



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

Mr. Shayne Kuhaneck
Acting Technical Director
File Reference No. 2019-780
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

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Proposed Accounting Standards Update – Codification Improvements

Dear Mr. Kuhaneck:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update. We support the continued effort by the Financial Accounting Standards Board (FASB or Board) to address stakeholder feedback on the Accounting Standards Codification (ASC or Codification) and make improvements to US GAAP. For the most part, we agree that the proposed changes would clarify or correct the unintended application of the guidance and make minor improvements to the Codification that would not be expected to have a significant effect on current accounting practice or create a significant administrative cost for most entities. However, we have concerns about certain proposed amendments.

While in general we agree with the Board's reasons for removing the references to the FASB Concepts Statements in the Codification, we have some concerns about how those references are being replaced. For example, the inclusion of "equitable and constructive obligations" in the definition of liabilities that is being added to ASC 805-20 (Issue 10) and ASC 410-20 (Issue 8) could have unintended consequences. That is because, while the proposal notes that the Board would be including the actual text of the definitions that were "intended to be applied in the guidance," this presumes that, in each of these instances, Codification users understood how the definitions are intended to be applied and applied them in a consistent manner.

Furthermore, the language in the summary noting that "Codification users would be able to see all requirements necessary to apply a standard in one place" suggests that in these instances, an entity would no longer be expected to look to the Concepts Statements when applying authoritative guidance. However, we understand that, in practice, entities refer to the characteristics of the elements in FASB Concepts Statement No. 6, *Elements of Financial Statements* (CON 6), to help them apply the definitions of assets and liabilities. Without these characteristics, we question whether entities would know how to apply the definitions of assets and liabilities going forward.

Moreover, by adding the definitions to some Topics and not others, the Board may call into question how those terms are considered in all Topics. Inconsistencies in the Codification's use of these terms (i.e., defined in some cases and not others) could be confusing to users.

We encourage the Board to consider outreach to stakeholders to understand how the Concepts Statements are used in practice. We suggest that the Board then consider each of the amendments in Section A and incorporate the appropriate elements from the Concepts Statements to minimize the potential for unintended consequences and confusion. The Board may need to consider how it initially considered those concepts in developing the authoritative guidance. The Board also may want to expand its explanation of Section A's amendments by clarifying its expectations for the use of the Concepts Statements when applying authoritative guidance. We have included additional comments on some of these and other proposed amendments below.

Issue 1

The term "expected losses and expected residual returns" refers to amounts derived from expected cash flows, as described in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements* (CON 7). The guidance on expected cash flows in CON 7 was codified in ASC 820, *Fair Value Measurement*. The FASB proposed deleting the references to the guidance in CON 7 but did not add a reference to the glossary term and guidance in ASC 820. Accordingly, we believe the FASB should revise the individual terms to add a link to the term "expected cash flows" and reference ASC 820 to help avoid any unintended consequences.

In addition, there was additional guidance in the term "expected losses and expected residual returns" that was not included in the individual terms. We believe that, to help avoid any confusion, the FASB should add the additional guidance from the eliminated term (i.e., to state that expected losses and expected residual returns refer to amounts discounted and otherwise adjusted for market factors and assumptions rather than to undiscounted cash flow estimates).

We have illustrated our proposed changes below:

Expected losses

A legal entity that has no history of net losses and expects to continue to be profitable in the foreseeable future can be a variable interest entity (VIE). A legal entity that expects to be profitable will have expected losses. *Expected losses refers to amounts derived from expected cash flows [add glossary link] as described in ASC 820. However, expected losses refers to amounts discounted and otherwise adjusted for market factors and assumptions rather than to undiscounted cash flow estimates.* A VIE's expected losses are the expected negative variability in the fair value of its net assets exclusive of variable interests and not the anticipated amount or variability of the net income or loss.

Expected residual returns

A variable interest entity's (VIE's) expected residual returns are the expected positive variability in the fair value of its net assets exclusive of variable interests. *Expected residual returns refers to amounts derived from expected cash flows [add glossary link] as described in ASC 820. However, expected residual returns refers to amounts discounted and otherwise adjusted for market factors and assumptions rather than to undiscounted cash flow estimates.*

Issue 6

We believe that the FASB's proposal to link the word "transferring" to the term "transfer" in the Master Glossary may be confusing for users. We suggest adding the term "transfer" to the glossary in ASC 230 and changing the language in paragraph 230-10-50-4 as follows:

Examples of noncash investing and financing transactions are converting debt to equity; acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; obtaining a right-of-use asset in exchange for a lease liability; obtaining a beneficial interest as consideration for a {add glossary link} transferring {add glossary link} of financial assets (excluding cash), including the transferor's trade receivables, in a securitization transaction; obtaining a building or investment asset by receiving a gift; and exchanging noncash assets or liabilities for other noncash assets or liabilities.

