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Financial Accounting Standards Board
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24 October 2016

Invitation to Comment, *Agenda Consultation* (File Reference No. 2016-290)

Dear Ms. Cospers:

We appreciate the opportunity to provide feedback on the Invitation to Comment (ITC), *Agenda Consultation*, and commend the Financial Accounting Standards Board (FASB or Board) for its thorough and thoughtful approach to deciding which financial reporting issues to add to its future agenda. We agree that now that the Board has completed many of its major projects, the Board has an opportunity to consider its direction for the next few years. However, we do not believe that now is the time for the FASB to begin actively working on any new major projects other than continuing to conduct research for future major projects. We are concerned that, given the volume of major new standards entities will have to implement over the next few years, it would be difficult for preparers, users, auditors and regulators to continue monitoring new standard-setting initiatives while effectively managing changes resulting from the major new standards.

We believe that, over the next few years, the Board should focus its efforts on:

- ▶ monitoring implementation of the new standards and maintaining existing standards
- ▶ completing major projects, including the conceptual framework, already on the FASB technical agenda¹
- ▶ completing targeted improvements already on the Board's technical agenda
- ▶ addressing additional issues that may arise

Once the Board has completed the major projects now on its agenda, we agree that it could tackle some of the topics identified in the ITC to address complexity, conceptual inconsistencies, lack of comparability, difficulties with interpretation and application, limited transparency and diversity in practice.

¹ The FASB's major projects currently include (1) Conceptual framework: measurement and presentation, (2) Disclosure framework, (3) Accounting for financial instruments: hedging and (4) Insurance: targeted improvements to the accounting for long-duration contracts.

In the Appendix, we provide our responses to the topic-specific questions the Board raised in the ITC in the event the Board decides to move forward with any of the potential projects raised in the ITC.

Monitoring implementation of new standards and maintaining existing standards

The FASB's major new standards on revenue recognition, classification and measurement of financial instruments, credit impairments and leases will affect financial accounting and reporting by all reporting companies. Their adoption requires entities to make changes in systems and internal controls and potentially reconsider contractual relationships. Extensive preparer and investor education will continue to be necessary through the adoption date. To facilitate effective implementation, the Board should continue to devote adequate resources to monitor the implementation of these standards to determine whether their objectives are being met, identify areas of diversity in practice and implementation issues, and address issues timely.

We encourage the Board to consider new and novel ways of providing implementation support. For example, the Board could conduct its own post-implementation review of how Fortune 1000 companies implement the new revenue and leases standards during the first 18 months of adoption. The Board also could look at how a range of banks implement the new credit impairment guidance. These reviews, which would differ in scope from a Financial Accounting Foundation Post-Implementation Review (PIR), could help the Board evaluate the consistency of application. Studying how entities manage change to implement these major new standards also would provide the Board with a unique opportunity to evaluate both the costs and benefits of standard setting and its process for analyzing those costs and benefits. The Board could use lessons learned from these reviews to enhance its standard-setting process.

As issues are identified, we encourage the Board to add them to the agenda of the Emerging Issues Task Force (EITF), which we believe is underutilized, to help the Board timely issue interpretations to reduce diversity in application.

Major projects

The Board has many projects on its agenda, some of which have been active for several years. The outcome of some of these projects could affect how the Board approaches standard setting for years to come. We believe the completion of the major projects on the disclosure framework, the conceptual framework, hedging and insurance should remain a priority for the Board.

Disclosure framework – The disclosure framework project has taken on added importance because (1) the new revenue recognition, leases and credit impairment standards require more disclosures, (2) the Securities and Exchange Commission (SEC or Commission) is considering referring certain overlapping disclosure requirements to the FASB for potential incorporation into US GAAP as part of its disclosure effectiveness initiative and (3) many entities are interested in providing their constituents with more meaningful and understandable financial reporting.

We encourage the Board to focus its testing and outreach in this area in an effort to develop a framework that can be used by the Board to evaluate existing disclosure requirements and for future standard-setting efforts. We believe that crafting a disclosure framework is a critical precursor to addressing any new major financial reporting issue.

Conceptual framework – The conceptual framework project is intended to set forth objectives and fundamental concepts that will be the basis for development of financial accounting and reporting guidance. The concepts “guide the selection of transactions and other events and conditions to be accounted for; their recognition and measurement; and the means of summarizing and communicating them to interested parties.”² Decisions reached on the conceptual framework will inform the decisions the FASB makes in standard setting. Therefore, we recommend that the Board complete the relevant components of the conceptual framework that it believes are necessary as a basis for major new projects, to promote consistent application of the concepts within the standards.

For example, the ITC proposes a holistic approach to examining the accounting for distinguishing liabilities from equity, which we broadly support. However, we believe that instead of beginning with a standard-setting project and reverse engineering the conceptual framework, the process should start with the conceptual framework by focusing on improving the definitions of liabilities and equity and providing the related measurement and financial statement presentation basis. Once these conceptual issues are addressed, then the FASB can address specific models or issues to address the accounting for distinguishing liabilities from equity. A standard that is based on sound and clear concepts will result in improved financial reporting that provides users with a consistent presentation of instruments and will reduce complexity in classifying instruments that have characteristics of liabilities and equity.

Separately, we note that the FASB’s Rules of Procedure require at least a majority of the Board to approve the issuance of a Statement of Financial Accounting Concepts. We suggest that the Board consider requiring a supermajority³ vote for approval, given the implications and the need to establish concepts that are broadly accepted as being appropriate to guide future standard setting.

Hedging – The hedging project is intended to more clearly portray the economics of an entity’s risk management activities in its financial statements and simplify the application of hedge accounting in certain situations. The proposed amendments would expand the risk management strategies that qualify for hedge accounting and reduce some of the operational complexity when applying hedge accounting to current strategies.

Insurance – This project is focused on changing how insurers account for long-duration contracts, including how they measure, recognize and make disclosures about insurance liabilities and deferred acquisition costs. Today, insurers follow different models that have evolved over many years to address the changes in the nature of life, annuity and long-term health contracts. This project is intended to eliminate some of the differences.

² Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting, Chapter 1, *The Objective of General Purpose Financial Reporting*, and Chapter 3, *Qualitative Characteristics of Useful Financial Information*.

³ The Board will need to consult with the SEC’s Office of the Chief Accountant and Office of the General Counsel to make sure that the adoption of a supermajority requirement for the non-authoritative conceptual framework does not affect the Commission’s recognition of the FASB’s accounting principles as generally accepted for the purposes of the securities laws under Section 19(b)(1)(A)(iv) of the Securities Act of 1933 as amended by Section 108(a)(2) of Sarbanes-Oxley Act of 2002.

