FASAC FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL

Virtual Meeting via Zoom
Thursday, September 24, 2020
Agenda

10:30–10:35 am EST (5 minutes)	**Introductions and Opening Remarks** (Mr. Michael Morrow)
10:35–10:55 am (20 minutes)	**Topic 1—Highlights on Current Hot Topics** • FASB Highlights (Mr. Richard Jones) • SEC Highlights (Mr. John Vanosdall) • PCAOB Highlights (Ms. Megan Zietsman)
10:55–11:15 am (20 minutes)	**Topic 2—Accounting Standards and Financial Statements in the Current Environment** *Session Structure:* • Full group discussion *(20 minutes)*
11:15 am–12:30 pm (75 minutes)	**Topic 3—Accounting for Research and Development** *Session Structure:* • Introductions and description of the breakout group tasks– 11:15 -11:25 am *(10 minutes)* • ***Brief break*** to move to breakout groups 11:25 – 11:35 am (10 minutes) • Breakout discussions -11:35 am -12:30 pm *(55 minutes)*
12:30-1:15 pm	**BREAK (45 minutes)**
1:15–2:00 pm (45 minutes)	**Topic 3—Accounting for Research and Development (continued)** • Reconvene to analyze and further explore the similarities, differences, and other linkages in Council members' views from the breakout groups

2:00-3:00 pm (60 minutes)	**Topic 4 —Implementation of Credit Losses** • Introduction from FASB staff 2:00 – 2:05 pm *(5 minutes)* • Full group discussions – 2:05 – 3:00 pm *(55 minutes)*
3:00 pm	**ADJOURNMENT**

FASAC
Attachment 1

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REPORT OF THE FASB CHAIR

April 1, 2020 through June 30, 2020

ITEM 1: STANDARDS-SETTING ACTIVITIES

A. FINAL STANDARDS AND DOCUMENTS ISSUED FOR PUBLIC COMMENT

1. The Board issued the following final document:
   a. Accounting Standards Update No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, issued June 3, 2020.
2. The Board issued the following proposed document for public comment:
   a. Proposed Accounting Standards Update, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities* (issued April 21, 2020). Comment deadline: May 6, 2020.

B. CHANGES TO THE STANDARDS-SETTING AGENDA

1. The Board added the following projects to its technical agenda:
   a. Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities
   b. Insurance—Deferral of the Effective Date and Amendments to Early Application in Update 2018-12.

C. SIGNIFICANT TECHNICAL DECISIONS

1. Effective date considerations due to Coronavirus Disease 2019 (COVID-19) disruptions:
   a. In April, the Board decided to add a project to its technical agenda to amend the effective dates of Topic 606, Revenue from Contracts with Customers, and Topic 842, Leases, for certain entities and add a project to its research agenda to evaluate how to reduce implementation costs for the franchisor industry related to applying Topic 606 to initial franchise fees. At that meeting, the Board directed the staff to draft a proposed Accounting Standards Update for vote by written ballot with a 15-day comment period.

b. In May, the Board discussed comments received and completed its redeliberations on proposed Accounting Standards Update, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities,* that was issued in April. For that final Update the Board decided:

   i. To amend the effective date of Topic 606 for all entities that have not yet adopted the guidance (that is, entities that have not yet issued financial statements or made their financial statements available for issuance reflecting the adoption of Topic 606), including franchisors. For those entities, the effective date of Topic 606 will be for annual reporting periods beginning after December 15, 2019, and interim reporting periods within annual reporting periods beginning after December 15, 2020. Early application will continue to be permitted.

   ii. To amend the effective date of Topic 842. For private companies and private not-for-profit (NFP) entities, the effective date of Topic 842 will be for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. For NFP entities that have issued or are conduit bond obligors for securities that are traded, listed, or quoted on an exchange or an over-the-counter market (public NFP entities) and that have not yet issued financial statements (or made their financial statements available for issuance) reflecting the adoption of Topic 842, the effective date will be fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption will continue to be permitted.

c. The Board concluded that the expected benefits would justify the expected costs of the effective date deferrals and directed the staff to draft a final Accounting Standards Update for vote by written ballot.

d. At the May meeting, the Board also decided to retain the effective date of Accounting Standards Update No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*.

2. Insurance accounting implementation:

a. The Board discussed two agenda requests regarding the effective date of Accounting Standards Update No. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*.

b. The Board decided to add a project to its technical agenda to amend the effective date of the amendments in Update 2018-12 by proposing a one-year deferral of the effective date of those amendments for all insurance entities and changing the early application provisions of Update 2018-12 whereby the early application transition date would be the beginning of the prior period.

c. The Board directed the staff to draft a proposed Accounting Standards Update for vote by written ballot with a 45-day comment period.

3. Distinguishing liabilities from equity (including convertible debt):
   a. The Board completed its redeliberations on the project and as part of that discussion clarified its intent about certain decisions in the proposal and decided to retain certain guidance that was previously deleted as part of the proposal.
   b. The Board concluded that it had received sufficient information and analysis to make an informed decision on the perceived costs of the changes and that the expected benefits would justify the expected costs of the amendments in the final Update and directed the staff to draft a final Accounting Standards Update for vote by written ballot.
4. Not-for-profits (NFP) Gifts-in-kind:
   a. The Board discussed feedback received and completed redeliberations on proposed Accounting Standards Update, *Not-for-Profit Entities (Topic 958): Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*.
   b. The Board affirmed its decisions about scope and presentation and made various decisions about specific disclosures.
   c. The Board affirmed that an NFP should apply a retrospective method of transition and decided that the amendments will be effective for NFPs for annual reporting periods beginning after June 15, 2021, and interim periods within fiscal years beginning after June 15, 2022, with early adoption permitted.
   d. The Board concluded that it received sufficient information and analysis to make an informed decision on the perceived costs of the changes and that the expected benefits would justify the expected costs of the amendments in the final Update and directed the staff to draft a final Accounting Standards Update for vote by written ballot.

ITEM 2: PREAGENDA RESEARCH

A. CHANGES TO THE RESEARCH AGENDA

1. The Board added a project to its research agenda on Revenue Recognition—Initial Franchise Fees.

B. SIGNIFICANT RESEARCH ACTIVITIES

1. The staff performed research on:
   a. Interest income
   b. Lease modifications impacted by COVID-19
   c. Hedging relationships forecasts impacted by COVID-19

d. Paycheck Protection Program loans

e. Disclosure of government assistance

f. Fair value measurement

g. Private company profit interests and partnership accounting

h. Discussion/feedback on accounting for Federal Reserve Main Street Facility

i. Borrower accounting for debt modifications

j. Initial discussion on first quarter 2020 quarterly disclosures for credit losses

k. Negative interest rates

l. Purchased callable debt.

C. ACTIVITIES OF THE FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL (FASAC) AND FASB ADVISORY COMMITTEES

1. FASAC meeting:

   a. Seven Board members, the acting technical director, the incoming FASB chair, and several FASB staff members participated in the June 23, 2020 virtual public FASAC meeting. The meeting topics focused on FAF/FASB Post-Implementation Review (PIR) and highlights on current hot topics and accounting standards and financial statements in the current environment.

2. The following advisory committee meetings were held:

   a. Seven Board members, the acting technical director, the incoming FASB chair, and several FASB staff members participated in the April 7 virtual public meeting of the Not-for-Profit Advisory Committee (NAC). Meeting topics focused on reporting of contributed nonfinancial assets (gifts-in-kind) by not-for-profit entities (NFPs); implementation of major/other updates; the FASB's project on goodwill and intangibles; and recent trends, concerns, and observations of NAC members (especially COVID-19-related matters). One Board member, the acting technical director, and other staff subsequently met twice by videoconference with a subgroup of NAC members regarding COVID-19-related matters.

   b. Three Board members, the acting technical director, the incoming FASB chair, and several FASB staff members participated in the May 7 virtual private meeting of the Small Business Advisory Committee (SBAC). The SBAC members received an update on the Board's recent decisions on matters related to the effect of COVID-19 and on future standard-setting activities for current project deliberations. The SBAC members also provided feedback about the accounting issues that the small business community currently faces.

c. Three Board members, the acting technical director, the incoming FASB chair, and several FASB staff members participated in the May 14 virtual private Investor Advisory Committee (IAC) meeting. The IAC members received an update on the implications of COVID-19 on the FASB's standard-setting efforts and on the implementation status of both Leases and credit losses (CECL). The IAC members also provided feedback on investor emerging issues and trends and provided input on what the future priorities should be for FASB standard setting.

3. Advisory committee membership changes:

   a. None.

D. OTHER SIGNIFICANT STAKEHOLDER OUTREACH ACTIVITIES

1. One Board member and the incoming FASB chair participated in the April 6, 2020 discussion with the Financial Executives Institute on Corporate Reporting (CCR). The topics included an overview of the operational challenges in the current environment, the CARES Act, as well as discussions on impairment, CECL, tax provisions, and disclosures.
2. Two Board members and the incoming FASB chair participated in the June 9, 2020 Institute of Management Accountants Financial Reporting Committee (FRC) virtual meeting. The meeting topics included COVID-19 challenges, PIR plans for revenue recognition, leases and CECL, and updates on the conceptual framework elements Exposure Draft and convertible debt versus equity.
3. Three Board members, the incoming FASB chair, and the acting technical director participated in the June 25, 2020 CCR virtual meeting. The meeting included an update on segment reporting, government assistance, income tax disclosures and accounts payable programs, as well as COVID-19 discussions.

E. INTERACTION WITH PRIVATE COMPANY STAKEHOLDERS

1. Seven Board members, the acting technical director, the incoming FASB chair, and several FASB staff members participated in the April 17, 2020 Private Company Council (PCC) meeting. The PCC discussed and provided input on FASB projects, including revenue recognition and the conceptual framework—elements, measurement, and presentation. The PCC also discussed current issues in financial reporting affecting private companies arising from the COVID-19 pandemic in the areas of leases, fair value measurement, interest income recognition, and Small Business Administration loans. The PCC considered the progress on PCC Issue No. 2018-01, "Practical Expedient to Measure Grant-Date Fair Value of Equity-Classified Share-Based Awards." Previously, in February 2020, the Board endorsed the PCC's decision to issue a proposed Update on that practical expedient. However, because many private company stakeholders currently are experiencing resource constraints and may be unable to provide feedback at this time, the

PCC unanimously agreed to delay the issuance of the proposed Update until later in the second quarter of 2020. The PCC member from academia presented some of his private company research findings for the PCC to consider.

2. Seven Board members, the acting technical director, the incoming FASB chair, and several FASB staff members participated in the June 25, 2020 PCC meeting. The PCC discussed and provided input on FASB projects, including FASB Accounting Standards Update No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, distinguishing liabilities from equity, and profits interests and their interrelationship with partnership accounting. The PCC also discussed current issues in financial reporting affecting private companies arising from the COVID-19 pandemic in the areas of impairment of nonfinancial assets, debt modifications and troubled debt restructurings, government assistance & related disclosures, and going concern. The PCC considered further delaying issuance of the proposed Update resulting from Issue 2018-01 because many private company stakeholders continue to experience resource constraints and still may be unable to provide feedback at this time. The PCC unanimously agreed to delay the issuance of the proposed Update for public comment until August 2020.
3. There were no Private Company Town Halls in the second quarter of 2020.

