



EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: July 19, 2013

Comments Due: September 17, 2013

Receivables—Troubled Debt Restructurings by
Creditors (Subtopic 310-40)

Reclassification of Collateralized Mortgage Loans upon a
Troubled Debt Restructuring

a consensus of the FASB Emerging Issues Task Force

This Exposure Draft of a proposed Accounting Standards Update of Subtopic 310-40 is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director

File Reference No. EITF-13E

Financial Accounting Standards Board
of the Financial Accounting Foundation

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The Board invites comments on all matters in this Exposure Draft and is requesting comments by September 17, 2013. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at [Exposure Documents Open for Comment](#)
- Emailing a written letter to director@fasb.org, File Reference No. EITF-13E
- Sending written comments to “Technical Director, File Reference No. EITF-13E, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

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CONTENTS

	Page Numbers
Summary and Questions for Respondents.....	1–4
Amendments to the <i>FASB Accounting Standards Codification</i> ®	5–8
Background Information and Basis for Conclusions	9–13
Amendments to the XBRL Taxonomy	14

Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

In recent years, the number of vacant or abandoned residential real estate properties resulting from the general economic conditions, including weakness in the housing market, has affected the rate of residential real estate foreclosures and has increased the potential for higher levels of foreclosed real estate owned by banks or similar lenders (creditors). U.S. generally accepted accounting principles on troubled debt restructurings include guidance on situations in which a creditor obtains one or more of a debtor's assets in satisfaction of all or part of the receivable. That guidance indicates that a creditor should reclassify a collateralized mortgage loan such that all or a portion of the loan should be derecognized and the debtor's asset recognized when it determines that there has been *in substance a repossession or foreclosure* by the creditor, that is, the creditor receives *physical possession* of the debtor's assets *regardless of whether formal foreclosure proceedings take place*. However, the terms *in substance a repossession or foreclosure* and *physical possession* are not defined in the accounting literature and there is diversity in their application for purposes of reclassifying the loan receivable and recognizing the asset received. That diversity has been highlighted by the extended foreclosure timelines and processes related to residential real estate properties.

The objective of the amendments in this proposed Update is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, such that all or a portion of the loan should be derecognized and the real estate property recognized.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to both public entities and nonpublic entities.

What Are the Main Provisions?

The amendments in this proposed Update would clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon (1) the creditor obtaining legal title to the residential real

estate property or (2) completion of a deed in lieu of foreclosure or similar legal agreement under which the borrower conveys all interest in the residential real estate property to the creditor to satisfy that loan, even though legal title may not yet have passed. Additionally, the proposed amendments would require that an entity that receives physical possession of residential real estate property collateralizing a consumer mortgage loan disclose a roll-forward schedule reconciling the change from the beginning to the ending balance of such foreclosed properties at every reporting period. In addition, an entity would be required to disclose the recorded investment in consumer mortgage loans secured by residential real estate properties that are in the process of foreclosure according to local requirements of the applicable jurisdiction.

How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

The amendments in this proposed Update would reduce diversity in practice by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that all or a portion of the loan should be derecognized and the real estate property recognized. Holding foreclosed real estate property presents different operational and economic risk to creditors compared with holding an impaired loan. Therefore, consistency in the timing of loan derecognition and presentation of foreclosed real estate properties is of qualitative significance to many users of the creditor's financial statements. Additionally, the proposed roll-forward schedule reconciling the change from the beginning to the ending balance of foreclosed residential real estate properties and disclosure of the recorded investment in consumer mortgage loans secured by residential real estate properties that are in the process of foreclosure are expected to provide decision-useful information to many users of the creditor's financial statements.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied on a modified retrospective basis to collateralized residential consumer mortgage loans and foreclosed residential real estate properties held by the creditor at the date of adoption through a cumulative-effect adjustment as of the beginning of the annual reporting period for which the proposed amendments are effective. The cumulative-effect adjustment would be recorded at the date of adoption by reflecting any reclassification between residential consumer mortgage loans and foreclosed residential real estate properties in the carrying amounts of those assets as of the beginning of the current year presented. A corresponding