Simplification/targeted improvements

We believe the Board should continue to focus on targeted areas for improvement that are on its agenda and add new issues as they arise. In the last few years, the Board has identified numerous narrow projects through channels including its simplification initiative, PIRs of existing standards, Private Company Council input and general stakeholder feedback. These projects have contributed to reducing the cost and complexity of financial reporting while improving or maintaining the usefulness of information provided to investors. We believe the Board should continue to focus on narrow-scope improvements that address persistent and relevant concerns of stakeholders. We believe this approach embodies the FASB's guiding principle to "balance the desire for comprehensive improvements in standards with the need for incremental changes that produce timely reporting improvements in areas important to users."⁴

If the FASB's projects overlap with those on the agenda of the International Accounting Standards Board (IASB), we encourage the FASB to continue sharing research and thinking on these topics with the IASB, through regular meetings at either the staff or Board level. We believe that such discussions are consistent with the FASB's commitment to a standard-setting process that "mutually informs each standard setter's thinking and contributes to the shared understanding of perspectives"⁵ by working with other national and regional standard setters.

Outreach

We commend the FASB on the improvements it has made to its outreach programs, including obtaining greater investor input throughout the process. The Board's concerted effort to hear directly from users about the nature of information they need is an important component of successful standard setting that we believe has positively affected the quality of its standard-setting process. We encourage the Board to continue asking users what information they need that is not presented, or is not presented clearly, and to better understand (1) *how* they will use the information requested and (2) *what effect* the information requested would have on the users' behavior. This type of directed discussion with users, including but not limited to investors, may present opportunities for the Board to consider recognition, measurement, presentation and disclosure requirements in a different light. For example, some users use data points as inputs for their proprietary models and therefore may prefer additional disclosure and may have less interest in complex measurement alternatives being required by preparers. Understanding the way information is used could affect the direction of current and future projects.

We also encourage the Board to consider improvements to communicate the specifics behind user input. For example, the Board could better articulate this information in the Background Information and Basis for Conclusions sections of future Accounting Standards Updates. We believe that stakeholders would benefit from a more transparent discussion of this element of the Board's cost-benefit analysis.

⁴ *Rules of Procedure, Amended and Restated through 11 December 2013*, by the FASB.

⁵ *Strategic Plan, April 2015* by the Financial Accounting Foundation, the FASB and the Governmental Accounting Standards Board.

Next steps

We do not believe that taking on major new projects is the best use of the Board's available resources at this time, given the level of change in the system. However, we believe that the Board could continue to actively research projects on the accounting for distinguishing liabilities from equity and financial performance reporting. Once the Board finalizes its active projects and has allocated sufficient resources to provide implementation support for the new standards, we believe the Board could consider moving these projects from research to the active agenda.

- ▶ Accounting for distinguishing liabilities from equity is an area of financial reporting that needs improvement. The complexity of this topic results from the fragmented nature of the current guidance, which was developed over time to address narrow issues as they arose. Numerous pieces of literatures, including rules and exceptions, continue to cause challenges and diversity in application. Additionally, the accounting in this area has not kept pace with the development of new instruments over the past decade. The terms of these complex instruments pose challenges when applying the current standard. We agree that a more holistic approach focusing on the basic distinctions between liabilities and equity is the logical and necessary first step to addressing issues in this area.
- ▶ The Board currently has on its research agenda a project on financial performance reporting. We recommend that the Board continue to pursue its research, giving consideration to the interrelationship between each financial statement and the related notes. In particular, we urge the Board to spend time with investors to understand their views on what type of information should be included in the financial statements.

The ITC highlights two other potential projects on which the Board is requesting feedback:

- ▶ We are not supportive of the Board taking on a major project on pensions and other postretirement benefit plans (OPEBs). Instead, we recommend that the FASB consider targeted improvements to the accounting for hybrid plans (e.g., cash balance plans). As hybrid plans have evolved and grown in popularity, the accounting guidance has not kept pace. The resulting diversity in practice has made it difficult for investors to evaluate the plan results.
- ▶ We do not believe that wholesale changes with respect to the accounting for intangible assets are necessary. Moreover, we believe that making significant changes to the accounting for intangible assets could be challenging. However, targeted changes, such as eliminating the differences in accounting for research and development costs incurred as part of an asset acquisition versus as part of a business combination, could be addressed as part of the Board's future phase of the project on clarifying the definition of a business (Phase 3) to address the differences in the recognition and derecognition of assets and businesses.

We have provided more detail on each of these potential areas of focus in the Appendix to this letter to assist the Board in its decision-making process. We also have suggested alternative projects for the Board to consider as it moves forward, including the development of a single consolidation model.



We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

Ernst & Young LLP

Appendix – Responses to questions for respondents

Question 0.1: Are there major financial reporting issues that are not considered in this ITC that should be addressed by the FASB before any of the issues discussed in the ITC are addressed? What are the considerations or criteria that you used to identify these issues? Please describe any of those issues and your perspective about how the FASB should resolve the issues.

As discussed above, we do not believe the Board should take on major new projects at this time. However, we believe the Board should continue to focus on targeted areas for improvement and simplification initiatives to reduce the cost and complexity of financial reporting by addressing narrow topics. Therefore, we suggest that the Board consider the following topics for targeted improvements:

Business combinations involving newly formed entities

We believe that the FASB should provide additional guidance on when a new entity formed to consummate a business combination (known as a Newco) should be considered the accounting acquirer and, therefore, should record the acquiree's assets and liabilities using a new basis. Accounting Standards Codification (ASC) 805-10-55-15 provides limited guidance when making this evaluation.

Under current practice, the Newco may be the accounting acquirer if it is determined to be substantive (i.e., the newly formed entity would not be viewed as an entity formed solely to issue equity interests to effect a business combination). The SEC staff has historically evaluated whether a Newco is substantive by considering whether the Newco had significant precombination activities.⁶

In a 16 August 2001 letter to the FASB, the SEC staff reiterated its view that if the new entity has been involved in significant precombination activities (e.g., raising capital, identifying acquisition targets, negotiating transactions, promoting the business combination), it would be considered substantive and could be the accounting acquirer. The FASB staff indicated that the SEC staff's interpretation was not inconsistent with the guidance in ASC 805, *Business Combinations*. However, we believe that determining whether a newly formed entity is involved in "significant precombination activities" is a matter of judgment. In addition, because practice is largely based on SEC staff interpretations, greater diversity in practice exists, including when private companies apply the guidance.

Formation of a joint venture

We believe the FASB should provide guidance on how a joint venture should record the assets contributed by a venturer (and assumed liabilities, if any) when the joint venture is formed. US GAAP currently does not address the accounting by a joint venture for noncash assets contributed at formation and excludes the formation of a joint venture (but not an equity method investment) from the scope of ASC 805's guidance on business combinations (ASC 805-10-15-4).