F. SIGNIFICANT PROJECT-SPECIFIC OUTREACH ACTIVITIES

1. The FASB members and staff conducted 134 outreach meetings (11% with investors and other users, 41% with practitioners, 21% with preparers, 6% with regulators, and 21% with others*) to discuss issues in 22 different FASB and EITF active projects or final standards, most notably CECL, leases, revenue recognition for initial franchise fees, insurance, and revenue recognition under Topic 805.

   *Others (including trade group representatives, other standard setters, academics, consultants, valuation professionals, and state societies of CPAs)

2. Through 76 comment letters and 16 external reviews, the Board received feedback from a range of stakeholder types (45% auditors, 19% financial statement preparers, 5% trade organizations, and 31% others*) on different FASB and EITF projects.

   *Others (including consultants, regulators, academics, and state societies of CPAs)

G. EMERGING ISSUES TASK FORCE (EITF) ACTIVITIES

1. The EITF did not meet in the second quarter of 2020.

H. INTERNATIONAL ACTIVITIES

1. Activities between the FASB and the IASB were as follows:
    a. The chair, incoming chair, and a Board member participated in the IASB's Accounting Standards Advisory Forum by video conference.
2. Activities between the FASB and other national standards setters included the following:
    a. The chair, incoming chair, and two Board members met twice by video conference privately with representatives of the Multi-Lateral Network (MLN).
    b. The chair, incoming chair, and a Board member met by video privately with the Accounting Standards Board of Japan and discussed matters of mutual interest.
    c. The chair, incoming chair, and a Board member met by video privately with the Korean Accounting Standards Board and discussed matters of mutual interest.
    d. A Board member and the acting technical director participated in the International Accounting and Reporting Forum by video conference.
    e. The International Forum of Accounting Standard Setters meeting in DC to be sponsored by the FASB was cancelled.

I. VIDEOS AND WEBINARS

1. The FASB featured 4 videos and 2 webinars:
    a. Video: Meet the FASB Chair: Rich Jones
    b. Text Video: COVID-19 support 1
    c. Text Video: COVID-19 support 2
    d. Text Video: Upcoming Liabilities & Equity/Convertible Debt standard
    e. Webinar: *IN FOCUS:* FASB Update for Private Companies and Not-for-Profit Organizations (semiannual)
    f. Webinar: *IN FOCUS:* 2020 GAAP and SEC Reporting Taxonomy Improvements and SEC Update.

J. SPEECHES DELIVERED

1. FASB members or staff delivered 24 speeches at different conferences/virtual events:
    a. Accounting CPE Network (ACPEN) Not-for-Profit Update
    b. AICPA Not-for-Profit Conference
    c. American Society of Appraisers (ASA) 15th Annual Fair Value Conference

d. California Society of CPAs (CalCPA) Not-for-Profit Organizations Conference
e. CalCPA Accounting Principles & Assurance Services Annual Meeting
f. Connecticut Society of CPAs Not-for-Profit Conference
g. CFA Society of New York
h. Evercore CECL Webinar
i. EY 2020 Compliance Audit, OMB Uniform Guidance, Not-for-Profit, Health and Government and Public Sector Executive Event
j. Florida Institute of CPAs Not-for-Profit Organizations Conference
k. Georgia Society of CPAs Not-for-Profit Conference
l. Gonzaga University
m. Houston Texas Society of CPA Foundation Financial Reporting Symposium
n. IIF International Accounting and Reporting Forum (IARF)
o. International Franchise Association (IFA) Webinar
p. Kansas Society of CPAs Governmental Nonprofit Accounting & Auditing Conference
q. National Association of College and University Business Officers (NACUBO) Higher Education Forum
r. SEC Institute 35th Midyear SEC Reporting & FASB Forum
s. Tax Executives Institute Financial Reporting Seminar
t. Texas Society of CPAs Nonprofit Organizations Conference
u. University of South Florida Accounting Circle Conference
v. University of Wisconsin Professional Practice Issues in Accounting, Auditing, and Taxation Course
w. Wall Street Journal CFO Network Roundtable
x. Wipfli LLP Rocky Mountain Check-In.

K. PRESS RELEASES, MEDIA ADVISORIES, AND SOCIAL MEDIA

1. The FASB issued 14 press releases, media advisories, meeting recaps, or stakeholder emails on a variety of topics with accompanying social media.

L. OTHER COMMUNICATIONS ACTIVITIES AND EDUCATION

1. 2Q 2020 issue of the "FASB Outlook" newsletter was issued on May 12, 2020.

2. FASB's COVID-19 stakeholder support web portal debuted in April.
3. Interviews, statements, and background interviews were conducted on credit losses and COVID-19, reference rate reform, goodwill, and other topics.

ITEM 3: STRATEGIC, ADMINISTRATIVE, AND PROCEDURAL ACTIVITIES

A. STRATEGIC PLAN ACTIVITIES

1. None.

B. PROFESSIONAL DEVELOPMENT PROGRAMS

1. "Academic Research on Non-GAAP Reporting."

ITEM 4: FEDERAL GOVERNMENT AND REGULATORY LIAISON ACTIVITIES

A. REPRESENTATIVES OF CONGRESS AND FEDERAL REGULATORY BODIES

1. The chair and two FASB members met virtually with Treasury Department staff on June 6.

ITEM 5: FAF/FASB/GASB INTERACTION

A. The GASB and FASB meeting minutes were shared with the FASB and GASB Board members and staff.

B. MEETINGS

1. The FASB and GASB directors met monthly to discuss their technical agenda projects and other matters of mutual interest.
2. The FASB and GASB chairmen and their respective directors held their quarterly meeting to discuss technical issues and other matters of mutual interest.

C. DOCUMENT DRAFT REVIEWS

1. The GASB sent the following drafts to the FASB staff for review:
   a. Final standard on Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans
   b. Final standard on Subscription-Based Information Technology Arrangements
   c. Exposure Draft on Postponement of Effective Dates on Certain Authoritative Guidance
   d. Exposure Draft on Conceptual Framework: Recognition
   e. Exposure Draft on Financial Reporting Model Reexamination

f. Preliminary Views on Revenue and Expense Recognition

g. Proposed Technical Bulletin on Accounting and Financial Reporting Issues Related to the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 and COVID-19.

2. The FASB staff distributed the following drafts to the GASB for review:

   a. Proposed Accounting Standards Update, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*

   b. Proposed Accounting Standards Update, *Financial Services—Insurance (Topic 944): Effective Date and Early Application*

   c. Proposed Statement of Financial Accounting Concepts, *Conceptual Framework for Financial Reporting—Chapter 4: Elements of Financial Statements*.

ITEM 6: XBRL ACTIVITIES

The FASB is responsible for the ongoing development and maintenance of the GAAP Financial Reporting Taxonomy (Taxonomy) and the SEC Reporting Taxonomy (SRT) applicable to public issuers registered with the U.S. Securities and Exchange Commission (SEC).

A. TECHNICAL ACTIVITIES

1. The FASB published Taxonomy Updates as final (pending annual update) for:

   a. Accounting Standards Update No. 2020-05—*Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*.

2. The FASB published a Taxonomy Exposure Draft for:

   a. Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities.

3. The FASB published a Staff Q&A on the Application of the Taxonomy to COVID-19 Pandemic and Relief Disclosures.

4. The Taxonomy staff performed the following research projects supporting various Board-level projects:

   a. Post Implementation Review of ASU 2016-02, Leases under Topic 842

   b. Impact of the adoption of CECL on Trade Receivables of Fortune 500 companies

   c. Effect of COVID-19 on going-concern disclosures

   d. Effect on and interaction of business combinations and goodwill

e. The effect of the CARES Act on a bank's decision to defer CECL and its impact on loan growth, that is whether banks that chose to defer had a different rate of loan growth then those that did not

f. The impact of the adoption of SOFR.

B. OUTREACH ACTIVITIES

1. The more significant Taxonomy-related outreach activities this quarter included the following:

   a. Taxonomy staff working with two academics developed two workshops for research and using XBRL in the classroom that were presented on June 11, 2020, virtually at the American Accounting Association Virtual SPARK Meeting.

   b. Taxonomy staff presented "FASB Requirements for Extensible Enumerations in the US GAAP Taxonomy" at XBRL US webinar on April 13, 2020.

   c. The Chief of Taxonomy Development participated as a panelist on XBRL US webcast, "SEC Filer Toolkit: FASB and XBRL US Resources for XBRL Preparation."

2. Hosted or participated in meetings of the FASB Taxonomy Advisory Group, XBRL US Data Quality Committee, various XBRL International technical working groups (including Taxonomy staff chairing the XBRL Standards Board and the Entity Specific Disclosure Task Force), the IASB IFRS Taxonomy Consultative Group, and the SEC Division of Economic and Risk Analysis (DERA) staff.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

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Technical Agenda Overview

as of July 1, 2020

FRAMEWORK PROJECTS	Current Stage	Timing
Conceptual Framework: Elements	Drafting ED	**Q3 2020**
Conceptual Framework: Measurement	Initial deliberations	
Conceptual Framework: Presentation	ED redeliberations	

RECOGNITION & MEASUREMENT: BROAD PROJECTS	Current Stage	Timing
Distinguishing Liabilities from Equity (including convertible debt)	Drafting final standard	**Q3 2020**
Identifiable Intangible Assets and Subsequent Accounting for Goodwill	Initial deliberations	

RECOGNITION & MEASUREMENT: NARROW PROJECTS	Current Stage	Timing
Accounting by a Joint Venture for Nonmonetary Assets Contributed by Investors	Initial deliberations	
Codification Improvements	ED redeliberations	
Codification Improvements—Financial Instruments—Credit Losses (Vintage Disclosure: Gross Writeoffs and Gross Recoveries)	Initial deliberations	
Codification Improvements—Hedge Accounting	ED redeliberations	
Consolidation Reorganization and Targeted Improvements	ED redeliberations	
Distinguishing Liabilities from Equity Phase 2	Initial deliberations	
Hedging—Last-of-Layer Method	Initial deliberations	
Improving the Accounting for Asset Acquisitions and Business Combinations	Initial deliberations	
Insurance—Deferral of the Effective Date and Amendments to Early Application in Update 2018-12	Drafting ED	**Q3 2020**
PCC Issue No. 2018-01, Practical Expedient to Measure Grant-Date Fair Value of Equity-Classified Share-Based Awards	Drafting ED	**Q3 2020**
Revenue Recognition—Contract Modifications of Licenses of Intellectual Property (EITF 19-B)	Initial deliberations	

Warrant Modifications: Issuers' Accounting for Modifications of Equity Classified Freestanding Call Options That are Not in the Scope of Topic 718 or Topic 815 (EITF 19-C)	Initial deliberations	

PRESENTATION & DISCLOSURE PROJECTS	**Current Stage**	**Timing**
Disclosure Framework: Disclosure Review—Income Taxes	Revised ED redeliberations	
Disclosure Framework: Disclosure Review—Inventory	ED redeliberations	
Disclosure Framework: Disclosures—Interim Reporting	Initial deliberations	
Disclosure Improvements in Response to the SEC's Release on Disclosure Update and Simplification	ED redeliberations	
Disclosures by Business Entities about Government Assistance	ED redeliberations	
Financial Performance Reporting—Disaggregation of Performance Information	Initial deliberations	
Not-for-Profit Reporting of Gifts-in-Kind	Drafting final standard	**Q3 2020**
Segment Reporting	Initial deliberations	
Simplifying the Balance Sheet Classification of Debt	Revised ED redeliberations	

RESEARCH PROJECTS
Disclosure Review—Intangibles, Share-based Payment, and Foreign Currency
Financial Performance Reporting: Financial Statements of Not-for-Profit Entities Structure of the Performance Statement
Hedge Accounting—Phase 2
Income Taxes—Backwards Tracing
Inventory and Cost of Sales
Recognition and Measurement of Revenue Contracts with Customers under Topic 805
Revenue Recognition—Initial Franchise Fees
Targeted Improvements to the Statement of Cash Flows
Variable Interest Entity Related Party Guidance

FASAC FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL

ATTACHMENT 2

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Financial Accounting Standards Advisory Council
June 24, 2020

Objectives of This Session

The objectives of this session are to gain an understanding of Council members' views about:

(a) The accounting (capitalization versus expense) for research and development (R&D) acquired in a business combination, an asset acquisition, and internally developed

(b) Whether improvements to the accounting for R&D should be a priority for the Board's future agenda.