adjustment, if any, would be made to the opening balance of retained earnings for the current year. Prior periods would not be adjusted. Early adoption would be permitted. The effective date will be determined after the Task Force considers stakeholder feedback on the proposed Update.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS does not contain any guidance specific to the reclassification of collateralized mortgage loans to foreclosed residential real estate property.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Should the scope of the proposed amendments about the timing of reclassification of receivables to foreclosed residential real estate properties be extended to commercial real estate mortgage loans? If yes, please explain why, including a discussion on any special considerations related to reclassifying commercial real estate mortgage loans.

Question 2: Should the scope of the proposed amendments about the timing of reclassification of receivables to foreclosed assets also be extended to loans collateralized by nonfinancial assets other than real estate (for example, auto loans)? If yes, please explain why, including a discussion on any special considerations related to reclassifying loans that are collateralized by nonfinancial assets other than real estate.

Question 3: Do you agree that a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan upon (a) the creditor obtaining legal title to the residential real estate property or (b) completion of a deed in lieu of foreclosure or similar legal agreement under which the borrower conveys all interest in the residential real estate property to the creditor to satisfy that loan, even though legal title may not yet have passed? If not, please explain why.

Question 4: Do you agree that the recurring disclosures of (a) the recorded investment in consumer mortgage loans secured by residential real estate properties that are in the process of foreclosure according to local requirements

of the applicable jurisdiction and (b) a roll-forward schedule reconciling the change from the beginning to the ending balance of foreclosed residential real estate properties provide decision-useful information and should be required to be provided in interim and annual financial statements? If not, please explain why and what disclosures, if any, you would propose.

Question 5: If the scope of the proposed amendments is extended to commercial real estate mortgage loans and/or loans collateralized by nonfinancial assets other than real estate (for example, auto loans), should different disclosures be required for these loans? Please describe how and why you think the disclosures should be different.

Question 6: Do you agree that the proposed amendments should be applied to both collateralized residential mortgage loans and foreclosed residential real estate properties existing at the date of adoption by means of a cumulative-effect adjustment as of the beginning of the annual reporting period for which the guidance is effective? If not, please explain why.

Question 7: If an entity is required to reclassify foreclosed residential real estate property to consumer mortgage loans upon transitioning to the proposed guidance, at what amount should those loans be recorded at the date of adoption? For example, (a) should the recorded investment in such consumer mortgage loans at the date of adoption be the initial recognition basis of the foreclosed residential real estate property and (b) should any difference between the carrying amount of the foreclosed residential real estate property at the date of adoption and its initial recognition basis be recorded as an allowance for loan losses for such consumer mortgage loans? Please explain the reasons for your view.

Question 8: Do you agree that the proposed amendments should apply to both public entities and nonpublic entities? If not, please describe how and why you think they should be different.

Question 9: Do you agree that an entity should be permitted to early adopt the proposed amendments? If not, please explain why.

Question 10: How much time would be needed to implement the proposed amendments, and should the effective date differ for nonpublic entities versus public entities? Please explain why.

Amendments to the *FASB Accounting Standards Codification*[®]

Summary of Proposed Amendments to the Accounting Standards Codification

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–6. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck-out~~.

Amendments to Subtopic 310-10

2. Amend paragraph 310-10-50-11 and add paragraph 310-10-50-35 and its related heading, with a link to transition paragraph 310-40-65-2, as follows:

Receivables—Overall

Disclosure

> Foreclosed and Repossessed Assets

310-10-50-11 Paragraph 310-10-45-3 states that foreclosed and repossessed assets included in other assets on the balance sheet shall have separate disclosures in the notes to financial statements. For each interim and annual reporting period presented, an entity that has received physical possession as described in paragraphs 310-40-40-6 and 310-40-55-10A of residential real estate property collateralizing a consumer mortgage loan shall provide a reconciliation of the beginning and ending balances related to such foreclosed real estate properties, separately presenting changes during the period attributable to the following:

- a. Additions due to foreclosures of residential real estate properties collateralizing consumer mortgage loans
- b. Reductions for sales or transfers of foreclosed residential real estate properties

- c. Adjustments made to record foreclosed residential real estate properties at the lower of its carrying amount or fair value less costs to sell
- d. Other adjustments (with explanation of significant amounts, if the nature of the adjustment is not evident from the caption used for other adjustments).

