity Securities

16. The questions for the Board on this potential project are as follows:

Questions for the Board
1. Does the Board want to add a project to its technical agenda to reconsider the current accounting for equity securities? 2. If the answer to Question 1 is yes, does the Board (a) have feedback on the project's objective or scope and/or (b) request that the staff conduct additional research or outreach on certain potential solutions?

Issue Background

17. The Board received an agenda request stating that the accounting for equity securities at fair value in accordance with Accounting Standard Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,* (a) creates unnecessary volatility in the income statement that results in information that does not provide users with decision-useful information and (b) reduces users' ability to understand and compare net income between competitors because of the effects from equity securities.

[8] Paragraph 480-10-35-1
[9] In accordance with paragraph 835-30-35-4, other methods of amortization may be used if the results obtained are not materially different from those that would result from the interest method.
[10] Paragraph 835-30-35-2
[11] Paragraph 835-30-15-2

18. The request is that the Board allow entities to make an election to present subsequent changes in fair value of equity securities in other comprehensive income (OCI), similar to IFRS 9, *Financial Instruments*.

GAAP Accounting Guidance for Equity Securities

19. Update 2016-01 was issued in January 2016. The objective of the Update was to (a) provide investors with more decision-useful information about equity securities and (b) remove certain costs and complexity by eliminating the need for entities to complete an impairment analysis for available-for-sale (AFS) equity securities in a loss position.[12]

20. The amendments in Update 2016-01 for equity securities were added to the newly created Topic 321, Investments—Equity Securities, and are applicable to both public and private companies. As it relates to equity securities, the amendments in Update 2016-01:

    (a) Require that an entity measure equity securities (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) at fair value with gains and losses included in net income in the period of the change. The amendments in that Update do not address how the gains and losses should be presented in the income statement.

    (b) Allow an entity to elect to measure equity securities without readily determinable fair values at cost minus impairment (if any), plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Any change in value related to observable price changes are included in net income.

    (c) Simplified the impairment assessment of equity securities without readily determinable fair values by requiring a qualitative assessment to identify an impairment. When a qualitative assessment indicates that an impairment exists, an entity is required to measure the investment at fair value if the fair value is less than its carrying value.

    (d) Require disclosures at interim and annual periods related to:

        (i) Equity securities without readily determinable fair values

        (ii) The portion of unrealized gains and losses for the period that relate to equity securities still held at the reporting date and the net gains and losses recognized during the period.

[12] There were other amendments in Update 2016-01 related to other assets and liabilities. However, those amendments are not relevant to this agenda request and will not be discussed further.

21. Before the issuance of Update 2016-01, the accounting for equity securities was as follows:

    (a) An entity could classify equity securities with readily determinable fair values as either trading or AFS. Equity securities classified as trading were measured at fair value with gains or losses recognized in net income. Equity securities that were classified as AFS were measured at fair value with unrealized gains and losses included in OCI until the gains or losses were realized (either through disposal or an other-than-temporary impairment).

    (b) Equity securities without readily determinable fair values (other than those accounted for under the equity method) were measured at cost (less impairment) unless the fair value option was elected under Topic 825, Financial Instruments.

    (c) Entities were required to assess equity securities accounted for under the AFS or cost model for impairment (that is, whether the carrying amount of the equity security was higher than the fair value of the equity security). However, impairment was not recognized unless it was determined to be other than temporary.

IFRS Accounting Guidance for Equity Securities

22. In June 2014, the International Accounting Standards Board (IASB) issued IFRS 9 with an effective date for annual periods beginning on or after January 1, 2018. IFRS 9 requires most equity instruments to be measured at fair value through net income. However, an entity may make an irrevocable election on an equity instrument-by-instrument basis[13] at initial recognition to present subsequent changes in fair value in OCI with no subsequent reclassification of gains and losses to net income.

23. In December 2022, the IASB issued its post-implementation review report on IFRS 9. The IASB concluded that the classification and measurement requirements in IFRS 9 are working as intended.

Accounting for Held-to-Maturity (HTM) Debt Securities

24. The questions for the Board on this potential project are as follows:

Questions for the Board
1. Does the Board want to add a project to its technical agenda to eliminate the HTM classification for debt securities? 2. If not, does the Board want to add a project to its technical agenda to make targeted amendments to any of the following:

[13] Equity instruments held for trading are not eligible for this election.

(a) Balance sheet presentation of HTM debt securities

(b) Fair value disclosure of HTM debt securities by non-public business entities (PBEs)

(c) Hedge accounting guidance for HTM debt securities?