Discussion questions are included on page 13.

As background for that discussion, this paper describes:

(a) GAAP Requirements

(b) International Requirements

(c) Previous FASB Projects

(d) Related Projects on the FASB's Current Technical or Research Agenda

(e) Previous FASAC Input

(f) Potential Alternatives.

Note: These materials are provided to facilitate understanding of the issues to be addressed at the September 24, 2020 FASAC meeting. These materials are presented for discussion purposes only; they are 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.

GAAP Requirements

Research & Development

Under GAAP (Topic 730, Research and Development) research and development costs are expensed as incurred. An entity is required to disclose the total amount of research and development (R&D) costs incurred in each period for which an income statement is presented. That guidance does not apply to in-process R&D acquired in a business combination (or an acquisition by a not-for-profit entity).

When that guidance on research and development originally was issued in 1974, the FASB decided that R&D costs should be expensed as incurred for the following reasons:

(a) Future economic resource—At that time, most R&D costs are incurred, the future benefits are at best uncertain, and there is no indication that an economic resource is created.

(b) Measurability—Even if future benefits from a particular R&D project may be foreseen, they generally cannot be measured with a reasonable degree of certainty.

(c) Correlation—There is normally little, if any, direct relationship between the amount of current R&D expenditures and the amount of resultant future benefits to an entity.

(d) Matching—Because there is a lack of discernible future benefits at the time that the costs are incurred, the immediate recognition principle of expense recognition should apply.

Acquired In-Process R&D

The accounting for acquired in-process R&D differs based on the manner in which the project is acquired (an asset purchase or a business combination).

In 2001, the FASB issued FASB Statement No. 142, *Goodwill and Other Intangible Assets,* which required identifiable intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) to be recognized and measured at cost. If the acquisition is not a business, the acquirer would expense acquired tangible and intangible research and development assets (the “cost” is based on relative fair value) *unless the assets have alternative future uses* and are then capitalized and subsequently amortized (paragraph 730-10-25-2(c)).

In 2007, the FASB issued Statement No. 141 (Revised 2007), *Business Combinations,* which required intangible assets, including in-process R&D, acquired in a business combination to be recognized and initially measured at fair value, capitalized as indefinite-lived assets, tested for impairment (that is, the fair value of the indefinite-lived intangible is compared with its’ carrying value both annually and more frequently if there is an indication that the intangible asset is

impaired), and remain on the balance sheet until the completion or abandonment of the associated R&D project. Additional costs to complete the in-process R&D project are expensed in accordance with Topic 730.

Prior to Statement 141(R), FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, required an acquirer to measure and immediately expense tangible and intangible assets to be used in research and development that had no alternative future use. A research and development asset was recognized as such only if it had an alternative future use.

Internally Generated Intangibles

Under Topic 350, Goodwill and Other, the costs of internally developing, maintaining, or restoring intangible assets (including goodwill) that are not specifically identifiable, have indeterminate lives, or are inherent in a continuing business and related to an entity as a whole are recognized as an expense when incurred. Other than that guidance, GAAP does not have overarching recognition and measurement guidance for internally developed intangible assets. Instead, GAAP has different guidance for recognizing and measuring some internally developed intangible assets, including software, certain oil and gas industry assets, film costs, record costs, title plant costs, and some other costs associated with obtaining a contract with a customer. For example, an entity is required to capitalize the costs incurred in creating computer software after technological feasibility has been achieved under Topic 985, Software.

Although stakeholders often think about R&D when considering unrecognized internally generated intangible assets, there are several other intangible items that are either not recognized or not always recognized. Depending on an entity, those other unrecognized internally generated intangible assets might be individually or in the aggregate more valuable to the entity than R&D. Examples of other intangible items that are commonly asserted as assets include:

(a) Brands and logos

(b) Supply agreements with terms that are more favorable than current market terms

(c) Noncompetition agreements

(d) Collaboration agreements

(e) Goodwill

(f) Data.

Some previous Board members questioned whether those assets, if recognized, would (i) provide useful information to investors or (ii) have associated financial reporting benefits that

justify the costs. However, many unrecognized internally generated intangible items are required to be recognized as assets if externally acquired.

In addition, previous Board members have had various views about whether those other intangible items meet the definition of an asset within Concepts Statement No. 6, *Elements of Financial Statements, which* states:

> *Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.*

On July 16, 2020, the Board issued an Exposure Draft that proposed changes to that Concepts Statement definition. The Board expects that most assets that met the definition of an asset in CON 6 will continue to qualify as assets under the proposed definition of an asset. That Exposure Draft also seeks stakeholders' input on internally generated intangible assets—specifically, whether the proposed definition is helpful in resolving issues of identifying intangible assets. The proposed definition of an asset is:

> *An asset is a present right of an entity to an economic benefit.*

Appendix 2A includes additional information about the Board's proposed definition and the characteristics of assets (excerpts from paragraphs E17—E30 of the Exposure Draft).

International Requirements (International Financial Reporting Standards (IFRS))

IAS 38, *Intangible Assets*, issued in 2004, specifies recognition criteria for capitalizing initial costs incurred to acquire or internally generate an intangible asset and subsequent costs incurred to add to, replace part of, or service the asset. An entity is required to recognize an asset if the intangible is identifiable and if the following criteria are met:

(a) It is probable that the expected future benefits that are attributable to the asset will flow to the entity.

(b) The cost of the asset can be measured reliably.

Under IAS 38, internally generated intangible assets that meet the criteria described in the previous paragraph are required to be recognized on the balance sheet at cost and intangible assets acquired in an asset acquisition are required to be recognized at the purchase price plus any directly attributable cost of preparing the asset for its intended use. Under IFRS 3, *Business Combinations*, intangible assets acquired in a business combination are required to be recognized at fair value as of the acquisition date.

A difference between IAS 38 and GAAP is the accounting for R&D. IAS 38 makes a distinction between accounting for research costs and accounting for development costs. Expenditures

incurred during the research phase should be expensed as incurred, while expenditures incurred during the development phase should be recognized as an intangible asset if an entity can demonstrate all of the following:

(a) The technical feasibility of completing the intangible asset so that it will be available for sale

(b) Its intention to complete the intangible asset and use or sell it

(c) Its ability to use or sell the intangible asset

(d) How the intangible asset will generate probable future economic benefits (for example, the existence of a market or the usefulness of the intangible asset)

(e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset

(f) Its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Previously, stakeholders indicated that there is a high amount of subjectivity involved in capitalizing development phase costs under IAS 38. Stakeholders also indicated that although the requirements for internally developed development costs between GAAP and IFRS Standards are different, the financial reporting outcomes are not always significantly different because the threshold for recognizing development under IFRS Standards is both high and subjective.

In 2020, the IASB issued Discussion Paper, DP/2020/1, *Business Combinations—Disclosures, Goodwill and Impairment.* The Discussion Paper sets out the IASB's preliminary view that entities should continue to be required to recognize identifiable intangible assets separately from goodwill. The IASB concluded in that Discussion Paper that there is no compelling evidence that the requirements in IAS 38 should be amended.

Previous FASB Projects

The FASB has undertaken previous efforts to consider and seek input on the following:

(a) The hurdles to creating accounting principles that would lead to capitalizing costs associated with intangible assets

(b) Possible improvements that might provide financial statement users with additional information and/or align the GAAP with IFRS Standards.

Below is a description of those past projects.

Special Report: More Information About Intangible Assets

The FASB completed a research project in 2001 about a potential disparity between information provided in financial statements and the informational needs of investors and creditors about intangible assets and published Financial Accounting Series No. 219-A Special Report, *Business and Financial Reporting, Challenges in the New Economy* (referred to as the Special Report). The Special Report indicated that because of a "new economy," financial statement users need more information about intangible assets.

The Special Report identified the following two hurdles that historically have impeded attempts for creating accounting principles in the United States that would lead to capitalizing costs associated with the generation of intangible assets:

(a) The time gap—The period of time is undeterminable between when R&D costs are being incurred and when those expenditures and efforts can be demonstrated to have probable future benefits.

(b) The correlation gap—The cost of R&D is not a reliable measure of the future economic benefit research and development may generate.

The Special Report identified the following possible standards-setting projects that might provide users with additional information about intangible assets:

(a) A project to require disclosures about internally developed intangible assets

(b) A project to require recognition of intangible assets created as the result of R&D projects and potentially discrete efforts to expand the capitalization of other intangible assets.

Project to Improve the Information About R&D Costs

In response to the Special Report, in August 2001, the FASB issued *Proposal for a New Agenda Project, Disclosure of Information About Intangible Assets Not Recognized in Financial Statements,* which requested that stakeholders provide comments on the objective and scope of a project to establish standards for improving disclosure of information about intangible assets that are not recognized in financial statements.

The primary goal of the project was to provide financial statement users with more information about R&D costs. Financial statement users generally supported the project. However, preparers expressed reservations about disclosing additional information related to R&D expenditures because of concerns about disclosing proprietary information.

In January 2002, the FASB added to its technical agenda a project on disclosure of information about intangible assets that are not recognized in financial statements in response to the favorable feedback received from financial statement users. In January 2004, the FASB removed the project from its agenda. The FASB acknowledged the importance of this project but decided that the nature and timing of such a project should be considered in the context of its plans for a coordinated agenda with the IASB. Intangible assets was one of the projects included in the 2006 Memorandum of Understanding (MoU) between the IASB and the FASB when the Boards agreed to work together to remove differences between IFRS Standards and GAAP; however, it was not added to either the IASB's or the FASB's technical agenda.

Related Projects on the FASB's Current Technical or Research Agenda

More recently, the FASB has undertaken efforts related to:

(a) Narrowing differences between the accounting for acquisitions of assets and for the acquisitions of businesses

(b) The accounting for goodwill and identifiable intangible assets in a business combination.

The objective of those projects and decisions reached are described below.

Additionally, the Board has a project on its research agenda to review current disclosure requirements to improve the financial information in the notes to financial statements about intangible assets. Similar to other disclosure review projects, when conducting this research, the Board would use the conceptual framework chapter related to notes to financial statements[1] to identify a broad range of possible information to consider when deciding on the disclosure requirements for a particular topic. From that intentionally broad set, the Board would identify a narrower set of disclosures about that topic to be required on the basis of, among other considerations, an evaluation of whether the benefits of entities providing the information justify the costs.