> Loans in Process of Foreclosure

310-10-50-35 At the end of each interim and annual reporting period presented, an entity shall disclose the recorded investment in consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction.

Amendments to Subtopic 310-40

3. Amend paragraph 310-40-40-6, with a link to transition paragraph 310-40-65-2, as follows:

Receivables—Troubled Debt Restructurings by Creditors

Derecognition

> Foreclosure

310-40-40-6 Except in the circumstances described in the following paragraph, a troubled debt restructuring that is in substance a repossession or foreclosure by the creditor, that is, the creditor receives physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place, or in which the creditor otherwise obtains one or more of the debtor's assets in place of all or part of the receivable, shall be accounted for according to the provisions of paragraphs 310-40-35-7; 310-40-40-2 through 40-4 and; if appropriate, 310-40-40-8. For guidance on when the creditor shall be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, see paragraph 310-40-55-10A.

4. Amend paragraph 310-40-55-1 and add paragraph 310-40-55-10A and its related heading, with a link to transition paragraph 310-40-65-2, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

310-40-55-1 This Section provides guidance concerning the following aspects of **troubled debt restructuring**:

- a. Classification of **debt** restructurings by debtors and creditors
- b. Use of zero coupon bonds in a troubled debt restructuring.
- c. Physical possession of residential real estate property collateralizing a consumer mortgage loan.

>> Physical Possession of Residential Real Estate Property Collateralizing a Consumer Mortgage Loan

310-40-55-10A A creditor would be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan only upon the occurrence of either one of the following:

- a. The creditor obtaining legal title to the residential real estate property
- b. Completion of a deed in lieu of foreclosure or similar legal agreement under which the borrower conveys all interest in the residential real estate property to the creditor to satisfy that loan, even though legal title may not yet have passed. The deed in lieu of foreclosure or similar legal agreement is completed when agreed terms and conditions have been satisfied by both the borrower and the creditor.

Amendments to Subtopic 360-10

5. Add paragraph 360-10-50-4 and its related heading, with a link to transition paragraph 310-40-65-2, as follows:

Property, Plant, and Equipment—Overall

Disclosure

> Foreclosed Properties Held for Sale

360-10-50-4 See paragraph 310-10-50-11 for a disclosure requirement related to foreclosed residential real estate properties.

6. Add paragraph 310-40-65-2 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2013-XX, Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Collateralized Mortgage Loans upon a Troubled Debt Restructuring

310-40-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2013-XX, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Collateralized Mortgage Loans upon a Troubled Debt Restructuring:*

- a. The pending content that links to this paragraph shall be effective for fiscal years and interim periods within those years beginning after [date to be inserted after exposure].
- b. The entity shall apply the pending content that links to this paragraph on a modified retrospective basis to residential consumer mortgage loans and foreclosed residential real estate properties existing at the date of adoption by means of a cumulative-effect adjustment as of the beginning of the annual reporting period for which the guidance is effective. Any reclassification between residential consumer mortgage loans and foreclosed residential real estate properties at the date of adoption shall be reflected in the carrying amounts of those assets as of the beginning of the current year presented. A corresponding adjustment, if any, shall be made to the opening balance of retained earnings for the current year.
- c. Earlier adoption of the pending content that links to this paragraph is permitted.
- d. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Leslie F. Seidman, *Chairman*
Daryl E. Buck
Russell G. Golden
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this proposed Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. In recent years, the number of vacant or abandoned residential real estate properties resulting from the general economic conditions, including weakness in the housing market, has affected the rate of residential foreclosures and increased the potential for higher levels of foreclosed real estate owned by creditors. Because of the extended foreclosure processes, some creditors are reviewing their policies on when to reclassify residential real estate property collateralizing a residential consumer mortgage loan, such that all or a portion of the loan should be derecognized and the real estate property recognized. Considering that foreclosed real estate property is held by a creditor for reasons other than to conduct its business, loan derecognition and presentation as foreclosed real estate may be of qualitative significance to many users of the creditor's financial statements.