⁶ Twenty-Fifth Annual National Conference on Current SEC Developments, remarks by Jeffrey N. Jones, SEC Professional Accounting Fellow.

Due to the lack of authoritative guidance, entities have generally looked to the views of the SEC staff to account for assets contributed (and liabilities assumed, if any) when a joint venture is formed. The SEC staff recently acknowledged that there is diversity in practice in the accounting for joint venture formation transactions,⁷ which the staff said is due to the lack of guidance and the inherent subjectivity in determining whether the purpose of the formation transaction is consistent with the definition of a joint venture in ASC 323, *Investments – Equity Method and Joint Ventures*.

Single consolidation model

Overall, we support the FASB's current research project on simplifying the consolidation guidance for variable interest entities (VIEs). However, we believe a more impactful project would be for the Board to consider the development of a single consolidation model. Having two models in today's guidance creates unnecessary complexity in consolidation accounting.

The FASB appeared to be trying to align the two models more closely in 2011 when it issued the Proposed Accounting Standards Update (ASU), *Consolidation (Topic 810): Principal versus Agent Analysis*. That proposal would have duplicated in the voting model the existing guidance for determining whether fees paid to a decision maker or service provider represent a variable interest. In our comment letter to the FASB on that proposal, we supported the alignment of the consolidation models for VIEs and voting interest entities and recommended that the Board continue down that path by developing a single consolidation model.

If the Board's primary objective for retaining two models was to require additional disclosures for certain types of entities, we believe the FASB could achieve that objective and reduce complexity by moving to a single model with specific disclosure requirements. Disclosures could be required to address the risks associated with an interest in another entity and the effects of those interests on the financial statements.

We recommend that the Board expand its current research project to determine the feasibility of a single consolidation model. We suggest that the Board look to International Financial Reporting Standards (IFRS) 10 *Consolidated Financial Statements* as a starting point for consideration of a single consolidation model, although we would recommend excluding certain of its concepts such as potential voting rights and *de facto* control.

Question 0.2: What is your view about the priority of addressing the major financial reporting issues addressed in this ITC? In other words, is addressing one or more of the issues more critical than others? Please describe your assessment criteria and why you prioritized certain issues above others.

Refer to our overall response to the ITC.

⁷ 2014 AICPA National Conference on Current SEC and PCAOB Developments, remarks by Christopher F. Rogers, SEC Professional Accounting Fellow.

Question 0.3: Is it necessary to resolve one or more of the issues before resolving others? In other words, is the resolution of any of the issues dependent upon the resolution of one or more other issues? Please identify any of the projects that should be completed before others and why.

Refer to our overall response to the ITC.

Chapter 1 – Intangible assets (including research and development)

As discussed above, we do not believe the Board should take on major new projects at this time. However, we have provided responses for the Board to consider if it decides to pursue a project on intangible assets.

Question 1.1: Is the accounting for intangible assets (including research and development) a major financial reporting issue that the FASB should consider for improvement? Please explain why.

We do not believe that the accounting for intangible assets is a major financial reporting issue or that comprehensive changes are necessary. We believe that making significant changes to the accounting for intangible assets could be challenging and that certain targeted changes could be addressed as part of the Board's future phase of the project on clarifying the definition of a business (Phase 3) to address the differences in recognition and derecognition of assets and businesses.

Question 1.2: If yes, should the issue be addressed broadly for all intangible assets or should it first be addressed for a subset of intangibles (for example, research and development)? Please explain why.

Not applicable.

Question 1.3: Which approach to addressing the issue is appropriate, considering the benefits and costs of each approach and why? If you recommend 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). If you recommend a disclosure approach, please explain the disclosure objective and recommend what specific information should be disclosed. If you recommend an approach to adopt IAS 38, please explain any implementation concerns.

As discussed above, we do not believe the Board should make comprehensive changes to the accounting for intangible assets. However, we have provided responses for the Board to consider if it decides to pursue the project. If the Board proceeds with any of the alternatives below, we believe further outreach to investors may be necessary to understand the usefulness of the information and whether such alternatives accomplish the desired objectives.

Alternative A – Recognize internally generated intangible assets

We believe that the recognition of additional internally generated intangible assets could present challenges because a clear threshold for initial recognition would be difficult to implement. In many cases, it is challenging to conclude that an intangible asset meets the definition of an asset until it is

almost ready for its intended use. That is, prior to that point, there is significant uncertainty about whether the intangible asset will generate future economic resources for the reporting entity. By the time an intangible asset is almost ready for its intended use, the majority of costs have already been incurred and recognized as expenses.

Measuring internally generated intangible assets would also be challenging. Recognizing internally generated intangible assets on the balance sheet at historical cost likely would not reflect their value to the reporting entity, but measuring intangible assets at fair value is often complicated and requires the right resources, knowledge and experience. The costs to prepare and audit periodic valuations for intangible assets would likely be significant.

Alternative B – Recognize research and/or development costs

If the Board decides to pursue a recognition model, we believe this alternative may be more practical than recognizing all internally generated intangible assets. However, as previously discussed, we believe the differences in accounting for research and development costs incurred outside versus as part of a business combination should be addressed as part of the Board's future phase of the project on clarifying the definition of a business (Phase 3) rather than through a separate discrete project.

Alternative C – Disclose internally generated intangible items

Before the Board decides to implement a disclosure approach, we believe it should further understand how the information provided would influence a user's decision making. Also, as noted in paragraph 1.45 of the ITC, such disclosures would likely make financial reporting more costly and complex.

Alternative D – Adopt IAS 38

We do not support adopting International Accounting Standard (IAS) 38, *Intangible Assets*, because we do not believe it would result in a significant improvement to financial reporting. As explained in paragraph 1.47 of the ITC, there generally is not a material difference between the accounting for internally generated intangible assets under US GAAP and IFRS because IAS 38 has a high hurdle for recognition of development costs. In addition, we have observed a significant level of diversity in the application of IAS 38 within and across industries.

Question 1.4: Recognition of an intangible asset if a threshold is met and measurement of that asset at fair value would likely result in (a) a gain in the period in which the asset initially is recognized and (b) gains or losses in each period for the change in the fair value of the asset. How should those initial and subsequent gains and losses be presented in the income statement?

We encourage the Board to conduct further outreach to understand the perspective of users on the presentation of initial and subsequent gains and losses.

Chapter 2 – Pensions and Other Postretirement Benefit Plans

As discussed above, we do not believe the Board should take on major new projects at this time. However, we have provided responses for the Board to consider if it decides to pursue a project on pensions and OPEBs.