Improving the Accounting for Asset Acquisitions and Business Combinations

The Board has a project on Improving the Accounting for Asset Acquisitions and Business Combinations (Phase 3 of the Definition of a Business Project). The objective of that project is to improve the accounting for asset acquisitions and business combinations by narrowing the differences between the two acquisition models (the accounting for acquisitions of assets and for the acquisitions of businesses).

[1] FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 8, Notes to Financial Statements*. Additional information about and access to that chapter is available online.

The accounting for R&D is one of the areas where there are differences. Specifically, given the guidance described above:

(a) For business combinations, an acquirer is required to recognize all tangible and intangible R&D assets acquired at fair value. After initial recognition, tangible assets acquired in a business combination that are used in R&D activities are accounted for in accordance with their nature. Intangible assets acquired in a business combination that are used in R&D activities (that is, in-process research and development (IPR&D)) are capitalized as indefinite-lived intangible assets and remain on the balance sheet until the completion or abandonment of the associated R&D project. During the period that they are considered indefinite lived, they are tested for impairment. That is, the fair value of the indefinite-lived intangible asset is compared with its carrying value both annually and more frequently if there is an indication that the intangible asset is impaired. Additional costs to complete the IPR&D project are expensed (in accordance with Topic 730).

(b) If the acquisition is not a business, R&D accounting is applied (paragraph 730-10-25-2), which requires that the acquirer expense acquired tangible and intangible R&D assets, unless the assets have alternative future uses.

In September 2020, the Board decided to exclude the accounting for IPR&D from this project. Some of the observations made by individual Board members during that meeting were that:

(a) R&D accounting could be looked at more holistically, which could include consideration of internally developed R&D.

(b) Expensing R&D in a business combination (consistent with the accounting required in an asset acquisition) would not provide users of the financial statements with beneficial information.

(c) Addressing R&D in the context of this project would potentially delay the completion of the project.

The differences in the accounting for IPR&D in the two acquisition models also are relevant to:

(a) The accounting for IPR&D by a primary beneficiary when it initially consolidates a variable interest entity that is not a business. The Board will consider this issue in its project on improving the accounting for business combinations and assets acquisitions.

(b) The accounting for IPR&D by a joint venture[2] upon formation in its standalone financial statements when it accounts for contributions by the venturers. The Board is

[2] As defined in the Master Glossary:

considering this issue as part of its project on the Accounting by a Joint Venture for Nonmonetary Assets Contributed by Investors.

Business Combinations/Accounting for Identifiable Assets in a Business Combination

In 2014, the FASB issued Accounting Standards Update No. 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination,* which is based on a consensus reached by the Private Company Council. The guidance in that Update provides private companies with an accounting alternative to not recognize separately from goodwill (a) customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of the business and (b) noncompetition agreements.

In 2018, in response to Update 2014-18, the FASB added a separate project to its agenda for public business entities and not-for-profit entities on the accounting for identifiable intangible assets in a business combination to evaluate whether certain intangible assets should be subsumed into goodwill, with a focus on customer relationships and noncompetition agreements. In May 2019, the FASB issued Accounting Standards Update No. 2019-06, *Intangibles—Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958): Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities,* that extends elements of the private company alternative to not-for-profit entities.

In July 2019, the Board issued an Invitation to Comment, *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*, to obtain formal input from stakeholders focusing on public business entities on the subsequent accounting for goodwill, the accounting for certain identifiable intangible assets, and the scope of the project on those topics. The Board discussed the feedback received from its July 2019 Invitation to Comment, supplemental outreach performed by the staff, and the November 2019 public roundtables. The Board discussed the general direction of the project. On the basis of that discussion, the staff plans to:

(a) Explore adding amortization to the goodwill impairment model, including the amortization method and period.

(b) Explore other changes to the goodwill impairment model.

An entity owned and operated by a small group of businesses (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a joint venture frequently is to share risks and rewards in developing a new market, product, or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a joint venture. The ownership of a joint venture seldom changes, and its equity interests usually are not traded publicly. A minority public ownership, however, does not preclude an entity from being a joint venture. As distinguished from a corporate joint venture, a joint venture is not limited to corporate entities.

(c) Consider the accounting for identifiable intangible assets.

(d) Address presentation, disclosure, and transition.

Previous FASAC Input

FASAC members have had multiple discussions about the accounting for R&D and intangible assets in past meetings. The feedback has been mixed, with a wide range of suggestions from Council members in terms of:

(a) The relative priority of improving the accounting for R&D

(b) Whether (and how to) address the recognition and measurement of R&D

(c) The adequacy of existing disclosures.

Below is a summary of each of those discussions, as well as the input from Council members on the 2015 FASAC survey on agenda priorities.

June 2016 FASAC Meeting

At the June 2016 meeting, Council members discussed their views about the financial reporting for intangible assets, potential improvements, and the relative priority of future improvements in this area. The breakout groups focused on (a) Council members' concerns or observations about the various accounting models for intangible assets, (b) whether the FASB should devote resources to making further improvements, and (c) the objective of the project (if the FASB decides to devote resources to make further improvements).

Council members broadly acknowledged that there is lack of comparability in certain areas, but that the current accounting is acceptable. Council members from an investor/user perspective were very focused on cash flows, which is why they concluded that changes to the accounting for intangible assets should not be a high priority for the FASB. Preparers understand the current accounting and did not raise any significant application issues that warrant the FASB's consideration. Council members generally agreed that measuring internally developed R&D or other internally developed intangible assets at fair value would be fundamentally difficult and costly. Furthermore, many members commented that the reliability of the information would be in question. Council members also discussed potential solutions to improving the information provided to users about intangible assets, focusing on potential and existing disclosures in the financial statements and in the Management's Discussion and Analysis.

2015 FASAC Survey Feedback

In June 2015, FASAC members participated in a periodic survey to provide input and advise the FASB on future project priorities on possible new agenda items. On the basis of the overall survey results, improving the accounting for intangible assets, including the capitalization of certain development costs, was one of top five potential projects that FASAC thought should be a priority for the FASB's agenda. It also was one of the top five potential projects that investors and other financial statement users (all from of the FASB advisory groups that participated in the survey) thought should be a priority for the FASB's agenda. Survey respondents stated the following concerns:

(a) Accounting for intangible assets does not have an overarching framework, which creates a lack of comparability for similar intangible assets (for example, many intangible items including IPR&D commonly are recognized as an intangible asset in a business combination, but the costs of the same efforts generally are recognized as an expense when incurred outside a business combination).

(b) There is inconsistent accounting between internally generated and purchased intangibles.

(c) Accounting for intangible assets could be simplified and potentially converged with IFRS Standards, including accounting for development costs.

(d) Financial statements are incomplete because they are missing information about intangible assets. Some stakeholders think one of the reasons for a significant difference between the book value and fair value of some entities' equity is some intangible assets are not recognized for financial reporting purposes while investors consider intangible assets in their valuations

September 2015 FASAC Meeting (Breakout)

At the September 29, 2015 FASAC meeting, one of the breakout groups had some discussion about intangible assets. That breakout group discussed whether certain R&D costs should be capitalized. Some preparers were frustrated that internally generated costs are accounted for in different ways. Breakout group members commented that the cost to account for goodwill is too high because of the impairment testing requirements. The benefit received from investors recognizing an impairment of goodwill (versus amortization) may not be worth it. A Council member asked if the members from that breakout group were suggesting that all costs related to intangible assets should be expensed. A member from that group responded that recognizing all costs as an expense may be a solution; there just needs to be more consistency.

September 2014 Meeting

At the September 11, 2014 FASAC meeting, a representative from a Fortune 500 technology company expressed concern about the accounting guidance for internally generated R&D costs and noted that the topic is a prime candidate to be reconsidered based on continuing evolution in technology.

Some FASAC members suggested that the FASB consider capitalizing certain development costs to better represent the economic reality of R&D expenditures. Some Council members suggested adopting IFRS guidance around the capitalization of development costs. Council members discussed expanding disclosures around R&D, but it was agreed that additional details provided in the disclosures should not go beyond R&D projects that have been announced publicly to avoid causing competitive harm.

Potential Alternatives

Potential approaches to provide financial statement users with more information about R&D that Council members have considered in the past include:

(a) Capitalize R&D (Alternative A). Require recognition of research and/or development on the balance sheet, either at cost or at fair value.

(b) Disclose R&D costs (Alternative B). Require expanded disclosures about R&D costs to provide users with additional information to assist in analyzing similar companies in industries in which intangible items are significant to future prospects

(c) Adopt IAS 38 (Alternative C). Adopt IAS 38 to increase consistency of accounting for intangible assets between GAAP and IFRS Standards.

Discussion Questions

Question 1: There is a lack of consistency in the existing accounting requirements based on how R&D is incurred and acquired. Should improving the accounting for (or the consistency in accounting for) R&D be a priority issue for the FASB? Why or why not?

Question 2: If addressed, which approach to addressing the issue do you prefer and why? If you prefer a recognition approach, please explain your view about (a) the threshold for recognizing the asset and (b) the measurement of the asset (cost or fair value).

Question 3: If addressed, should the issue be addressed broadly for all internally generated intangible assets or should it first be addressed for R&D? Why?

Question 4: (Preparers): Do the existing accounting requirements for R&D influence entities' decisions to invest and spend their capital on new or existing projects?

Question 5: (Investors/Users): How do you consider the value of R&D costs when analyzing an entity? Do you utilize the information about some R&D costs different than others? If so, which ones and why?

Appendix 2A – Proposed Concepts Definition of an Asset

From Proposed Statement of Financial Accounting Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4: Elements of Financial Statements

E17. An asset has the following two essential characteristics:

a. It is a present right.
b. The right is to an economic benefit.

The combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit.

E18. Assets commonly have features that help identify them—for example, assets may be contractual, tangible, exchangeable, or separable. However, those features are not essential characteristics of assets. Their absence is not sufficient to preclude an item from qualifying as an asset.

E19. The common characteristic of assets is "economic benefit"—the capacity to provide services or benefits to the entities that use them. In a business entity, that economic benefit eventually results in potential net cash inflows to the entity. In a not-for-profit entity, that economic benefit is used to provide desired or needed goods or services to beneficiaries or other constituents, which may or may not directly result in net cash inflows to the entity. Some not-for-profit organizations rely significantly on contributions or donations of cash to supplement selling prices or replace cash or other assets used in providing goods and services. The relationship between the economic benefit of an entity's assets and net cash inflows to that entity can be indirect in both business entities and not-for-profit entities.

E20. An asset has the capacity to be beneficial to an entity by being exchanged for something else of value to the entity, by being used to produce something of value to the entity, or by being used to settle the entity's liabilities. Things that give an entity no advantage beyond the common advantages of others because they are available to all do not qualify as assets. The ability to restrict others' access is a component of an asset of an entity because the ability to restrict creates an advantage in the form of privileged access and control of economic benefits. A right that is not restricted, such as a right to sue or a right to enjoy music, is not an asset of an entity. Access to a public road outside an entity's property might provide a right to an economic benefit, but if the entity cannot restrict access to that road, the road is not an asset of the entity. Although proximity of the road might add value to the property, there is no right that has granted privileged access or advantage to the entity.

E21. Incurring a cost to acquire an item does not in itself qualify the item to meet the definition of an asset, for example, services provided by other entities, including personal services that are received and used simultaneously. They can be assets of an entity only momentarily—as the entity receives and uses them—although their use may create or add value to other assets

of the entity. Rights to receive services of other entities for specified or determinable future periods can be assets of an entity.