BC3. Paragraph 310-40-40-6 addresses accounting for a troubled debt restructuring and states the following:

. . . a troubled debt restructuring that is *in substance a repossession or foreclosure* by the creditor, that is, the creditor receives *physical possession* of the debtor's assets *regardless of whether formal foreclosure proceedings take place*, or in which the creditor otherwise obtains one or more of the debtor's assets in place of all or part of the receivable, shall be accounted for according to the provisions of paragraphs 310-40-35-7; 310-40-40-2 through 40-4 and; if appropriate, 310-40-40-8. [Emphasis added.]

BC4. As such, a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan when it determines that it has, in substance, repossessed or foreclosed on the residential real estate property. However, the terms *in substance a repossession or foreclosure* and *physical possession* are not defined in the accounting literature resulting in diversity in the application of the guidance for derecognizing all or a portion of the consumer mortgage loan receivable and recognizing the residential real estate property. The guidance also indicates that a creditor should record foreclosed residential real estate property that is held for sale initially at its fair value less cost to sell. That amount becomes the initial cost basis of the foreclosed residential real estate property. A subsequent decrease or increase in the fair value less cost to sell should be recognized, but not in excess of the initial cost basis of the foreclosed residential real estate property.

Scope

BC5. The Task Force reached a consensus-for-exposure that the guidance in this proposed Update would apply to consumer mortgage loans held by creditors that are collateralized by the residential real estate property for which the loan was obtained. The Task Force decided to limit the scope to consumer loans collateralized by residential real estate properties, noting that the prevalent practice issue relates to residential consumer real estate lending arrangements due to extended foreclosure timelines and processes, including those resulting from regulatory and legal safeguards afforded to residential borrowers. The Task Force further noted that commercial real estate loans may involve structured financing arrangements that are beyond the scope of this Issue, such as use of special-purpose entities. The Task Force discussed whether the scope of the proposed amendments should be expanded to include commercial real estate loans and loans collateralized by nonfinancial assets other than real estate. The Task Force decided not to expand the scope of the proposed amendments to include those arrangements but rather to obtain stakeholder feedback through the comment letter process about those items.

Timing of Reclassification of a Collateralized Consumer Mortgage Loan to Foreclosed Residential Real Estate Property

BC6. The Task Force reached a consensus-for-exposure that an in substance repossession or foreclosure occurs, that is, a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that all or a portion of the loan should be reclassified to foreclosed residential real estate properties, upon (a) the creditor

obtaining legal title to the residential real estate property or (b) completion of a deed in lieu of foreclosure or similar legal agreement under which the borrower conveys all interest in the residential real estate property to the creditor to satisfy that loan, even though legal title may not yet have passed.

BC7. A deed in lieu of foreclosure generally is an agreement by which the borrower voluntarily conveys all interest in residential property to the creditor to satisfy a loan that is in default. The agreement is completed when agreed terms and conditions have been satisfied by both parties. The Task Force considered transfer of legal title and a completed deed in lieu of foreclosure to be similar because legal title typically can be obtained within a few months of a completed deed in lieu of foreclosure. Furthermore, the Task Force believes that the reference in paragraph 310-40-40-6 to the creditor receiving physical possession of the debtor's assets *regardless of whether formal foreclosure proceedings take place* contemplates situations in which a deed in lieu of foreclosure or similar legal agreement is completed without formal foreclosure proceedings taking place.

