FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout

Disclosure Framework—Disclosure Review: Income Taxes
January 23, 2019

Meeting Purpose

1. The January 23, 2019 meeting is a decision-making meeting. At its November 14, 2018 meeting, the Board began redeliberations on the amendments in the proposed Accounting Standards Update, *Income Taxes (Topic 740): Disclosure Framework—Changes to the Disclosure Requirements for Income Taxes*. During that meeting, the Board directed the staff to draft a revised proposed Update for external review. In addition, the Board directed the staff to perform further research on whether entities have disclosed the transition tax liability and whether certain proposed amendments resulting from the Board's tentative decisions made at the November 14, 2018 meeting should be included in a final Update. The purpose of this handout is to describe the results of the external review, additional feedback, and additional research performed.

2. This handout is organized as follows:
   (a) Issue background
   (b) Feedback from external review of draft proposed Update
   (c) Research on transition tax liability
   (d) Government assistance
   (e) Considerations for finalizing previously exposed disclosure requirements.

Questions for the Board

Feedback from External Review of Draft Proposed Update

1. Does the Board want to require the disaggregation of income tax expense (benefit) and income taxes paid by federal, state, and foreign amounts and clarify that tax expense and taxes paid on foreign earnings, even if they are imposed by the country of domicile of the entity, should be included as a foreign amount?

Transition Tax Liability

2. Does the Board want to require the disclosure of the amount of the transition tax liability from the Tax Cuts and Jobs Act and the line item in the statement of financial position in which the liability is presented?

Government Assistance

3. Does the Board want to affirm, amend, or remove the proposed disclosure in paragraph 740-10-50-23 that requires an entity to disclose the description of a legally enforceable agreement with a government, including the duration of the agreement, the commitments made with the government under that agreement, and the amount of benefit that reduces or may reduce its income tax burden?

General Questions for the Board

4. Does the Board want to issue a *revised* proposed Update for public comment? Does the Board also want to issue a final Update that will include certain disclosure requirements?

5. Does the Board think that the expected benefits of the changes justify the expected costs of the changes? If not, is there additional information that the Board needs to make that determination?

6. Does the Board give the staff permission to draft a proposed Update (and final Update, if necessary) for vote by written ballot?

7. What comment letter period does the Board select for the revised proposed Update?

Issue Background

3. At its November 14, 2018 meeting, the Board began redeliberations on the amendments in the proposed Update on Topic 740 and made the following decisions:

(a) Not to require any additional disclosures for any provisions of the Tax Cuts and Jobs Act, including global intangible low-taxed income, the base erosion anti-abuse tax, or foreign-derived intangible income

(b) To remove the disclosure in the proposed Update that would have required all entities to provide a description of an enacted change in tax law that is probable to have an effect in a future period

(c) To affirm the proposed amendment that would require all entities to disclose income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign; and to amend the proposed disclosure to clarify that entities should disclose pretax income (or loss) from continuing operations before intracompany eliminations

(d) To affirm the proposed amendment that would require all entities to disclose income tax expense (or benefit) and income taxes paid disaggregated between domestic and foreign; and to remove the proposed amendment that would have required all entities to disclose income taxes paid to any country that is significant to the total amount of income taxes paid

(e) To remove the proposed disclosure that would have required all entities to provide an explanation of the circumstances that caused a change in the assertion about the indefinite reinvestment of undistributed foreign earnings and the corresponding amount of those earnings; and to remove the existing guidance that requires all entities to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures

(f) To remove the proposed amendment that would have required all entities to disclose the aggregate of cash, cash equivalents, and marketable securities held by foreign subsidiaries

(g) To remove the proposed disclosure that would have required public business entities to disclose, within the reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, settlements using existing deferred tax assets separate from those that have been or will be settled in cash

(h) To affirm the proposed disclosure that would require public business entities to disclose the line items in the statement of financial position in which unrecognized tax benefits are presented and the related amounts of such unrecognized tax benefits with a minor clarification

(i) To affirm the proposed amendment that would remove the disclosure that requires entities to disclose unrecognized tax benefits that could change in the next 12 months

(j) To affirm the proposed disclosure that would require public business entities to disclose the amount and explanation of the valuation allowance recognized or released during the reporting period