Present right

E22. A right entitles its holder to have or obtain something or to act in a certain manner. Rights can be obtained in various ways. Often, rights are obtained by legal ownership, for example, owning a building. Legal ownership gives the owner access to economic benefits, including the ability to possess, use, and enjoy the right; to sell, donate, or exchange the right; or to exploit the right's value by, for example, pledging it as a security for borrowing.

E23. Legally enforceable rights to economic benefits can be obtained without legal ownership of the underlying benefit itself as is the case, for example, when property is leased or intellectual property is licensed or when an entity has the rights to specified certain cash flows, as in the case of a contract providing rights only to interest flows from a specified debt instrument. Other legally enforceable rights that give rise to assets include the right to require other parties to make payments or render services and the right to use a patent or a trademark. Legally enforceable rights include, among other rights, contractual rights (for example, rights from options held).

E24. Rights also might be enforceable by means equivalent to legal enforcement, such as those arising within a self-regulatory structure. If enforcement by other such means is sufficiently similar to legal enforcement, rights enforceable by those alternative enforcement mechanisms may be the equivalent of legally enforceable rights. An entity also can obtain economic benefits from a right in the absence of legally enforceable rights. For example, an entity might not have legally enforceable rights to secret know-how but can otherwise obtain economic benefits from it. The entity may use or sell the knowledge and restrict or otherwise prevent or limit other's access to the benefits.

E25. To qualify as an asset of an entity, that entity need not have an exclusive right to an economic benefit. Rights, including the ability to restrict access to a benefit, and restrictions may be single (held or imposed solely by the entity) or shared (held or imposed in conjunction with others). Two or more entities might have different rights and share the same economic benefit at the same time or might otherwise have rights to the same economic benefits at different times. For example, lease arrangements unbundle the economic benefits of the underlying asset by giving (a) the lessee the right to hold and use the property for a specified interval and (b) the lessor the right to receive lease payments and any residual value. Also, timeshare property owners have the rights to use property during specified time periods. Each entity has an asset based on its rights to the economic benefit.

E26. Two or more entities might have an undivided interest in an economic benefit, such as a parcel of land or mineral resources. Each entity has a right to economic benefits deriving from that right that might qualify as an asset, even though the right of each entity is subject, at least to some extent, to the rights of the other entity or entities. The entity with rights to an economic

benefit is the one that can exchange some or all of those rights, use the items to which it has the rights to produce goods and services or reduce other expenditures, exact a price for others' use of the rights, or use the rights to settle liabilities or make distributions to owners.

E27. Assets may be intangible, and even if they are not separable or exchangeable, they may be useable by an entity in producing or distributing goods or services. For example, a license may be nontransferable and therefore not exchangeable; however, the license provides the right to engage in economically beneficial activities.

E28. To meet the definition of an asset, the right must be a present right; that is, the right exists at the financial statement date. The existence of a present right at the financial statement date means that the right and therefore the asset have arisen from past transactions or other past events. Often, assets are obtained by purchasing or producing them, but other transactions or events may generate assets. Examples include the discovery of mineral deposits, the receipt of land or buildings from a government, or contributions received by a not-for-profit entity. The means of acquiring rights does not affect whether the item meets the essential characteristics of an asset. However, an examination of the history of how potential rights may have been created might help to determine whether a present right exists at the financial statement date.

E29. Transactions or other events expected to occur in the future do not in themselves give rise to assets today. An intention to purchase inventory does not by itself meet the definition of an asset. Equipment to be acquired next year is not a present right to that equipment today. A benefit that is expected only because of an anticipation of the action or performance of either a counterparty or the entity is not a present right. In contrast, an existing contract to purchase equipment (a right to purchase equipment) might give rise to an economic benefit that is distinct from the benefit embodied in the equipment itself.

E30. Sometimes present rights with uncertain amounts and timing are referred to as contingent assets. The term contingent asset has been a source of confusion because it is often thought to refer to circumstances in which the existence of a right depends on the occurrence or nonoccurrence of a future event. Absent a present right, the occurrence or nonoccurrence of a future event does not by itself give rise to an asset. Some items commonly described as contingent assets satisfy the definition of an asset because the contingency does not relate to whether a present right exists but instead relates to one or more uncertain future events that affect the amount of economic benefit for which a right exists. For those rights, the fact that the outcome is unknown affects the measurement but not the existence of the asset.

FASAC FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL

ATTACHMENT 3

IMPLEMENTATION OF CREDIT LOSSES
FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL (FASAC)
SEPTEMBER 24, 2020

Purpose of This Session

As part of the Board's post-effective assessment of the costs and benefits of credit losses, the staff and Board are planning to have a series of discussions with FASAC in the coming years. This session is the first in that series on credit losses.

The purpose of this first session is to discuss Council members' assessment of the initial costs of implementing the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, as well as any early views on the benefits.

The discussion will consider the application of the credit losses standard by all types of entities that have adopted the changes. In particular, given the broad applicability of the guidance to shorter-term receivables, the discussion will consider the application of the guidance to trade receivables. Future sessions will consider the ongoing costs and a comprehensive discussion of benefits of the credit losses standard.

Background Materials

These materials include:

1. ***(Refresher)*** FASB Post-Effective Date Activities (including implementation activities)
2. ***(Refresher)*** Assessment of Costs and Benefits during the Development of an Accounting Standard (including a description of costs)
3. What Types of Costs and Benefits Were Expected to Implement the Credit Losses Guidance
4. Requirements and Considerations Related to Trade Receivables
5. FASB Implementation Activities.

Discussion questions are included on page 9.

FASB Post-Effective Date Activities

An important part of the FASB's mission of developing high-quality standards is monitoring implementation after the effective date of a standard. The FASB's post-

effective date activities include:

1. **Implementation support and monitoring diversity:** This involves continuing to assist preparers and practitioners in their understanding and ability to consistently apply new standards.
2. **Continued education:** This involves educating stakeholders (including investors and other financial statement users) about the changes in an Accounting Standards Update after it is issued.
3. **Post-effective date assessments of costs and benefits:** The post-effective date evaluation of costs and benefits would begin after the effective date of the final standard and continues for approximately three to five years.
4. **Post-Implementation Review (PIR) process:**[1] The FASB's PIR process is an evaluation of whether a standard is achieving its objective by providing financial statement users with relevant information in ways that justify the cost of providing it. It is an important quality control mechanism built into FASB's standard-setting process that begins after the issuance of select standards. During the PIR process, the Board solicits and considers diverse stakeholder input and other research to evaluate the standards that are issued and whether there are areas of improvements that the Board should address. Currently, the FASB is reviewing Credit Losses, Leases, and Revenue. Additional information about the PIR process can be found at https://www.fasb.org/PIR#section_1. Additional information about individual projects, including credit losses, can be found at https://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176174972960

When there are different mandatory effective dates (as there are with credit losses), the timing of some of the activities for smaller public companies, private companies, and/or not-for-profit organizations would lag those for larger public companies.

Assessments of Costs and Benefits during the Development of an Accounting Standard

As a refresher, and for the benefit of new Council members, Attachment 3A includes a description of how the Board (1) defines and considers the expected costs and expected benefits of accounting standards and (2) has considered the potential for adverse economic consequences. That information comes from a variety of FASB communications, including its website, and prior FASAC materials.

At the September 2017 FASAC meeting, Council members generally agreed with how the

[1]During the June 23, 2020 FASAC meeting, Council members provided feedback on the FASB's Post-Implementation Revew (PIR) process, for which a change was approved by the Financial Accounting Foundation (FAF) Board of Trustees at its May 2020 meeting.

FASAC members generally supported the PIR process change and indicated that responding to evolving issues in a timely manner should be a priority. Council members commended the FASB's outreach efforts to engage all stakeholder groups in its PIR of recent major standards including revenue recognition, leases, and credit losses. Several Council members suggested that the Board consider future incorporation of smaller projects into the PIR process in a streamlined, accelerated, and cost-effective manner.

FASB defines and considers expected costs and expected benefits in the development of accounting standards. Council members provided observations about the nature of the costs, as well as costs outside the control of the FASB, such as inefficiencies in the financial reporting systems of companies. Some Council members acknowledged the challenges of estimating the costs and gathering data on benefits of a potential accounting change.

What Does the Board Mean by the Term Costs*?*

Improvements in financial accounting and reporting come at a cost—the costs to prepare, disseminate, and use accounting information. The majority of those costs are incurred by the companies that prepare financial information, but are passed on to shareholders in the form of lower returns. Those costs, both hard dollar and soft costs, typically include the following:

1. Costs incurred by companies to analyze, understand, and interpret new requirements
2. Costs incurred by companies to implement and/or maintain systems required to collect and process information or other accounting changes that a standard might require (including the costs to assess and/or update internal control processes)
3. Costs incurred by companies for audits of the systems and resulting information
4. Costs incurred by companies to disseminate the information to those that must receive it
5. Costs to users to analyze, understand, and interpret new information (new standards sometimes reduce the cost of using information by eliminating the need to make adjustments to reported financial information before using it in an analysis).

It is difficult, if not impossible, and costly to quantify with precision the costs for the U.S. economy, taken as a whole, in any meaningful way. Cost estimates will vary widely from entity to entity because of differences in circumstances (the estimates from a large multinational conglomerate will differ in both absolute and relative terms from that of a small private entity) and the inherent difficulty of estimating the costs of a change not yet made. Thus, it is difficult to meaningfully extrapolate firm-specific cost information.

What Types of Costs and Benefits Were Expected to Implement the Credit Losses Accounting Standard?

The Board issued the credit losses standard (Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*) in June 2016. Attachment 3B (in link—page 2)[2] is a summary of how the FASB considered the expected costs and expected benefits of the credit losses standard and the process that the FASB undertook in concluding that the expected

[2] https://www.fasb.org/cs/Satellite?c=Document_C&cid=1176168233403&pagename=FASB%2FDocument_C%2FDocumentPage

benefits justify the expected costs.

The basis for conclusions in that Update provides additional details about the expected costs and expected benefits of the credit losses standard. Paragraph BC8 of Update 2016-13 recaps some of those considerations.

> BC8. The Board recognizes that the amendments in this Update may require significant effort for many entities to gather the necessary data for estimating expected credit losses. The Board also recognizes that the guidance will require additional effort to review, audit, and examine financial statements. During the course of developing the amendments, the Board sought to minimize the cost of implementing the credit loss guidance and its complexity by developing an approach that:
>
> a. Permits an entity to utilize its current internal credit-risk management approaches and systems as a framework for applying the new measurement objective
> b. Does not include multiple measurement objectives that would have required different measures of credit losses depending on whether credit deterioration for financial assets has occurred for assets measured on an amortized cost basis
> c. Does not prescribe specific estimation methods to be used in any specific circumstance but, rather, allows an entity to apply judgment to develop estimation methods that are appropriate, practical, and consistent with the principles of the guidance
> d. Does not change the guidance for writing off uncollectible assets
> e. Does not change interest income reporting for originated loans on the basis of feedback received that preparers manage and users seek separate reporting of credit risk and interest income separately
> f. Requires an entity to consider forward-looking information rather than limiting consideration to current and past events, at the date of the statement of financial position
> g. Allows an entity to revert to historical loss information, with a straightline or immediate reversion both being acceptable methods if the expected contractual term of financial assets goes beyond periods for which reasonable and supportable forecasts can be obtained
> h. Makes targeted improvements to the impairment of available-for-sale debt securities, which was supported by both users and preparers
> i. Provides transition relief for a prospective transition approach for assets for which the guidance in previous GAAP (Subtopic 310-30) had been applied and for assets for which an other-than-temporary impairment had been recognized before the effective date.