Question 2.1: Is the accounting for pensions and other postretirement benefit plans a major financial reporting issue that the FASB should consider for improvement? Please explain why.

We believe that the accounting for hybrid plans should be addressed by the FASB through targeted improvements. Benefit plans are evolving from traditional pension plans to hybrid plans (e.g., cash balance plans), but the accounting guidance has not kept pace with the changes. There is limited guidance for these plans (e.g., for measuring the benefit obligation of these plans), and there is diversity in practice in the accounting for cash balance plans with variable interest crediting rates that are linked to an index (e.g., LIBOR-based).

While few companies are implementing new pension plans, companies with existing plans will need to continue to account for them for a long time. The forward-looking nature of certain assumptions (e.g., expected return on plan assets, future compensation levels) creates actuarial gains and losses that reduce the relevance of the results or increase complexity. Also, the settlement approach for developing assumptions results in bias and diversity in practice in how certain assumptions (e.g., discount rates) are developed using the guidance in ASC 715, *Compensation – Retirement Benefits*.

* * *

In our view, the questions regarding the usefulness of information about pensions and OPEBs are best addressed by users of the financial statements. However, we have provided our observations regarding the alternatives for the Board to consider if it decides to pursue a project on the accounting for pension and OPEBs.

Issue 1 – Delayed Recognition (Smoothing) in Earnings

Question 2.2: Would Alternative A (see paragraphs 2.15–2.16) and/or Alternative B (see paragraphs 2.17–2.19) improve the usefulness of financial information provided to users and be operable?

Alternative A

Alternative A would promote convergence with IAS 19 *Employee Benefits* and, in our view, it could reduce complexity in certain instances. This alternative would require the use of more uniform approaches for determining the discount rate for net interest, recognizing actuarial gains and losses (i.e., no recycling into the income statement) and recognizing prior service cost or credit (i.e., immediate recognition). This alternative also may reduce the reporting of related non-GAAP financial measures because actuarial gains and losses would be recognized in other comprehensive income (OCI).

While we believe Alternative A would be operable, companies may incur significant costs (either internally or from actuaries) to change their method of accounting, update systems and processes and report financial information. Additionally, as noted in the response to Question 2.3, we have certain concerns about adopting IAS 19 in its entirety and would recommend certain modifications to the approach if the FASB decides to proceed with Alternative A.

Alternative B

In our experience, some companies are already recognizing actuarial gains and losses immediately, and companies that do not capitalize pension or other postretirement benefit plan costs likely would not incur significant costs to make this change. Alternative B would reduce complexity by eliminating the deferral of actuarial gains and losses in OCI and the subsequent amortization of them to earnings. However, this alternative would increase volatility in the income statement, and companies may remove the effects of immediate recognition of pension remeasurements if they report non-GAAP financial measures.

If the FASB pursues Alternative B, it may consider revisiting the frequency of remeasuring the benefit obligation. Currently, this is done annually, unless a significant event requiring remeasurement occurs during interim periods. As a result, some companies characterize the item as a point-in-time occurrence recognized only in the fourth quarter. We note that if remeasurement occurred more frequently, companies may no longer be able to exclude the effect of remeasurements when reporting non-GAAP financial measures as they may be construed as recurring items. We understand that with improvements in technology, the requirement to remeasure benefit assets and obligation should not significantly increase the financial reporting cost.

Question 2.3: If you support Alternative A (convergence with IAS 19), would you recommend any modifications to IAS 19 or would you expect any implementation issues? Please explain why.

If the FASB proceeds with Alternative A, we recommend that it consider whether the current US GAAP requirement to recycle amounts from OCI into the income statement should be retained (i.e., the Board should reevaluate the fundamental basis for recognizing these amounts in OCI.) We also recommend removing the asset ceiling test in IAS 19 because it is complex and not usually relevant for companies in the US.

Additionally, while IAS 19 does not specifically preclude the use of the hypothetical bond model and asymmetrical yield curves, there is a general belief that IAS 19 does not permit their use because they involve the use of bias toward selecting bonds with higher interest rates for determining discount rates.⁸ We would recommend that the FASB provide more prescriptive guidance about the requirement to use unbiased assumptions.

⁸ IAS 19, paragraph 75.

The guidance in IAS 19 for determining the discount rate when there is no deep market in high-quality corporate bond obligations that are denominated in the currency of the promised benefit may result in a counterintuitive measurement of the benefit obligation. We recommend that the FASB carefully consider the guidance that requires using the market yields (at the end of the reporting period) on government bonds denominated in that currency to determine the discount rate in those circumstances. The FASB could consider alternative methods for determining the discount rates in these situations.

Question 2.4: Are there other approaches to consider for addressing the issue of delayed recognition in earnings? If so, please provide them in sufficient detail so that the FASB can consider your proposal(s). Please provide your rationale for why your proposal provides users of financial statements with more useful information.

We believe that instead of focusing on the recognition approach for actuarial gains and losses (i.e., delayed recognition versus immediate recognition in earnings or converging with IAS 19), the FASB could consider minimizing actuarial gains and losses by eliminating the use of certain forward-looking assumptions. For example, the FASB could eliminate the use of the “expected return on plan assets” assumption and instead adopt the net interest approach in IAS 19 (i.e., using the same discount rate to calculate the interest cost on the defined benefit obligation and to accrue interest income on the plan assets, rather than the expected long-term rate of return on plan assets). The FASB also could consider requiring the use of the accumulated benefit obligation method that measures the obligation based on employees’ history of service and compensation without an estimate of future compensation levels.

Issue 2 – Measurement of Defined Benefit Obligation

Question 2.5: Is the current measurement of a defined benefit obligation appropriate? If not, what changes do you suggest and why (for example, what characteristics of plans are not adequately reflected in the current measurement of the benefit obligation)?

Because the benefit promise is usually tied to future compensation levels and employee service, and due to the long-term nature of these benefit arrangements, we understand that there are limited alternative valuation methods available to measure the defined benefit obligation. As noted in our response to Question 2.4 above, the Board could consider using the accumulated benefit obligation method, which mitigates the use of forward-looking employment assumptions when determining the benefit obligation.

Additionally, we recommend that the FASB reconsider the settlement approach to determining the benefit obligation. We believe that the availability of numerous methods (e.g., yield curve method, bond matching method) to develop discount rates used in calculating benefit obligations has resulted in diversity in practice, with some methods resulting in the selection of a greater number of higher-yielding bonds (which results in a higher discount rate and a lower benefit obligation) than other methods.