Also, we note that the transition date for entities other than public entities should be updated for Accounting Standards Update (ASU) 2019-10 (i.e., revised to December 16, 2020, rather than December 16, 2019).

Issue 7

Paragraph 21 states that "Paragraph 350-30-25-4 contains a reference to asset recognition criteria in Concepts Statement 5. The reference does not require an entity to meet recognition criteria as part of the guidance." The guidance in paragraph 350-30-25-4 originated in paragraphs B28-B37 in the Basis for Conclusions of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). That discussion clarifies that, to be recognized, intangible assets acquired in transactions other than business combinations must meet the four recognition criteria in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises* (CON 5). Therefore, while we agree with the Board's decision to delete the reference to CON 5 in paragraph 350-30-25-4, we believe the explanation in paragraph 21 of the proposal should be revised.

Also, we recommend adding the definition of assets contained in CON 6 to the subtopic's glossary section (i.e., ASC 350-30-20) and linking to the existing glossary term "intangible assets" in ASC 350-30-20. We believe the other language in paragraph 350-30-25-4 addresses CON 5's recognition criteria of measurability, relevance and reliability. Adding the definition of assets here will make sure that an entity considers all four recognition criteria in determining whether it should recognize an intangible asset. However, as discussed above, we have some concerns about how the definitions of assets and liabilities are incorporated into the Codification to replace the references to CON 6 as currently proposed.

Issue 8

We agree with the Board's objective to simplify the format of the recognition requirements in ASC 410-20 and remove the reference to CON 6. However, we have some concerns about the proposed addition of the definition of "obligations" in paragraph 410-20-25-4A. This definition is broader than that of legal obligations and refers also to social obligations. Therefore, it conflicts with the scope of guidance on asset retirement obligations as stated in paragraph 410-20-15-2, which refers specifically to legal obligations.

Also, while paragraphs 410-20-55-1 through 55-4 provide implementation guidance to help entities determine whether a legal obligation exists, it is unclear how an entity would determine whether an obligation arises from a moral responsibility or one that is imposed socially. As suggested above, we believe the Board should carefully consider this amendment to minimize the potential for unintended consequences, which in this case could lead to expanding the scope of the asset retirement obligations guidance beyond legal obligations.

We also noted a few editorial changes that would clarify the proposed guidance. The last sentence of paragraph 24 refers to ASC 420, *Exit or Disposal Cost Obligations*, instead of ASC 410-20, *Asset Retirement and Environmental Obligations – Asset Retirement Obligations*, and should be modified as follows:

In addition, the guidance would be clarified to state that financial instruments that are liabilities under Topic 480 are also within the scope of ~~Topic 420, Exit or Disposal Cost Obligations Subtopic 410-20, Asset Retirement and Environmental Obligations – Asset Retirement Obligations~~.

The proposed addition to the guidance that would be moved to paragraph 410-20-25-4A currently refers to "[a] liability for the cost associated with an exit or disposal activity," which is in the scope of ASC 420, as opposed to ASC 410-20. Paragraph 410-20-25-4A should be modified as follows:

A liability for the cost associated with an ~~exit or disposal activity~~ asset retirement obligation is incurred when the following definition is met:

Issue 9

As discussed above, we have some concerns about how references to the Concepts Statements are being replaced and believe that there may be unintended consequences if the actual definitions of assets and liabilities are incorporated into the guidance as currently proposed. If the Board decides to add the actual text of the definitions to the Codification, we suggest the following changes so the language clarifies the recognition criteria, rather than being added as a definition:

420-10-25-2 A liability for a cost associated with an exit or disposal activity is incurred when ~~the following definition of a liability is met: it results in Liabilities are~~ probable future sacrifices of economic benefits arising from present obligations of ~~a particular~~ the entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. Probable is used with its usual general meaning, rather than in a specific accounting or technical sense, and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved (~~Webster's New World Dictionary of the American Language, 2d college ed. [New York: Simon and Schuster 1982], p. 1132~~). Its inclusion in the definition is ~~intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain~~. Obligations in the definition is broader than legal obligations. It is used with its usual general meaning to refer to duties imposed legally or socially; to that which one is bound to do by contract, promise, moral responsibility, and so forth (~~Webster's New World Dictionary, p. 981~~). It includes equitable and constructive obligations as well as legal obligations. Only present obligations to others are liabilities ~~under the definition~~. An obligation becomes a present obligation when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the

liability. An exit or disposal plan, by itself, does not create a present obligation to others for costs expected to be incurred under the plan; thus, an entity's commitment to an exit or disposal plan, by itself, is not the requisite past transaction or event for recognition of a liability.

Also, we note that the reference in the proposed new paragraph should be to paragraph 420-10-25-2A rather than paragraph 420-20-25-2A.

Issue 10

We understand the Board's reasons for removing the reference in paragraph 805-20-25-2 to the definitions of assets and liabilities in CON 6. However, as discussed above, we have some concerns about how these references are being replaced and think that there may be unintended consequences if the actual definitions of assets and liabilities are incorporated into the guidance as currently proposed.

If the Board decides to add the actual definitions to the Codification, for simplicity, we recommend that those be added to the subtopic's glossary section (i.e., ASC 805-20-20) with a link to those glossary terms in paragraph 805-20-25-2, rather than including the definitions in the aforementioned paragraph (as currently proposed).

We agree with the Board's decision to add financial instruments that are classified as liabilities under ASC 480 to the recognition exceptions in paragraph 805-20-25-17. However, as noted in our response to Question 3, we believe it would be helpful for the Board to explain the reasons for including ASC 480 liabilities in the recognition exceptions. Also, the Board should amend the reference in paragraph 805-20-25-16 to the paragraphs that discuss recognition exceptions to include the new paragraph 805-20-25-28C.

Question 3: Would the proposed amendment to Topic 805, *Business Combinations* (Issue 10), affect your assessment of liabilities assumed in a business combination?

We do not believe that an entity's assessment of liabilities assumed in a business combination would be affected by the proposed amendment. However, we believe it would be helpful for the Board to explain the reasons for the exception to the general recognition principle in ASC 805 for acquired financial instruments that are classified as liabilities under ASC 480 in the final ASU.

Issue 21

We agree with adding the guidance for entities to disclose separately accounting changes that are material with respect to an interim period to paragraph 250-10-50-12. However, we suggest retaining that guidance in paragraph 250-10-45-27 as well, to guide users on the appropriate reporting when an error is not material to the full year but is material to an interim period.

Issue 24

We suggest correcting the note at the end of paragraph 270-10-45-8 so it refers to ASC 270 instead of ASC 260 as follows:

[Content amended and copied to paragraph 270-10-50-1B]

Issue 26

We agree with the proposed change to paragraph 840-30-50-2. However, paragraph 840-30-45-5 also includes an option to include information in the notes, with no separate disclosure requirement in ASC 840-30-50, so we suggest amending paragraph 840-30-50-5 as follows:

If leveraged leasing is a significant part of the lessor's business activities in terms of revenue, net income, or assets, the components of the net investment balance in leveraged leases as set forth in paragraph 840-30-25-8 shall be disclosed in the notes to financial statements. **If the information required by paragraph 840-30-45-5 is not separately presented by the lessor in the income statement, it shall be disclosed in the notes thereto.**

Issue 28

We do not agree with the FASB's proposal to add paragraph 852-10-50-6B, given the existing guidance in paragraph 852-10-50-5, which states:

Paragraph 852-10-45-16 identifies a situation in which disclosure of a probable issuance of common stock or common stock equivalents is required.

If the FASB believes ASC 852-10-50-5 should explicitly state the disclosure requirement, we recommend that it revise the wording in that paragraph rather than add paragraph 852-10-50-6B.