FASB Implementation Activities

Clarifications and modifications to the credit losses standard include the items in the list below.

The Board finalized a number of Accounting Standards Updates after issuing the credit losses standard. Those Acounting Standards Updates are intended to provide clarification of the expected credit losses standard as well as targeted relief:

1. **Accounting Standards Update No. 2018-19**, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*
2. **Accounting Standards Update No. 2019-04**, Codification Improvements to Topic 326, *Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*
3. **Accountig Standards Update No. 2019-05**, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief*
4. **Accounting Standards Update No. 2019-11**, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*
5. **Accounting Standards Update No. 2020-03**, *Codification Improvements to Financial Instruments*

The Board also clarified and deferred the effective date of the credit losses standard by requiring only SEC filers that are not smaller reporting companies to be required to apply the credit losses standard in 2020, while all other entities would be required to adopt the standard in 2023:

1. **Accounting Standards Update No. 2019-10**, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 718), and Leases (Topic 842): Effective Dates* (for Private Companies, Not-for-Profit Organizations, and Small Public Companies)

In addition to a transition resource group, the Board has provided several resources to stakeholders to help with implementation of the credit losses standard, including the FASB's technical inquiry service,[3] educational materials (including FASB webcasts and external conferences), implementation webpages, public Board meetings about implementation status and issues, and regular discussions on implementation with advisory groups and liaison meetings. The FASB staff continues to work with stakeholders to clarify and apply the new guidance.

[3]The FASB's Technical Inquiry Service makes it easy for stakeholders to submit questions to the FASB staff. The service helps stakeholders to obtain input on applying standards to their specific circumstances. In addition to addressing individual concerns, this service helps the FASB identify reoccurring questions, themes, and issues that may need to be addressed more broadly.

Requirements and Considerations Related to Trade Receivables

The credit losses standard applies to all entities (with staggered effective dates), not just financial institutions and banks.

The credit losses standard affects entities holding financial assets that are not accounted for at fair value through net income, including:

1. Loans
2. Debt securities
3. Trade receivables
4. Net investments in leases
5. Off-balance-sheet credit exposures
6. Reinsurance receivables
7. Other financial assets not excluded from the scope that have the contractual right to receive cash.

The guidance does not prescribe a specific method for estimating the current expected credit losses for trade receivables (or for other financial assets within the scope).

The standard does provide an illustrative example (Example 5—see below) showing one way that an entity may estimate expected credit losses for trade receivables using an aging schedule.

> **326-20-55-38** Entity E manufactures and sells products to a broad range of customers, primarily retail stores. Customers typically are provided with payment terms of 90 days with a 2 percent discount if payments are received within 60 days. Entity E has tracked historical loss information for its trade receivables and compiled the following historical credit loss percentages:
>
> a. 0.3 percent for receivables that are current
> b. 8 percent for receivables that are 1–30 days past due
> c. 26 percent for receivables that are 31–60 days past due
> d. 58 percent for receivables that are 61–90 days past due
> e. 82 percent for receivables that are more than 90 days past due.
>
> **326-20-55-39** Entity E believes that this historical loss information is a reasonable base on which to determine expected credit losses for trade receivables held at the reporting date because the composition of the trade receivables at the reporting date is consistent with that used in developing the historical credit-loss percentages (that is, the similar risk characteristics of its customers and its lending practices have not changed significantly over time). However, Entity E has determined that the current and reasonable and supportable forecasted economic conditions have improved as compared with the economic conditions included in the historical information. Specifically, Entity E has observed that

unemployment has decreased as of the current reporting date, and Entity E expects there will be an additional decrease in unemployment over the next year. To adjust the historical loss rates to reflect the effects of those differences in current conditions and forecasted changes, Entity E estimates the loss rate to decrease by approximately 10 percent in each age bucket. Entity E developed this estimate based on its knowledge of past experience for which there were similar improvements in the economy.

326-20-55-40 At the reporting date, Entity E develops the following aging schedule to estimate expected credit losses.

Past-Due Status	Amortized Cost Basis	Credit Loss Rate	Expected Credit Loss Estimate
Current	$ 5,984,698	0.27%	$ 16,159
1–30 days past due	8,272	7.2%	596
31–60 days past due	2,882	23.4%	674
61–90 days past due	842	52.2%	440
More than 90 days past due	1,100	73.8%	812
	$ 5,997,794		$ 18,681

The credit losses standard also requires less extensive disclosures about trade receivables (as compared with the vintage disclosures required for public business entities for financing receivables, contract assets, and net investment in leases by vintage year of origination).

Entities with financing receivables that are loans or trade receivables are required to disclose the following:

310-10-50-2 The summary of significant accounting policies shall include the following:

a. The basis for accounting for loans and trade receivables
b. The method used in determining the lower of **amortized cost basis** or fair value of nonmortgage loans held for sale (that is, aggregate or individual asset basis)
c. The classification and method of accounting for interest-only strips, loans, other receivables, or retained interests in securitizations that can be contractually prepaid or otherwise settled in a way that the holder would not recover substantially all of its **recorded investment**
d. The method for recognizing interest income on **loan** and trade receivables, including a statement about the entity's policy for treatment of related fees and costs, including the method of amortizing net deferred fees or costs.

310-10-50-3 If major categories of loans or trade receivables are not presented separately in the balance sheet (see paragraph 310-10-45-2), they shall be disclosed in the notes to the financial statements.

310-10-50-4 The allowance for credit losses and, as applicable, any unearned income, any unamortized premiums and discounts, and any net unamortized deferred fees and costs, shall be disclosed in the financial statements.

Discussion Questions

Question 1: What types of financial assets did you (or the companies that you follow) apply the credit losses standard to? How has your experience to date been with the implementation (both from a change management process and a cost perspective)?

Question 2: Using the application of the credit losses standard to trade receivables (as an example), were there significant changes in cost as a result of applying the credit losses guidance to:

a. Systems (acknowledging different starting points based on the lifecycle of the companies)
b. Policies and procedures
c. Internal controls
d. Audit procedures/approach
e. Other?

Question 3: Acknowledging that the credit losses standard is currently effective for public companies:

a. What aspects of the guidance were most helpful (for example, was the illustration for trade receivables using an aging schedule useful)?
b. Are there other changes that the Board should consider to increase the benefits or decrease the costs of applying that guidance?

Question 4: (Preparers/Auditors): How do the actual categories, nature, and amounts of the implementation costs incurred compare with the anticipated compliance costs for preparers of financial statements? Were there unanticipated costs of applying the credit losses standard?

Question 5: (Investors/Users): How do the actual categories, nature, and amount of the costs of analysis for users of financial statements compare with the expected costs? Were there unexpected costs of implementing the credit losses standard?

Question 6: What are your expectations of the recurring costs (or savings) of applying the credit losses guidance? How does that compare with those associated with your prior accounting for credit losses?

ATTACHMENT 3A

Background: Principles and Use of the Terms *Costs* and *Benefits*

Below is a description of how the Board (a) defines and considers the costs and benefits of accounting standards and (b) has considered the potential for adverse economic consequences. That information is from a variety of FASB communications, including the website and prior FASAC materials.

FASB's Mission

The FASB's mission is to develop accounting standards that result in financial information that investors, creditors, donors, and others find useful in making rational investment, credit, and similar resource allocation decisions. The Board recognizes, however, that financial information comes at a cost. Accordingly, a fundamental principle guiding the Board's process is to issue standards only when the expected benefits exceed the perceived costs.

The Costs and Benefits of Accounting Standards

What Does the Board Mean by the Term *Benefits*?

Accounting information serves a purpose—facilitating economic decision making. The Board has long believed that the benefits of accounting standards are described best in terms of the usefulness of the resulting information. The primary benefit of accounting standards is the increased utility an investor, creditor, donor, or other user gains from the improved flow of accounting information, including the ability to select better among various investment options. Stated differently, the benefit from accounting standards lies in their ability to make a positive difference in reaching decisions about resource allocation and pricing.

And what makes accounting information useful?[4] Broadly speaking, information is useful when it makes it easier for users to assess and compare the risks and returns of various investment opportunities and select those that best match their risk and return preferences. More specifically, the Board has long believed that information is useful when it is relevant (capable of making a difference to users' decisions) and faithfully represents the underlying economic phenomena.

A critically important element of faithful representation is neutrality, meaning the financial information reports economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing decision making in any particular direction. A neutral depiction is not slanted, weighted, emphasized, deemphasized, or otherwise

[4]For simplicity, this paper discusses benefits in the context of for-profit businesses entities. The description of benefits differs in some respects in the context of not-for-profit organizations.

manipulated to increase the probability that financial information will be received favorably or unfavorably by users. The concept of neutrality is important because the Board has long viewed its role as one of facilitating decision making, not directing or influencing the consequences of those decisions in a particular direction. To the extent that accounting standards are subverted to achieve objectives unrelated to a fair and faithful presentation, the Board believes they fail in their purpose.

The Board also has long believed that changes in the utility of financial information cannot be quantified, particularly as they relate to a particular standard and particularly before a standard has been issued and applied. For that reason, the Board evaluates the change in utility qualitatively, using reasoned analysis informed by information received from investors, creditors, donors and other users about the utility of proposed changes to financial information.

What Does the Board Mean by the Term *Costs*?

Improvements in financial accounting and reporting come at a cost—the costs to prepare, disseminate, and use accounting information. The bulk of those costs are born by the companies that prepare financial information, but are passed on to shareholders in the form of lower returns. Those costs typically include the following:

1. Costs incurred to analyze, understand, and interpret new requirements
2. Costs incurred by companies of implementing and maintaining required systems to collect and process information or other accounting changes that the standard might require
3. Costs incurred by companies for audits of the systems and resulting information
4. Costs incurred by companies to disseminate the information to those who must receive it
5. Costs to users of analyzing, understanding, and interpreting new information (new standards sometimes reduce the cost of using information by eliminating the need to make adjustments to reported financial information before using it in an analysis).

And, although many of the costs are out-of-pocket costs, it is difficult and costly to quantify them with precision for the U.S. economy taken as a whole. Cost estimates will vary widely from entity to entity because of real differences in circumstances (the estimates from a large multinational conglomerate will differ in both absolute and relative terms from that of a small private entity) and the inherent difficulty of estimating the costs of a change not yet made. Thus, it is difficult to meaningfully extrapolate firm-specific cost information.

How Does the Board Weigh Costs and Benefits?

As noted above, one of the FASB's key principles is to issue standards only when the expected benefits justify the perceived costs. Said differently, the Board issues new accounting standards when the expected improvements in the usefulness of the reported information justify the perceived costs involved in preparing and using that information.

The FASB's standards-setting process is, in substance, a continuous evaluation of those benefits and costs, informed by information sought and obtained from stakeholders throughout the life-cycle of a project. A primary objective of the FASB's extensive stakeholder consultation is to gather evidence about the expected benefits and perceived costs of various reporting alternatives.