Finally, ASC 715-30-35-71 requires that the benefit obligation for hybrid plans (cash balance plans) with fixed interest crediting rates be determined using the traditional unit credit method. In developing the guidance now codified in ASC 715-30-35-71, the EITF noted that the traditional unit credit method is not appropriate for plans with variable interest crediting rates linked to a market index; however, additional guidance on the appropriate measurement method was not provided by the EITF. As a result, diversity in practice exists in accounting for cash balance plans with variable crediting rates linked to a market index. Some entities use the project unit credit method to measure the benefit obligation, while others analogize to the guidance in ASC 715-30-35-40 and 35-41 to recognize the aggregation of the employees' hypothetical cash balance accounts as the measurement of the defined benefit obligation. We recommend that the FASB consider providing guidance on the appropriate method to use when measuring benefit obligations for hybrid plans with variable interest crediting rates (e.g., projected unit credit, unit credit, another method) to eliminate this diversity in practice.

Path Forward

Question 2.6: What approach (that is, targeted improvements or comprehensive reassessment) would you recommend and why?

We recommend that the FASB consider targeted improvements to the accounting for pensions and OPEBs. The principles in ASC 715 and IAS 19 are largely the same. Therefore, a comprehensive reassessment of ASC 715 would not be necessary if the FASB converged with IAS 19, with certain modifications as discussed in our response to Question 2.3.

Additionally, as discussed above, we believe that further guidance is needed for measuring hybrid plans (cash balance plans) with variable interest crediting rates. This issue also exists under IAS 19 today.

Question 2.7: Are there other issues for pension and other postretirement benefit plan accounting that should be considered for improvement?

No additional comments.

Chapter 3 – Distinguishing Liabilities from Equity

As discussed above, we do not believe the Board should take on major new projects at this time. However, we have provided responses for the Board to consider if it decides to pursue a project on the accounting for distinguishing liabilities from equity.

Question 3.1: Is the accounting for distinguishing liabilities from equity a major financial reporting issue that the FASB should consider for improvement? Please explain why. In making your assessment, what criteria were used (for example, is the issue not sufficiently addressed in current GAAP, or is it addressed in a way that makes compliance costly or creates diversity in practice because the guidance is conceptually or economically flawed)?

We believe that the accounting for distinguishing liabilities from equity is a major financial reporting issue that could be addressed after completion of the conceptual framework. The complexity of this topic results from the fragmented nature of the current guidance, which was developed over time to address narrow issues as they arose and specific instruments as they were brought to the market. As a result, the guidance is generally rule-based and lacks a robust conceptual platform, which results in unintended consequences and inconsistencies in its application.

An entity must navigate through numerous pieces of literature, including rules and exceptions, to determine whether an instrument should be classified as a liability or as equity. Further, the classification guidance has not kept pace with the development of new instruments as firms' capital structures have grown more complex. There are also numerous bases for initially and subsequently measuring instruments and their components (e.g., accreted value, intrinsic value, fair value) and, similarly, numerous models for accounting for derecognition (e.g., maturity, early settlement, conversion, induced conversion, modification, extinguishment).

Today's classification model is based primarily on the structure and legal form of financial instruments or the forms of settlement that are theoretically possible but unlikely to occur (i.e., remote), rather than their substance, often resulting in different accounting treatments for economically similar financial instruments. Consequently, the guidance is frequently subject to financial engineering that aims to achieve a desired accounting outcome. In addition, the difficulty of navigating, interpreting and applying disparate pieces of literature has increased the risk that preparers will fail to consider all of the relevant standards and interpretive guidance when determining the accounting for a specific instrument or feature, especially for small, less-sophisticated entities that are more likely to issue complex or unique instruments to investors with more powerful bargaining positions. For these reasons, this topic continues to be a focus of the SEC and a leading cause for restatements.

Question 3.2: Is the issue of distinguishing between liabilities and equity a financial reporting issue that requires a holistic approach to resolve as opposed to targeted improvements? Please explain why.

We believe that a project on distinguishing liabilities from equity would require a holistic approach that considers the underlying concepts and various models for the distinctions between liabilities and equity, and the related measurement and presentation issues. We do not believe that targeted improvements would be effective in improving financial reporting. The current rule-based guidance is a result of standard setting to address specific practice issues as they arose. We agree with the comment in paragraph 3.14 of the ITC regarding targeted improvements that "such an approach also is likely to perpetuate the current system of instrument-specific rules resulting in the potential for inconsistent and complex guidance." Further, as financial instruments continue to grow more complex, targeted improvements would not be a sustainable solution.

In the 30 May 2008 response by our Global firm (Ernst & Young Global Limited) to the FASB's 2007 Preliminary Views (PV) and the IASB's Discussion Paper, both titled *Financial Instruments with Characteristics of Equity*, we urged the FASB and the IASB to consider a comprehensive model for distinguishing liabilities from equity. We said such an effort "is critical to improving financial reporting and should be expected to stand the test of time." Consistent with that view, we believe this project should start with the conceptual framework by focusing on improving the definitions of liabilities and equity and providing the related measurement and financial statement presentation basis. Subsequent standard setting would clarify the application and implementation of the concepts.

If the FASB decides that targeted improvements in certain areas would resolve practice issues without affecting the entire model, we suggest that the Board consider the following topics (in addition to its project on simplifying the balance sheet classification of debt):

- ▶ Simplification of the additional conditions necessary for equity classification within ASC 815-40, *Derivatives and Hedging – Contracts in Entity's Own Equity*
- ▶ Modifications or exchanges of debt and convertible debt, including modification of credit facilities that contain both term loans and revolving lines of credit
- ▶ Subsequent accounting for stock and equity-linked instruments, including modification or exchange and settlement transactions

Question 3.3: Are there other alternatives for simple instruments that the FASB should consider for resolving the issue of distinguishing between liabilities and equity? If so, please provide the alternatives in sufficient detail such that the FASB can consider your proposal(s). Please provide your rationale for why your proposal provides users of financial statements with more useful information.

The proposed alternatives for simple instruments are intended to address whether "claims" should be classified as liabilities or equity. We agree that a holistic, conceptual approach to defining liabilities and equity and determining the accounting for distinguishing liabilities from equity is appropriate. We believe, however, that the definitions and principles used in this project must be considered and aligned with the decisions the FASB reaches on the liability-equity distinction in the conceptual framework project.