Issue 33

We agree with removing the definition of "cash balance plan" from the Master Glossary and including language from that definition in ASC 715-20-25 and ASC 715-30-55. However, we suggest clarifying that the promised interest-crediting rate for certain cash balance plans could be indexed to the actual return on plan assets. That is, the individual account balances are still determined by reference to a hypothetical account, and the benefit is dependent on the employer's promised interest-crediting rate. The fact that the interest-crediting rate is indexed to the actual return on plan assets would not preclude classification as a cash balance plan. This could be clarified by modifying paragraph 715-20-25-3 as follows:

In a cash balance plan, individual account balances are determined by reference to a hypothetical account rather than specific assets, and the benefit is dependent on the employer's promised interest-crediting rate, **which is generally** not the actual return on plan assets.

Issue 35

We agree with removing the portion of the heading "and Disposals of Components" preceding paragraph 270-10-50-5. We believe the reference to paragraph 270-10-50-5 in paragraph 270-10-50-1(e) would be clearer if it were written as follows:

Unusual or infrequently occurring items (see paragraphs 270-10-45-11A and 270-10-50-5) and disposal of a component of an entity (see paragraph 270-10-45-11A).

Issue 37

We do not believe the addition of the phrase “[a]t each reporting period” to paragraph 310-20-35-33 is necessary. We believe that the addition of the word “next” throughout the paragraph sufficiently clarifies that the entity must perform a reassessment at each call date. If the Board continues to believe such a phrase is necessary, we suggest that the phrase be modified to say, “For each reporting period” The term “at” denotes a point in time, and any reset of the effective yield should be reflected as of the call date within a reporting period.

Additionally, we believe that the FASB should amend paragraph 310-20-35-33 to clarify that debt securities that are callable “on or after” a specific date (or dates) are within the scope of ASU 2017-08.

Question 4: The proposed amendments related to Issue 37 would be effective immediately. Do you have any concerns with that and, if so, why? Can you apply the guidance on a modified retrospective basis if you already have adopted the amendments in Accounting Standards Update No. 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*? Do you agree with the transition disclosures? If not, please explain why.

We are concerned that requiring entities that have already adopted ASU 2017-08 to immediately apply these amendments when they are issued and requiring a modified retrospective approach to transition may be operationally difficult. We suggest that the Board consider feedback from preparers about whether there is need for a delayed effective date or prospective transition.

Issues 38 and 49

Question 5: For entities that have adopted the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, the proposed amendments related to Issues 38 and 49 would be effective immediately. Do you have any concerns with that and, if so, why? Do you agree with the transition disclosures? If not, please explain why.

We have no concerns with the proposed effective dates or transition guidance for the amendments related to the new credit losses standard.

Issue 41

We agree with removing the term “interperiod tax allocation,” but it is unclear what the “deferred tax liability and deferred tax asset approach” means because this term is not defined in ASC 740. We propose modifying paragraphs 740-10-55-66 and 830-20-05-3 as follows:

Gain or loss resulting from an involuntary conversion of a nonmonetary asset to monetary assets that is not recognized for income tax reporting purposes in the same period in which the gain or loss is recognized for financial reporting purposes is a temporary difference for which ~~the a deferred tax liability and or deferred tax asset approach comprehensive interperiod tax allocation, should be recognized~~ as required by this Subtopic, ~~is required~~.

~~If A taxable exchange gains or tax-deductible exchange losses~~ resulting from an entity's foreign currency transactions ~~that is are~~ included in net income in a different period for financial statement purposes from that for tax purposes, ~~is a temporary difference for which a the deferred tax liability and or deferred tax asset approach interperiod tax allocation should be recognized is~~ as required by ~~under~~ Topic 740 Subtopic 740-10.

Issue 47

We agree with changing the heading level above paragraph 830-740-25-4 but suggest updating paragraph 830-740-25-1 since the guidance on price-level related changes would no longer be included within that header.

This Section addresses basis differences that result from remeasurement of assets and liabilities due to changes in functional currency ~~and price levels~~. These remeasurement changes will often affect the amount of temporary differences for which deferred taxes are recognized.

Also, we suggest modifying the new header before paragraph 830-740-25-6, since inside basis differences generally don't relate to the indefinite reversal criteria:

Inside Basis Differences within Foreign Subsidiaries That ~~Meet the Indefinite Reversal Criterion~~ **Arise From Revaluations**

Issue 50

We agree with the amendments to paragraphs 942-320-50-3 and 50-3A. However, paragraph 116, which introduces Issue 50, only references the disclosure requirements in paragraph 320-10-50-3 (related to securities classified as available for sale). We suggest adding a reference to the disclosure requirements in paragraphs 320-10-50-5 and 50-5B (related to securities classified as held to maturity) as follows:

The proposed amendments on certain disclosures for depository and lending institutions would clarify that the disclosure requirements in paragraphs ~~320-10-50-3, 320-10-50-5 and 320-10-50-5B~~ apply to the disclosure requirements in paragraphs ~~942-320-50-3 and 50-3A~~.