The FASB's evaluation of the benefits and costs of change is necessarily subjective and qualitative in nature. The evaluation of benefits requires the Board to judge whether the proposed accounting would provide information that is relevant and representationally faithful. Those judgments are difficult because the matters the Board deals with are those for which reasonable and informed users (and others) have different views. Although the costs of change are easier to identify and approximate, the evaluations are also subjective because it requires consideration of activities that have not been done previously—gathering, processing, understanding, and using information related to the new standard.

The Economic Consequences of Financial Reporting

Financial reporting has economic consequences. Some of the more significant of those consequences include:

1. Economic growth fostered by enhancing public confidence in our financial markets, more efficient capital allocation, greater market liquidity, and an overall lower cost of capital.
2. Spurring company managements to greater efficiency as a result of their accountability to shareholders, lenders, and others who can make more informed evaluations.
3. Increased credibility of a particular company's financial information, which may improve accessibility to capital markets, very possibly at lower costs.

Various empirical studies provide evidence that better reporting and disclosures reduce information asymmetry, increase market liquidity, and can reduce the market risk premium of the entire economy.[5] However, a particular change in financial reporting that produces an overall positive benefit may result in positive consequences for some individual firms or sectors and adverse consequences for others. Said differently, the overall economic benefits of a more efficient allocation and pricing of capital are not equally shared by all firms.

[5]Section 2 of "Global Accounting Convergence and the Potential Adoption of IFRS by the United States, An Analysis of Economic and Policy Factors" (Luzi Hail, Christian Leuz, and Peter Wysocki, February 2009) includes a discussion of the benefits of higher quality financial information. The FASB staff will provide a copy of that material upon request. It also can be downloaded on the Internet at the following address: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1357331.

During the development of a standard, the Board will sometimes hear that a proposed change may have adverse economic consequences for a particular entity, sector, or the economy as a whole. For example, the Board was told that:

1. A requirement to expense research and development costs would have a dampening effect on research and development in the United States.
2. Requiring the successful efforts method of accounting would make it difficult for many oil and gas companies (particularly smaller ones) to raise capital, potentially reducing the amount of oil and gas exploration in the United States.
3. Eliminating the pooling-of-interests method of accounting would impede the desirable consolidation within certain industries, reduce the amount of capital flowing to those industries, slow the development of new technology, or adversely affect our entrepreneurial culture.
4. Expensing stock options might make it difficult to attract and retain the talented employees that foster innovation in our economy.

When the Board is told that a proposal will or may have adverse economic consequences, it is an indication that the financial reporting change may significantly influence decision making (in other words, it is relevant). In those cases, the Board takes particular care in its deliberations to reevaluate or double-check the neutrality of the information that would result from the proposal to make sure that the proposals would not produce biased information that influences decisions in a particular direction. The Board reevaluates its decisions, asking:

1. Will the proposal produce a representationally faithful and neutral depiction of the transaction or event?
2. Will the proposal provide information that is complete in all material respects?
3. Will the information be presented in a way that users can comprehend its meaning and significance?

If the response to those questions is yes, it is likely that the perceived adverse consequences, were they to occur, are the result of a realignment of capital. And the Board does not attempt to alter financial reporting to mitigate such effects. To do so would be to bias the reporting in favor of a particular entity or group. And biasing information may reduce its usefulness.

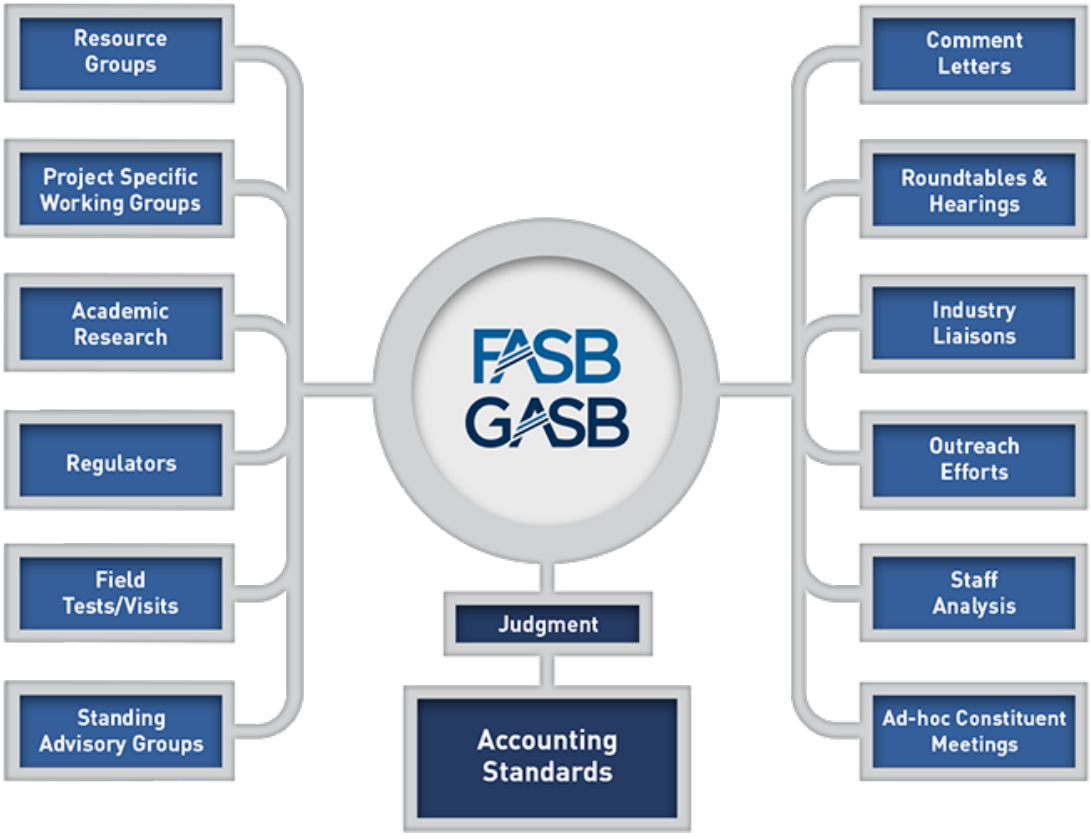
Background: Process Used by the FASB to Gather Information about Costs, Benefits, and Consequences of Its Proposals

How Does the FASB Gather Information about Potential Costs and Benefits of Standards?

An independent standard-setting process is critical to producing high-quality accounting standards, because it relies on the collective judgment of experts, and it is informed by the input of all interested parties through a thorough and deliberative process. The FASB

sets accounting standards through processes that are open and allow for extensive input from all stakeholders. These stakeholders represent a broad range of capital market participants, including investors, analysts, donors to nonprofit organizations, financial statement preparers, auditors, academics, and other interested parties.

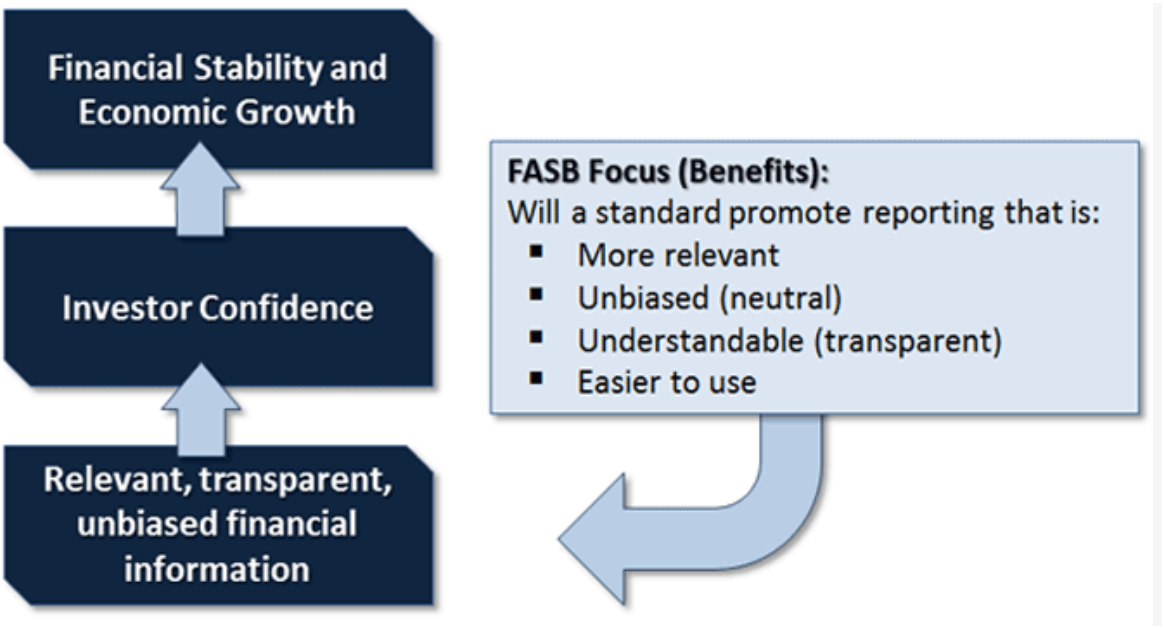
Throughout the stages of a project, the FASB's procedures, which are called "due process," are specifically designed to generate feedback about costs and benefits of a proposed new standard. Stakeholders are asked about the most faithful way to portray a transaction or economic phenomenon, as well as the most cost-effective ways to implement any changes. Before being implemented, every proposal is exposed for public commentary and discussed with numerous informed stakeholders. Technical decisions by the Board are made in public meetings after careful consideration of the input from stakeholders. The chart below illustrates the many elements that play into the Board's decision-making process.



Cost-Benefit Differs from an Analysis of Economic Consequences

The economic consequences of a new financial reporting standard are separate and distinct from an analysis of costs and benefits relating to the adoption of a new standard. The role of financial reporting is not to determine or influence what capital allocation decisions should be made or what actions should be taken by management. Rather, the role of financial reporting is to promote decisions that are well-informed and to provide

investors information they need to make those decisions. The FASB's objective in developing accounting standards is to show a complete and unbiased picture of a company's financial position and performance. Better information (which could be favorable or unfavorable for a particular organization) is expected to change capital allocation decisions, but the Board does not try to influence the outcome of those decisions.



A Case in Point—Accounting for Lease Transactions

As noted above, accounting standards are not intended to drive behavior in a particular way; rather, they seek to present financial information so that financial statement users can make informed decisions about how to best deploy their capital.

For example, the FASB issued a financial accounting and reporting standard in February 2016 that improves financial reporting about leasing transactions by providing financial statement users a more faithful representation of an organization's leasing activities.

The project was added to the Board's agenda in response to feedback from investors and other financial statement users concerned about the lack of transparency relating to material lease obligations that today are not included on the balance sheet. While some industries have argued that increased transparency about lease obligations would potentially create a less favorable economic picture of certain companies, the objective of the proposed standard is to provide a fair and complete representation of the obligations and rights of a company.

The purpose of our due process is to determine the appropriate representation of the economic phenomena. Investors may view the new information favorably or unfavorably

and that is the expected consequence of neutral information. The Board carefully considered the feedback received about the proposed changes to lease accounting before issuing the final standard. This document summarizes how the FASB considered the expected costs and benefits of the Leases standard.

The FASB remains committed to ensuring that our nation's financial accounting and reporting standards provide investors with the information they need to confidently invest in the U.S. markets.