Users of financial statements are interested in information they can use to assess the priority of claims on the entity's assets, the solvency of the entity, the dilution to existing owners, the liquidity of the entity, and the risks and rewards of those claims. The classification of financial instruments as liabilities or equity and related presentation and disclosures could be helpful to users in making these assessments. Any of these considerations, or a combination, could be used as a principle for distinguishing between liabilities and equity. However, it is not likely that a single model could reflect all of these considerations equally. As more factors are incorporated into the principle, the model becomes more complex, but is likely to better reflect in the financial statements the substance and economic reality of a financial instrument. It is important for any approach that the Board considers to strike an appropriate balance between accounting simplicity and the need to reflect economic reality. The three approaches considered by the FASB in its PV (i.e., Basic Ownership Approach, Ownership Settlement Approach and Reassessed Expected Outcomes Approach) used one or a combination of these criteria as a basis to make the distinction between liabilities and equity.

In our comment letter on the PV, we tentatively supported the Basic Ownership Approach due to its perceived simplicity with regard to initial classification and because it represents a principled response to the question of what constitutes equity – that is, the most residual claim (claims) are classified as equity. However, that support for a simple classification model was premised on our view that, while classification of liabilities and equity in the balance sheet is important, preparers and users are primarily focused on the measurement and the presentation of the changes in these instruments (i.e., in the statement of financial performance). We continue to believe users are primarily focused on measurement and presentation. Therefore, in reaching conclusions on classification in any future project on distinguishing liabilities from equity, it would be critical for the Board to also consider the measurement and presentation of the changes in these liability and equity instruments, as well as the associated disclosures to allow various users of the financial statements to draw the appropriate distinction between equity and liabilities for their use.

Before exploring other approaches, we suggest the Board reconsider the models it considered in the PV, or consider how its thinking has changed since the last standard setting on this topic. The Board should use its understanding of what worked in these models to further the development of a new model.

The IASB currently has a research project on distinguishing liabilities from equity and is investigating potential improvements (1) to the classification of liabilities and equity in IAS 32 *Financial Instruments: Presentation*, including potential amendments to the definition of liabilities and equity in its conceptual framework project and (2) to the presentation and disclosure requirements for financial instruments with characteristics of equity, irrespective of whether they are classified as liabilities or equity. It would be worthwhile for the FASB to also consider any models that are in the process of being developed by the IASB.

Question 3.4: Are there other alternatives for addressing the financial reporting issues with conversion options in complex instruments that the FASB should consider? If so, please provide sufficient detail such that the FASB can consider your proposal(s). Please provide your rationale for why your proposal provides the users of financial statements with more useful information.

No. We believe the two alternatives outlined in the ITC are sufficient for the Board to consider the issues related to convertible debt.

* * *

We believe the questions regarding the usefulness of information (Questions 3.5 through 3.8) are best addressed by users of the financial statements. However, we have provided our observations regarding the alternatives for the Board to consider if it decides to pursue a project on the accounting for distinguishing liabilities from equity.

Question 3.5: Considering the alternatives described for simple instruments, which alternative provides more useful information to the users of financial statements and why?

We believe Alternative B would provide more useful information to the users of financial statements because it better reflects the economic substance of a simple instrument.

Alternative A provides a narrower view of equity that is less likely to capture the underlying economics of even some relatively simple instruments and would make the financial statements less useful. For example, a preferred stock that is mandatorily convertible into a fixed number of the entity's common shares in one year with participating dividends possesses the fundamental characteristics of an entity's ownership interests but would be classified as a liability under Alternative A. Likewise, physically settled forward sale contracts or written call options would be classified as liabilities because a settlement is required. In our view, these instruments may best be classified as equity.

Under Alternative A, more financial instruments would be classified as liabilities than under existing US GAAP and Alternative B. This would result in more instruments requiring subsequent remeasurement. While Alternative A appears to reduce the complexity of determining the appropriate classification, it actually shifts the complexity to the subsequent measurement and valuation of the underlying instruments.

Alternative B better reflects the economics of simple instruments because it also incorporates the nature of return (i.e., whether the holder participates in the risks and rewards of equity ownership in an entity) in determining classification. Under this approach, a simple instrument that provides for settlement with a return profile that mimics that of holders of a residual interest and has no current obligation to transfer assets would be classified as equity.

Question 3.6: Considering the alternatives described for complex instruments, which alternative provides more useful information to users of financial statements and why?

We believe Alternative A would result in a better representation of the economic reality of a complex instrument. In the case of debt issued with an embedded conversion option, the funds received by the debtor represent a financing from selling straight debt (at a lower-than-market interest rate for similar debt without the conversion option), as well as from selling an embedded conversion option. By separating the conversion option (equity component) from the liability component, Alternative A would cause entities to more appropriately report the cost of the borrowing in the income statement (i.e., as interest expense) because of the amortization of the debt discount created by separating the embedded conversion option. That is, the portion of the borrowing cost that has been "paid" with the embedded conversion option (a written call option) would be appropriately reported as interest expense, which is consistent with the economic reality of the transaction.

In contrast, Alternative B would likely not reflect the true borrowing cost of the issuing entity when a portion of the borrowing cost is "paid" with the embedded conversion option (unless the embedded conversion option is bifurcated and separately accounted for pursuant to ASC 815). In addition, Alternative B could result in different accounting treatment for instruments with similar economics. For example, consider on the one hand, debt with an embedded conversion option (i.e., convertible debt) and, on the other hand, straight debt with contemporaneously issued detachable warrants (i.e., a basket transaction) with the same terms as the conversion option embedded in the convertible debt. Although these two transactions are economically identical, Alternative B would result in different accounting treatments for the convertible debt and the basket transaction. As a result, Alternative B could subject transactions to financial engineering that aims to achieve a desired accounting outcome.

Question 3.7: Which provides more useful information to the user of financial statements: remeasuring liability classified instruments at fair value or at intrinsic value? Please provide the rationale for your choice.

Instruments classified as liabilities may be in the form of equity-linked instruments (e.g., options, forwards), debt or mandatorily redeemable stock (a liability under ASC 480, *Distinguishing Liabilities from Equity*). The ITC focuses on the difference between measurement at fair value and measurement at intrinsic value, so our response addresses the measurement attribute of equity-linked instruments such as options or forwards.

We generally believe fair value is a more meaningful measurement attribute for equity-linked instruments that are classified as liabilities, similar to derivatives that are within the scope of ASC 815, *Derivatives and Hedging*. However, if the ultimate settlement of the instruments between the issuer and investor (as opposed to a sale of the instrument in the market by the investor) is at intrinsic value, we generally believe that measuring the liability at intrinsic value better conveys the manner in which investors would receive their return (or alternatively, the gain or loss experienced by other existing investors in the entity). Measuring equity-linked instruments at intrinsic value could also reduce the complexity in subsequent measurement.

Question 3.8: Are there instances in which the remeasurement of liability-classified instruments at each reporting period is not useful? If so, which instances and why?