BC8. The Task Force observed that before obtaining title or other legal conveyance of property in satisfaction of the loan, the creditor generally only has protective rights associated with that property for which it is not legally the owner. In such circumstances, the actions taken by a creditor with regard to the property, including maintaining the physical property, paying taxes to avoid a tax lien being placed on the property, and obtaining insurance coverage, are to protect the creditor's interest in the property and prevent deterioration in the property so as to maximize the recovery value. The creditor lacks the most important rights associated with ownership in that it cannot receive rent income or sell or otherwise transfer the real estate property to recover its loan before title is obtained (or all interest is conveyed). Therefore, the most important benefits of ownership are dependent on possessing title or upon the borrower legally conveying all interest in the property, such as evidenced by a completed deed in lieu of foreclosure.

BC9. The Task Force observed that under U.S. regulatory guidance for financial institutions, the recorded investment in a collateral-dependent delinquent loan that is significantly past due (as would be typical for a loan within the scope of this proposed Update) generally would be written down to the fair value of the collateral less cost to sell. Therefore, in terms of the effect on reported financial results of reclassifying a loan to foreclosed real estate owned, both foreclosed real estate and a collateral-dependent delinquent loan that is significantly past due generally would be measured at the same amount by a creditor that is subject to that regulatory guidance; that is, on the basis of the fair value of the collateral less cost to sell.

Disclosure

BC10. The Task Force reached a consensus-for-exposure that creditors would be required to disclose the recorded investment in residential consumer mortgage loans secured by residential properties that are in the process of foreclosure. The determination of whether such a loan is in the process of foreclosure should be made by reference to local requirements of the applicable jurisdiction. The Task Force observed that this proposed requirement would be similar to the disclosure of the unpaid principal balance of loans secured by one to four family residential properties in process of foreclosure that currently is required on a quarterly basis for regulated financial institutions that are required to file a Consolidated Report of Condition and Income (Call Report). The Task Force believes that the disclosure should be brought into U.S. GAAP financial statements within the context of existing credit-quality disclosures in Section 310-10-50 to provide timely and complete information to many users of a creditor's financial statements about the progression of collateral-dependent residential consumer mortgage loans from performing to nonperforming and, ultimately, to foreclosure. The Task Force expects that users of financial statements would benefit from understanding the trend of progression toward foreclosure over time.

BC11. In addition, the Task Force reached a consensus-for-exposure that creditors that receive physical possession of real estate property collateralizing a residential consumer mortgage loan would be required to disclose a roll-forward schedule reconciling the change from the beginning to the ending balance of such foreclosed properties. Such a disclosure would highlight the extent of reclassification of residential consumer mortgage loans to foreclosed real estate as well as sales or transfers of foreclosed real estate each period. The Task Force believes that those disclosures would provide decision-useful information to users of the entity's financial statements.

Transition

BC12. The Task Force reached a consensus-for-exposure that entities would apply the amendments in this proposed Update on a modified retrospective basis to residential consumer mortgage loans and foreclosed residential real estate properties held by the creditor at the date of adoption through a cumulative-effect adjustment as of the beginning of the annual reporting period for which the guidance is effective. The Task Force determined that a modified retrospective approach would provide consistency and comparability in accounting and presentation of foreclosed real estate properties within and across entities in the year of adoption.

BC13. The Task Force decided to permit early adoption of the proposed amendments to eliminate existing diversity as soon as is practicable.

Benefits and Costs

BC14. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC15. The Task Force does not anticipate that entities will incur significant costs as a result of the amendments in this proposed Update. The proposed amendments would make clear when a collateralized consumer mortgage loan should be reclassified to foreclosed residential real estate property by clarifying guidance that already exists in U.S. GAAP. The proposed amendments would not create new accounting requirements other than additional disclosures for which information should be readily available. In selecting a transition alternative, the Task Force determined that a modified retrospective approach requiring a cumulative-effect adjustment as of the beginning of the reporting period for which the guidance is effective is justified from a cost-benefit and relevance perspective.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). We welcome comments on these proposed changes to the UGT at [ASU Taxonomy Changes](#) provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the UGT will be made available for public comment at www.fasb.org and finalized as part of the annual release process.