Issue 51

We believe the proposed deletion of paragraph 958-605-55-25 could have unintended consequences or result in diversity in practice. Paragraph 958-605-55-25 requires a not-for-profit entity (NFP) to recognize a contribution for an asset for which the resource provider retains legal title during the term of an arrangement (that is an exchange transaction), if it is probable that the NFP will be permitted to keep the asset when the arrangement terminates. The proposal notes that this guidance is inconsistent with the Board's conclusions in ASU 2018-08 because a probability assessment should not be used when determining whether a contribution is conditional.

While we agree that the amendments in ASU 2018-08 will assist in evaluating whether transactions should be accounted for as a contribution or as an exchange transaction and in determining whether a contribution is conditional, we don't think it will help NFPs determine whether to recognize a contribution and corresponding asset in the circumstances described in paragraph 958-605-55-25. The determination of whether an asset has been contributed is separate from the determination of whether a contribution is conditional.

Moreover, we suggest that the Board consider whether an NFP should follow the guidance in paragraph 958-605-55-25 or the guidance on noncash consideration in an exchange transaction in paragraph 606-10-32-24. Both paragraphs describe similar circumstances – the contribution of goods or services by a customer to be used in the fulfillment of the contract in an exchange transaction. If an NFP determines that receipt of the asset is a form of noncash consideration under ASC 606 (i.e., because it has obtained control and expects to receive the asset), the NFP would include its fair value in the transaction price as part of the exchange transaction. On the other hand, using the guidance in paragraph 958-605-55-25 may result in the recognition of a contribution. If it were the Board's intent that NFPs follow the ASC 606 guidance in these circumstances, paragraph 958-605-55-25 could be revised to reference paragraph 606-10-32-24.

If the Board concludes that the guidance in paragraph 958-605-55-25 should be deleted, the related disclosure requirement in paragraph 958-360-50-4(d) should be deleted as well.

Issue 54

The FASB proposed adding a reference in paragraph 958-815-55-2 to the hedge accounting guidance in paragraph 815-20-25-143 to make it easier for users to find this NFP-specific guidance. We believe that it would be more appropriate for ASC 958-815 to reference broader guidance related to the application of hedge accounting by NFPs, as opposed to just the guidance in paragraph 815-20-25-143 regarding the timing of when hedge documentation and hedge effectiveness assessments must be completed. Paragraph 815-10-15-1 highlights the application of the guidance in ASC 815 to entities that do not report earnings as a separate caption in a statement of financial performance (including NFPs). Therefore, we suggest adding the reference to paragraph 815-20-25-143 to paragraph 815-10-15-1, and adding a reference in ASC 958-815 pointing to paragraph 815-10-15-1 for NFP-specific application guidance.

Transition and effective date information

The effective date proposed in paragraph 105-10-65-XB for "other entities" is less than one year after the proposed effective date for public business entities, certain NFPs and certain employee benefit plans. Generally, the Board provides additional time for these entities to adopt new guidance. We suggest that the Board consider providing an additional year for other entities for transition on these amendments by extending the effective date to annual periods beginning after 15 December 2021, and interim periods within annual periods beginning after 15 December 2022.



Other suggested amendments

We also believe the following area indirectly related to the proposed amendments requires further clarification.

Paragraph 942-320-50-2 includes equity securities on a list of major security types that depository and lending institutions must include to comply with certain ASC 320 disclosure requirements. Because ASU 2016-01 removes equity securities from the scope of ASC 320, we believe the Board should clarify whether equity securities should continue to be included as a major security type in paragraph 942-320-50-2. Additionally, paragraph 942-320-50-2A says, "Investments in mutual funds that invest only in U.S. government debt securities may be shown separately rather than grouped with other equity securities in the disclosures by major security type required by paragraph 942-320-50-2." As noted above, it is unclear whether equity securities should continue to be a major security type, and, therefore, we believe the Board should also clarify its intent for disclosures of investments in mutual funds that invest only in US government debt securities.

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

Very truly yours,

Ernst & Young LLP