Issue Background

25. The Board received an agenda request letter from a stakeholder requesting that the Board consider eliminating the HTM classification in response to the failures of Silicon Valley Bank (SVB) and Signature Bank (Signature) in March 2023. In its agenda request, the stakeholder stated that, in its view, financial accounting and reporting were clearly not the cause of SVB's collapse, but its failure raises questions about the appropriateness of certain provisions in accounting standards. That stakeholder stated that amortized cost fails to provide information about key risks of financial instruments, including liquidity, interest-rate sensitivity, and asset and liability duration mismatches. That stakeholder asserted that fair value provides more information about those risks. While acknowledging that the fair value of financial instruments is required to be disclosed, the author of the agenda request stated that fair value is a more relevant measure for financial instruments than amortized cost and, thus, should be reflected in the measurement of financial instruments in the financial statements. That stakeholder expressed concern that management's intent and ability to hold a debt security to maturity is subjective and can be called into question in times of stress.

26. However, after those bank failures:

    (a) Other investors indicated a preference for HTM debt securities to remain measured at amortized cost basis, favoring the mixed measurement model over fair valuing all debt securities.

    (b) Risk Management Association members suggested that the fair value of debt securities could be made more prominent by requiring disclosure on the face of the balance sheet rather than in the footnotes and that the Board should consider narrowly scoped amendments to disclosure requirements that would provide more transparency into the fair value of debt securities held by entities that are not PBEs.

    (c) Some investors called for hedge accounting to better reflect a financial institution's macro risk management activities and for those activities to be better explained. Some preparers raised the concern that the prohibition on applying hedge accounting for HTM debt securities is inconsistent with financial institutions' interest rate risk management; they highlighted that interest rate risk is dynamically managed by institutions on an overall balance sheet basis, not an individual security basis.

27. The Board will consider whether to add a project or projects to its technical agenda to:

    (a) Issue 1: Eliminate the HTM classification for debt securities

    (b) Issue 2: Make other potential amendments related to the HTM classification, which could include:

        (i) Requiring financial institutions to parenthetically disclose the fair value of HTM debt securities on the face of the balance sheet

        (ii) Requiring non-PBE financial institutions to disclose the fair value of HTM debt securities measured at amortized cost under the same requirements as PBEs

        (iii) Permit interest rate risk hedge accounting to be applied to HTM debt securities.

Topic 740, Income Taxes, Backwards Tracing

28. The questions for the Board on this potential project are as follows:

Questions for the Board
1. Does the Board want to add a project to the agenda to amend Topic 740 to eliminate the prohibition of backwards tracing?

Issue Background

29. The Board received an agenda request letter from a stakeholder requesting that the Board consider amending the guidance in Topic 740 to eliminate the prohibition on backwards tracing.

30. Backwards tracing is the recognition of current year changes to previously recognized deferred tax amounts in the same line item that they were initially recorded.

31. Topic 740 requires a deferred tax asset (DTA) to be recognized when the results of operations by a tax-paying entity create tax benefits that are not allowable in the current period tax liability calculation but are available (or deductible) in future periods. A DTA is required to be measured as of each financial statement reporting period using the enacted tax rate (statutory rate) and tax law and is recorded gross with an offsetting credit to deferred income tax expense.

32. If an entity determines that it expects to realize a DTA for an amount less than initially measured, a valuation allowance (VA) must be established to reduce the gross DTA to the net tax benefit that is expected to be realized in future periods. An entity is required to consider all available positive and negative evidence, at each reporting period, for the existence of future taxable income or taxable capital gains and judgmentally determine whether DTA realizability is more likely than not or whether a VA is necessary for amounts considered unrealizable.

33. DTAs, including any related VAs established in prior periods, must be remeasured in future periods if the applicable tax rate or tax law has been changed and enacted or if the entity changes its estimate for the amount of DTA expected to be realized. Topic 740 requires that those type of remeasurements be recognized in the period that they occur with an offsetting entry to income tax expense (or benefit) for the current period.

34. Generally, deferred tax positions are recognized through an offsetting entry to deferred income tax expense in the income statement. Paragraph 740-20-45-11(b) provides an exception for unrealized gains and losses recognized in accumulated other comprehensive income (AOCI). Those periodic fair value remeasurements are recorded in AOCI net of tax such that a DTA is initially recognized with no current period income statement effect. Paragraph 740-20-45-15 permits the amount recognized net of tax in AOCI to include the initial recognition of a VA such that the initial DTA measurement, net of VA, equals the tax benefit expected to be realized. If a VA is not initially established in AOCI or if an entity changes its estimate for the DTA amount expected to be realized during periods after the initial recognition of the unrealized loss and corresponding DTA, Topic 740 requires that the VA be recognized through an offsetting entry to current period income tax expense.

35. The Board has periodically received similar requests to consider amending Topic 740 to permit backwards tracing, including in 1992 through the public exposure process of FASB Statement No. 109, *Accounting for Income Taxes* (codified as amended as Topic 740) and in 2014 through stakeholder feedback.

36. More recently, in 2018 the Board released Accounting Standards Update No. 2018-02, *Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* The amendments in Update 2018-02 responded to the Tax Cuts and Jobs Act (TCJA) signed into law on December 22, 2017. The Board recognized the pervasive financial statement implications created by the TCJA and provided for a one-time exception to the requirements of Topic 740 to allow stranded balances in AOCI (created by remeasuring deferred tax positions to the new rate) to be reclassified to retained earnings instead of a charge to the income statement. The Board specified in its basis for conclusions that the amendments in Update 2018-02 were targeted improvements to address immediate concerns created by the TCJA and not a broader change to the GAAP prohibition on backwards tracing.