Remeasuring liability-classified instruments at each reporting period may not provide useful information to users of financial statements when:

- ▶ Debt solely comprises principal and interest payments – Investors are primarily interested in the entity's ability to make interest and principal payments. In this case, amortized cost seems to be the appropriate measurement attribute.
- ▶ Equity-linked instruments that require issuances of a fixed number of shares⁹ – Users of financial statements are concerned about dilution of existing owners' interests. The earnings-per-share metric could likely provide the relevant information to investors.

Chapter 4 – Reporting Performance and Cash Flows

As discussed above, we do not believe the Board should take on major new projects at this time. However, we have provided responses for the Board to consider if it decides to pursue a project on reporting performance and cash flows.

⁹ These equity-linked instruments may be classified as a liability because of "down round" features or contingent redemption features.

Income Statement

Question 4.1: Is income statement presentation a major financial reporting issue that the FASB should consider for improvement? Please explain why. In making your assessment, what criteria were used?

We do not believe the user input summarized in the ITC makes a compelling case that income statement presentation is a major financial reporting issue (i.e., that a change in income statement presentation would significantly affect the behavior of users of financial statements). It is possible that greater transparency into user concerns would provide a basis for making changes.

Question 4.2: How should the components of net income be categorized, if at all? If the FASB were to develop an operating activities category and display a subtotal for operating income, how should the category be defined or described?

Before the FASB makes any changes to income statement presentation, we believe it would need to explore more broadly whether a prescriptive or management-type approach to income statement presentation would be more appropriate. As discussed in our response to Question 4.1, we believe additional insight into the needs of users of financial statements would be helpful in making this assessment.

Question 4.3: Could an operating activity category be defined or described consistently and effectively for all types of reporting entities (for example, entities involved in financial services, investing, banking, and financing)?

We do not believe that an operating activity category can be defined or described consistently for all types of reporting entities. Because entities engage in a wide range of activities, transactions and events, the earnings components that should be categorized within operating activities likely differ across entities. For example, a financial institution with primary operations that include mortgage lending likely should categorize interest income within operating activities. However, a manufacturing company that produces widgets but also owns a small investment portfolio on which it earns interest likely should not categorize interest income within operating activities. It is unclear to us how in this example a standardized definition of an operating activity would appropriately capture the differences in the nature of the entities' operations. We are concerned that a standardized definition of an operating activity may not capture the most relevant information for all entities and could result in financial information that is not meaningful to users of financial statements. In addition, as discussed in our response to Question 4.2, we believe the FASB should first explore more broadly whether it believes a prescriptive or management-type approach to income statement presentation is more appropriate and best satisfies the needs of users of financial statements.

Question 4.4: How should the FASB evaluate the benefits of a standardized definition versus a management determination of an entity's operating activities?

Providing a standardized definition of an entity's operating activities likely would result in financial information that is more comparable across all entities than allowing management to determine the composition of operating activities through an accounting policy. However, we believe the FASB should gain more insight into the needs of users of financial statements and explore more broadly whether it believes a prescriptive or management-type approach to income statement presentation is more appropriate. For example, the Board should obtain more insight into the needs of users of financial statements to determine whether the benefits of comparable financial information afforded by a standardized definition outweigh the potential negative effects that such a definition may have on the relevance and usefulness of the information provided to the users.

Question 4.5: Which, if any, of the three alternatives described for combining or separating items provides more useful information to users of financial statements, and why?

Consistent with our response to Question 4.1, we believe that the existing structure and usefulness of the income statement provides users of the financial statements with sufficient information to make informed investment decisions. We are not aware of evidence that any of the alternatives described significantly improve the way information in the income statement is presented to users of financial statements.

Question 4.6: Are there other alternatives for presenting lines within the income statement that the FASB should consider?

We do not believe there are other alternatives for presenting lines within the income statement that the Board should consider.

Segment Reporting

Question 4.7: Is segment disclosure a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

We do not believe segment disclosure is a major financial reporting issue that the FASB should consider for improvement or that significant enhancements are necessary. Further, we do not believe that any of the alternatives included in the ITC would significantly improve the standard.

* * *

We believe the questions regarding the usefulness of information in Questions 4.8 and 4.9 are best addressed by users of the financial statements. However, we have provided our observations regarding the alternatives for the Board to consider if it decides to pursue this project.

Question 4.8: Considering the three alternatives described for improving aspects of the Topic 280 disclosure requirements, which, if any, alternative provides more useful information to the users of financial statements and why?

Alternative A – Additional disclosures by segment

The additional disclosures may not significantly improve or enhance the information provided to users. Also, it may be challenging to identify metrics that are important to users across all industries.

Alternative B – Structured table format

In our experience, many companies already present their segment information in tabular format, and those tables often reconcile to the consolidated line items to which the segment information relates.

Alternative C – Segment information based on financial statement line items

ASC 280, *Segment Reporting*, requires disclosure of the measure of segment profit or loss that is reviewed by the chief operating decision maker (CODM). Oftentimes, the measure of segment profit or loss reviewed by the CODM and used in making key operating decisions is a non-GAAP measure (other than the requirement in US GAAP to disclose that non-GAAP measure as a part of the segment disclosures). If entities were required to report segment information on the basis of lines from the income statement, it is not clear how companies would present the information when the performance measure does not align with a line item in the income statement.

Alternative C indicates that amounts for individual reportable segments would be reported as zero in the table if the amounts are not reported to the CODM. However, because the CODM may not review all line items, amounts presented in the table may not be clear. For example, if the total for current assets is reviewed by the CODM but the individual components within current assets are not, the individual line items would be reported as zero for each reportable segment. However, the subtotal for current assets would have an amount.

Also, in our experience, the CODM may review no or limited balance sheet information by segment. In those circumstances, the proposed format would show a total column with no amounts or only limited amounts allocated to segments, creating incremental disclosures that would provide little, if any, additional information for users.

Question 4.9: Would the described improvements to (a) reexamine the aggregation criteria and (b) apply the segment standard from a governance perspective provide more useful information to users of financial statements and why?

Reexamination of the aggregation criteria

We do not support introducing quantitative thresholds or bright lines. Although the ITC notes that users would like the aggregation criteria to be more rigorous, in practice, the aggregation criteria is viewed as a high hurdle. The SEC staff has emphasized this point in remarks at the AICPA National

Conference on Current SEC and PCAOB Developments in 2014¹⁰ and 2015¹¹ (the Conferences). Although analyzing the aggregation criteria requires significant judgment, we do not believe additional rigor within the standard is necessary. Instead, we believe the FASB could consider codifying items discussed in the Basis for Conclusions to Statement of Financial Accounting Standards No. 131 (SFAS 131), *Disclosures about Segments of an Enterprise and Related Information*, on the application of the aggregation criteria to provide more consistency in the application of the criteria. For example, the Board could consider codifying the principle articulated in paragraph 73 of the Basis for Conclusions to SFAS 131, that “separate reporting of segment information will not add significantly to an investor’s understanding of an enterprise if its operating segments have characteristics so similar that they can be expected to have essentially the same future prospects.”