FASB Understanding Costs and Benefits

ASU: Credit Losses (Topic 326)

This document summarizes how the Financial Accounting Standards Board (FASB) considered the expected benefits and costs of its new Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments—Credit Losses (Topic 326)*, and the process the FASB undertook in concluding that the expected benefits of the amendments in the ASU justify the anticipated costs.

The FASB issues new financial accounting and reporting standards only when the benefits of a standard—which include improvements in the relevance and neutrality of reported financial information—justify the costs it imposes on financial statement preparers to implement the new standard, and on users to consider and respond to the new information.

The FASB concluded that the expected benefits of the amendments in this ASU justify the anticipated costs.

Both users and preparers have previously raised concerns about the delayed recognition of credit losses on financial assets measured at amortized cost. To address these concerns, the new standard measures all expected credit losses over the life of the financial assets. Enhanced disclosures will facilitate users' assessment of management's initial credit loss estimate for newly originated financial assets, as well as subsequent changes to those estimates.

Organizations are likely to incur costs associated with implementing the new requirements; however, the FASB has sought to minimize the cost of implementation and complexity based on preparer feedback. Additionally, the new requirements will provide users of financial statements with more useful information about expected credit losses.

Organizations applying the new standard will be able to leverage many of their existing financial reporting processes. This is because specific estimation methods are not prescribed, and while forward-looking information must be considered, an organization may revert to historical loss information in periods where a reasonable and supportable forecast cannot be obtained.

The new standard affects all organizations that hold financial assets and net investments in leases that are not accounted for at fair value with changes in fair value reported in net income.

The ASU on credit losses will take effect for calendar year-end SEC filers in 2020. For other calendar year-end organizations, the ASU on credit losses will take effect in 2021.

Early application will be permitted in 2019 for all organizations.

BACKGROUND

Today in Generally Accepted Accounting Principles (GAAP), organizations are required to use an "incurred loss" methodology when recognizing credit losses on financial assets measured at amortized cost. This approach delays recognition until it is probable a loss has been incurred, which has been criticized by both preparers and users. The Financial Crisis Advisory Group (FCAG) also cited the delayed recognition of credit losses as a weakness in GAAP.

The Credit Losses project was added to the FASB's agenda based on feedback from preparers, users, and the FCAG. Several different impairment models were evaluated before the FASB ultimately decided on the current expected credit loss (CECL) model. The CECL model was developed in response to feedback that previously proposed models were complex and/or inoperable.

The main objective of the new standard is to provide financial statement users with more useful information about expected credit losses. This objective is achieved by:

- Removing the probable threshold in current GAAP
- Broadening the range of information that is considered in determining expected credit losses, and
- Providing enhanced disclosures.

Overview of Costs and Benefits of the New Credit Losses Standard

BENEFITS	COSTS
More timely reporting of credit losses Measurement using forward-looking information Greater transparency on • The extent of expected credit losses • Changes in expected credit losses • Credit quality indicators • Portfolio composition Enhance comparability through a single measurement objective Decrease in costs for users because credit losses will now be reported based on expectations and forward-looking information, consistent with the analysis performed by users.	Implementation costs • Gathering data • Incorporating new inputs into processes • Review and audit of new estimates • Personnel costs for process changes and education • Investor costs for education on the transition impact from the incurred loss methodology to expected credit loss methodology Once implementation activities are complete and an organization's processes have been fully updated, the ongoing costs associated with preparing the allowance for credit losses are similar to those in current GAAP. This is because many of the same estimation methods will be permitted (for example, loss rate methods, probability of default methods, discounted cash flow methods, and aging schedules), although the data used as inputs will be different than what is used today.

The credit losses measured under this approach will be better aligned with the forward-looking information considered by users. Additionally, the CECL model aligns the accounting for credit losses with underwriting decisions because expected losses (rather than only incurred losses) generally are considered when underwriting a loan or other financial asset.

The standard changes the accounting for purchased financial assets with credit deterioration (PCD assets). The allowance for credit losses for PCD assets is determined in a similar manner to other financial assets measured at amortized cost; however, the initial allowance for credit losses is added to the purchase price rather than being recorded as credit loss expense. This approach excludes credit-related discounts from interest income on a prospective basis, which results in enhanced comparability between PCD assets and non-PCD assets.

The accounting for credit losses on available-for-sale debt securities is similar to current GAAP; however, the new standard will require credit losses to be recorded through an allowance for credit losses, which will allow subsequent reversals in credit loss estimates to be recognized in current income. In addition, the allowance for credit losses on available-for-sale debt securities will be limited by the amount the fair value is less than amortized cost.

OUTREACH WITH STAKEHOLDERS

Since the project's inception in 2008, the FASB has requested and received significant input from stakeholders on the application of the proposed guidance. This input includes stakeholder responses to the proposed amendments in three public documents:

1. The 2010 Exposure Draft (2010 ED)
2. The 2011 Joint Supplementary Document (2011 JSD), and
3. The 2012 Exposure Draft (2012 ED).

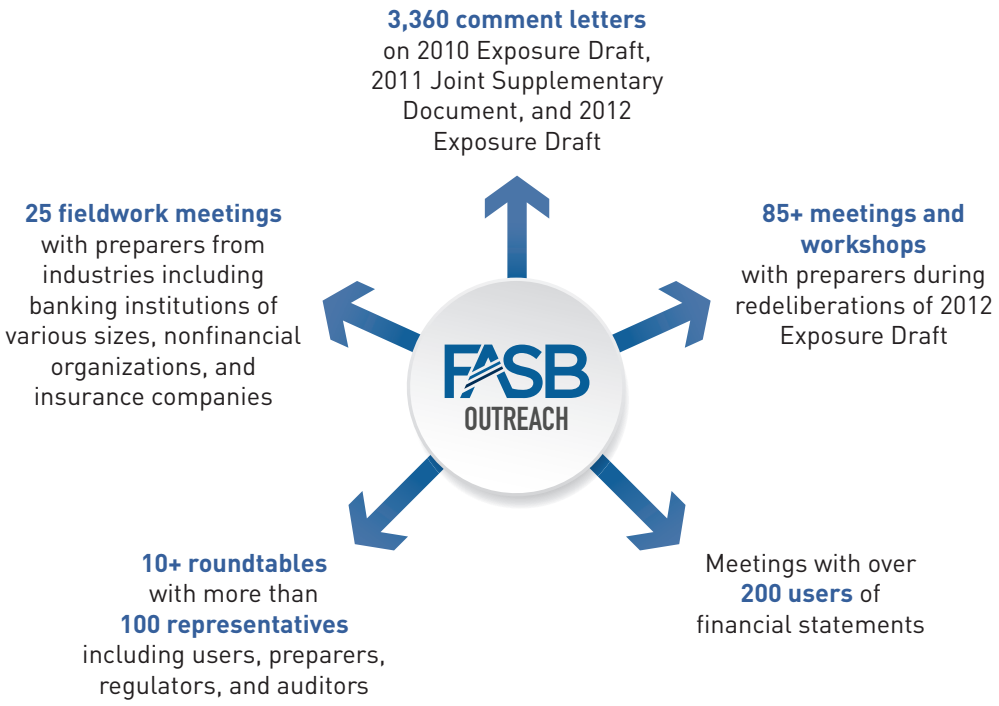
A significant amount of input on the 2012 ED was received and considered in redeliberation meetings in 2013 through 2016.

During that time period, stakeholder feedback, including feedback from community banks and credit unions, prompted various changes to the CECL model to reduce cost and complexity.

Additional outreach was performed in the final stages of redeliberations to confirm the operability of the standard, and the feedback received indicated that the changes made have reduced costs and complexity.

STAKEHOLDER CONCERNS

The FASB considered various credit loss models before moving forward with CECL. There was initially strong opposition to each of the previous models based on complexity or operability concerns. The Board has considered the feedback received throughout the



project and believes CECL most appropriately addresses the concerns of stakeholders. In connection with the feedback received, the following key changes were made during the development of CECL:

- Eliminated the "probable threshold" in current GAAP
- Eliminated a good book/bad book methodology, multi-stage methodology, or other credit deterioration methodology because of operability concerns addressed by stakeholders
- Allowed various estimation methods because of the emphasis placed on the importance of a scalable approach for institutions of all sizes
- Incorporated forward-looking information into the estimate, but will allow for use of historical loss information in periods where a reasonable and supportable forecast is not available
- Kept separate accounting for interest income and credit losses
- Retained current practices for nonaccrual assets
- Excluded available-for-sale (AFS) debt securities from the CECL model, and improved the existing AFS impairment model
- Reduced the complexity in accounting for purchased credit-deteriorated assets
- Disaggregated credit quality indicators by vintage, which is operationally easier than the previously proposed roll-forward of amortized cost basis
- Added a phase-in approach for vintage disclosures for smaller financial institutions
- Tiered effective dates to provide more implementation time for smaller financial institutions.

COSTS: APPLYING THE NEW ASU

The FASB understands that reporting organizations will incur additional costs as a result of the new ASU.

For example, organizations will, in general, incur initial costs to educate employees about how to apply the new requirements and to explain to users the effects of the changes in accounting for credit losses on the organization's financial statements.

In addition, many organizations may need to consider changes to processes and controls to ensure that they are measuring credit losses in accordance with the new standard. Organizations may also need to gather and/or obtain incremental data relevant to the expected credit loss method that they believe is appropriate for their type of assets and sophistication level.

However, once these implementation activities are complete and an organization's processes have been

Costs of Applying the New ASU:

- Personnel costs to change processes and controls to apply the new requirements
- Costs to educate stakeholders about new reporting requirements
- Costs to obtain incremental data related to expected credit loss method.

fully updated, the ongoing costs for most organizations of preparing the allowance for credit losses under the new ASU should not be significantly above the costs of complying with the accounting model in current GAAP. This is because many of the same estimation methods will be permitted (for example, loss rate methods, probability of default methods, discounted cash flow methods, and aging schedules).

The FASB concluded that, based on substantial outreach with preparers of financial statements, many organizations will be able to apply the requirements of the new ASU using similar systems and processes to what they used before to meet current GAAP reporting and disclosure requirements.

BENEFITS: APPLYING THE NEW ASU

The FASB observed that the new ASU will provide benefits to many investors and other users of financial statements by increasing the transparency of information provided on credit losses. More specifically, the new ASU accomplishes the following:

- Results in more timely reporting of credit losses
- Results in greater transparency about the extent of expected credit losses on financial assets held at the reporting date
- Improves a user's ability to understand changes in expected credit losses that have taken place during the period
- Allows preparers to consider forward-looking information rather than limiting consideration to current and past events
- Improves a user's ability to compare purchased financial assets with credit deterioration with originated financial assets
- Enhances consistency when credit losses are measured at the individual asset level, as compared with the portfolio level, because the credit losses that are expected will be recorded for all assets
- Provides greater transparency to the user in assessing the credit quality indicators of a loan portfolio and changes in composition of the loan portfolio over time.

Benefits of Applying the New ASU:

- More timely reporting of credit losses
- Increased transparency about the extent of expected credit losses for users
- Consistency in measurement between assets.

CONCLUSION

The FASB's assessment of the costs and benefits of issuing this ASU is unavoidably more qualitative than quantitative because there is no identified method to objectively quantify all costs to implement the new guidance or to quantify the value of improved information in financial statements.

Overall, the FASB concluded that the expected benefits of the amendments in the new ASU justify the anticipated costs.

More information on the ASU, including a press release, *FASB in Focus*, and a video, can be found on the FASB website.

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