37. In connection with Update 2018-02, the Board added a project to its research agenda to further consider the potential alternatives to backwards tracing. This project was removed from the research agenda in December 2020 and the Board asked for stakeholder feedback on backwards tracing through the 2021 Invitation to Comment agenda prioritization. The Invitation

to Comment feedback was discussed by the Board in May 2022 and the Board decided not to add a project to its technical agenda at that time.

Agenda Request

38. Life insurance firms hold a significant amount of AFS debt securities as a source of liquidity funding for long-term policyholder liabilities. Those AFS portfolios typically include high credit-quality securities that have fair value measurements largely attributable to changes in the interest rate environment since the issuance of the security. The fair value of debt securities portfolios across the industry was reported with significant unrealized non-credit-related unrealized losses after risk-free benchmark borrowing rates began increasing in the first quarter of 2022 and continued through September 2023.

39. The agenda request discusses the stakeholder's concern that economic conditions in future periods will impair an entity's ability to conclude that it is more likely than not that a DTA will be fully realized, resulting in VA to adjust the carrying amount of the DTA to the amount expected to be realized. Given the magnitude of AFS unrealized losses currently recorded, more specifically the corresponding DTA, the agenda request describes how financial results for future periods could be significantly distorted because recognition (or remeasurement) of the VA is recorded to income tax expense and included in current period earnings. The agenda request letter further states that this outcome is a negative implication of the prohibition on backwards tracing because the financial results are not an accurate reflection of income for the users of an entity's financial statements.

Accounting for Commodities

40. The questions for the Board on this potential project are as follows:

Questions for the Board
1. Does the Board want to add a project to its technical agenda to address the accounting for commodities? 2. If the answer to Question 1 is yes, does the Board have feedback on the project objective or scope and/or requests for the staff to complete additional research or outreach on specific areas?

Issue Background

41. Some preparers and practitioners that responded to the June 2021 Invitation to Comment suggested that the Board address the accounting for commodities as well as executory contracts related to physical commodities. Some indicated a desire to expand the fair value

option in Topic 825 to commodity inventories; others suggested expanding the scope of the industry-specific guidance for broker-dealers.

42. Currently, physical commodities are primarily accounted for under Topic 330, Inventory, because most physical commodities meet the Master Glossary definition of inventory, although certain entities apply industry guidance in Topic 905, Agriculture, or Topic 946, Financial Services—Investment Companies, to account for their physical commodities.

43. Additionally, on June 8, 2021, the International Swaps and Derivatives Association submitted an agenda request that asked the Board to expand the scope of the fair value option to commodities and executory contracts related to physical commodities.

44. On December 15, 2021, in response to feedback received on the Board's June 2021 Invitation to Comment, the FASB chair added a research project on the accounting for and disclosure of a subset of digital assets and exchange-traded commodities.

45. At its May 11, 2022 meeting, the Board added a project to its technical agenda to improve the accounting for and disclosure of certain crypto assets. The chair decided to retain a project on commodities on the research agenda.

46. As a starting point in its research, the staff developed two potential paths forward for the project. Path One would be a narrow-scope project that would focus on entities whose business model regarding physical commodity inventory is to buy and sell that inventory without engaging in processing or conversion activities necessary to make them saleable or marketable. Path Two would be a broader project that would evaluate whether fair value represents a more decision-useful measurement basis for physical commodities held by a broader population of entities, including those that conduct limited processing activities.

47. The staff has continued its research and developed two narrow-scope alternatives (under Path One) to improve the information provided to investors and other allocators of capital (herein referred to as investors) by making targeted improvements to the accounting for commodities for trading purposes (held primarily by financial institutions). Alternative 1 would require or permit entities that meet certain criteria to record commodity inventories at fair value (Topic 330 inventory approach), and Alternative 2 would require or permit entities that are subject to financial services industry-specific Topics (industry-specific approach) to record commodity inventories at fair value.

Stakeholder Outreach

48. The staff performed targeted outreach with investors that cover financial institutions. Overall, most investors supported fair value measurement of commodity inventories held for trading purposes. One investor noted that fair value measurement may better reflect the underlying

economics of commodity inventories than other measurement bases. That investor also observed that financial institutions often economically hedge commodity inventories and that because the hedging instruments are accounted for at fair value, there is often a mismatch in measurement bases between the commodity inventories and the hedging instruments and that the inconsistent measurement creates earnings volatility.

49. The staff also performed outreach with financial institution preparers and practitioners to determine whether Alternative 1 or Alternative 2 would be more operable. Most participants supported Alternative 1 with suggested adjustments. Almost all participants agreed that Alternative 2 would have additional complexity because financial institutions comprise many different types of legal and reporting entities and only some of those entities are subject to industry-specific guidance.