Application from a governance perspective

We believe that application of the standard from a governance perspective could result in fewer reporting segments for many companies and less information for users because the board of directors generally reviews information at the same level or at a higher level than the CODM. This approach would seem counter to the concern highlighted in the ITC that there are limited reporting segments today.

The ITC notes that advances in technology have improved access to a variety of financial information, which makes it harder to determine what information the CODM is reviewing regularly. We note that ASC 280 specifies that the information must be used by the CODM to make decisions about the allocation of resources and assessment of performance, not just reviewed by the CODM. We believe that the concern the FASB raised in the ITC could be addressed, at least in part, by codifying factors highlighted by the SEC staff in remarks at the Conferences to identify the level at which the CODM is evaluating the business and making key operating decisions (e.g., organizational structure, process used by management to make key operating decisions, budgeting process, the basis for which executive compensation is determined). We also believe codifying this guidance could help provide clarity and improve consistency in the application of the management approach to determining operating segments.

Question 4.10: Are there other alternatives for improving segment reporting that the FASB should consider? If so, please provide them in detail to help the FASB in considering your proposal(s). Please provide your rationale for why your proposal provides users of financial statements with more useful information.

No additional comments.

¹⁰ 2014 AICPA National Conference on Current SEC and PCAOB Developments, remarks by Dan Murdock, SEC Deputy Chief Accountant.

¹¹ 2015 AICPA National Conference on Current SEC and PCAOB Developments, remarks by Courtney D. Sachtleben, SEC Professional Accounting Fellow.

Other Comprehensive Income

Question 4.11: Is the presentation of other comprehensive income a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

We do not believe the presentation of OCI is a major financial reporting issue that the Board should consider improving. We recognize that some stakeholders have expressed concerns with understanding OCI, but we do not believe these issues result from the presentation of OCI. Rather, we believe that the Board's basis for recognizing certain amounts in OCI is not well understood. Accordingly, the Board's resources may be better directed to reevaluating the fundamental basis for recognizing amounts in OCI (e.g., the basis for the requirements in the accounting standards identified in paragraph 220-10-45-10A).

Question 4.12: Considering the two alternatives described for minimizing the use of reclassification adjustments, which alternative provides more useful information to the users of financial statements and why?

If the Board considers any improvements related to OCI, we do not believe it should consider narrow issues related to presentation and reclassification adjustments. Rather, we believe the Board should reevaluate the fundamental basis for recognizing amounts in OCI through the individual accounting models that result in entries to OCI.

Question 4.13: Do the described improvements to (a) remove the option for presenting comprehensive income over two statements and (b) emphasize other earnings per share measures improve the relevance of the performance information included in other comprehensive income?

We believe that providing the option for presenting total comprehensive income over two separate but consecutive statements is necessary. If any approach is mandated, we suggest the Board require the use of separate statements, given the concerns related to OCI. We do not believe other earnings-per-share measures would improve the relevance of the information included in OCI.

Question 4.14: Are there other alternatives for improving the relevance of other comprehensive income that the FASB should consider? If so, please describe them in detail to help the FASB in considering your proposal(s). Please provide your rationale for why your proposal provides users of financial statements with more useful information.

As previously discussed, we believe the best alternative for improving the relevance of OCI is to reevaluate the fundamental basis for recognizing amounts in OCI.

Cash Flow Statement

Question 4.15: Is the presentation of cash flows a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

We do not believe the presentation of cash flows is a major financial reporting issue that the FASB should consider improving. We believe that the existing three-category structure provides for comparability across entities and is generally well understood by users of the financial statements. The Board's recent issuance of ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, and the Emerging Issues Task Force's final consensus on restricted cash (Issue 16-A) further illustrate that existing issues related to the statement of cash flows are narrow in nature.

Question 4.16: Do you recommend that the FASB retain or reconsider the three-category structure and the definitions of operating, investing, and financing activities within the statement of cash flows?

We recommend that the FASB retain the three-category structure and the existing definitions of operating, investing and financing activities within the statement of cash flows.

If the FASB Maintains the Current Three-Category Structure and Definitions:

Question 4.17: What specific cash flows should be disaggregated in the future that are not being disaggregated today and is that disaggregation feasible?

We do not believe there are any cash flows that should be further disaggregated. We believe the level of disaggregation required under existing standards provides users of financial statements sufficient information to make informed investment decisions.

Question 4.18: What specific cash payments and receipts are in need of additional classification guidance?

We do not believe there are other cash payments or receipts for which additional classification guidance is needed. However, we would encourage the Board to consider providing cash flow classification guidance when it issues new accounting standards, similar to how it provided balance sheet and income statement presentation guidance in many new standards.

If the FASB Reconsiders the Current Three-Category Structure and Definitions:

Question 4.19: How should the cash flow statement be categorized, if at all? Considering the three alternatives that would reconsider the current structure of the cash flow statement, which, if any, alternative provides more useful information to users of financial statements and why? How should the FASB define or describe those categories?

Not applicable.

Question 4.20: How should the FASB evaluate the benefits of a standardized structure versus a management determination to classification of cash flows?

Not applicable.

Question 4.21: If you prioritize a standardized structure and recommend an operating activities category, how should the Board evaluate the benefits of aligning the description or definition of that category across the income and cash flow statements?

Not applicable.

Question 4.22: Are there other alternatives for improving the cash flow statement that the FASB should consider? If so, please describe in detail to help the FASB in considering your proposal(s). Please provide your rationale for why your proposal provides users of financial statements with more useful information.

We do not believe there are other alternatives for improving the cash flow statement that the FASB should consider.

Paths Forward

Question 4.23: What type of project or projects do you recommend that the FASB prioritize to improve the reporting of performance and cash flow information? If you recommend multiple projects or different combinations, please explain the recommended sequencing of those projects.

As previously discussed, we believe the Board's resources would be best directed to completing active projects and providing implementation support for its recently completed major projects. However, if the Board decides to move forward with other projects, we recommend that it consider a narrow project to evaluate whether certain commonly used non-GAAP financial measures (e.g., EBITDA and funds from operations) should be defined and disclosed in the footnotes. We believe the scope of this project should be very narrow and not be broadened (e.g., it should not attempt to define the types of items that are "recurring" and "non-recurring").

Question 4.24: What issues and solutions should be addressed within those projects? Please consider the priority of pursuing the issues and solutions.

See response to Question 4.23.