(k) To affirm the proposed disclosure that would modify the existing rate reconciliation requirement for public business entities to be consistent with SEC Regulation S-X, which requires separate disclosure for any reconciling item that amounts to more than 5 percent of the amount computed by multiplying the income before tax by the applicable statutory federal income tax rate; and to affirm the proposed disclosure that would require public business entities to explain year-to-year changes in the reconciling items included in the rate reconciliation

(l) To remove the proposed requirement for public business entities to disclose the non-tax-effected amount of carryforwards; and to add a requirement for public business entities to disclose the valuation allowance associated with the tax-effected amounts of federal, state, and foreign carryforwards

(m) To amend the proposed disclosure that would require entities other than public business entities to disclose the non-tax-effected amount of carryforwards by requiring those entities to show credit carryforwards separate from loss carryforwards

(n) To require a disclosure of interim taxes paid for all entities that prepare interim financial statements.

4. At its November 14, 2018 meeting, the Board directed the staff to draft a revised proposed Update for external review and present to the Board any significant comments raised during the external review.

5. The Board also directed the staff to research practice to determine what disclosures, if any, entities currently provide for the transition tax under Internal Revenue Code section 965, *Treatment of Deferred Foreign Income upon Transition to Participation Exemption System of Taxation*, which requires taxpayers that have untaxed foreign earnings and profits to pay a tax as if those earnings and profits had been repatriated to the United States.

6. The proposed Update issued in 2016 included a requirement to describe legally enforceable agreements with a government. That disclosure originated from the project on disclosures by business entities about government assistance, but the Board subsequently determined that the disclosure should be included in the disclosure review—income taxes project. Feedback on that proposed disclosure was not discussed at the November 14, 2018 Board meeting.

Feedback from External Review of Draft Proposed Update

7. A draft of the proposed Update was reviewed by external review participants in 2019. The staff was able to address most of the comments from external review participants through clarifications to the language of the proposed Update. However, there were two comments on the requirement to disclose pretax income (or loss) from continuing operations, income tax expense (or benefit), and income taxes paid disaggregated between domestic and foreign. One firm indicated that the intent of the

disaggregation disclosure was to include the requirements of the U.S. Securities and Exchange Commission (SEC) Regulation S-X 210.4-08(h)(1), *General Notes to Financial Statements—Income Tax Expense*, in the Codification. That regulation requires an entity to disaggregate income (or loss) from continuing operations before income tax expense between domestic and foreign. However, a note to that requirement indicates that income tax expense should be disaggregated among U.S. federal income taxes, foreign income taxes, and other income taxes. That external review participant indicated that registrants generally disaggregate state income taxes as “other” income taxes. That participant suggested amending proposed paragraph 740-10-50-10B to disaggregate income tax expense (or benefit) among federal, foreign, and other income taxes to align with the SEC Regulation.

8. Three participants suggested that the Board clarify whether U.S. federal income taxes on foreign earnings should be included in foreign income taxes or federal income taxes. Without clarification, the participants indicated that diversity in practice may result. For example, some preparers could include the tax on global-intangible-low-taxed income (GILTI) in foreign income taxes because it is a tax on foreign earnings whereas another entity could include the tax on GILTI in federal income taxes because the tax is imposed by the U.S. federal government. One participant indicated that the relationship between domestic income before continuing operations and domestic income tax expense could be skewed if taxes on GILTI (or other similar taxes) are included in domestic income tax expense because the related earnings would be included in foreign income before continuing operations.

9. In addition, some external review participants provided feedback on two of the Board’s tentative decisions. One participant indicated that the requirement to disclose the disaggregation of domestic and foreign income (or loss) from continuing operations before intra-entity eliminations may not be operational for some entities because intra-entity eliminations may be performed at a higher level than domestic and foreign entities (for example, at the reportable segment level). Two participants indicated that the requirement to disclose the valuation allowance recognized for deferred tax assets for federal, state, and foreign carryforwards could result in operational challenges because the disclosure could require an entity to schedule out the reversal of temporary differences to determine how a partial valuation allowance is allocated between a net operating loss and other tax attributes.

Research on Transition Tax Liability

10. Section 965 of the Internal Revenue Code requires taxpayers that have untaxed foreign earnings and profits to pay a tax as if those earnings and profits had been repatriated to the United States. A member of one of the FASB advisory groups who is a user indicated that some entities had not disclosed the transition tax liability.

Stakeholder Feedback

11. The FASB staff performed additional research to determine the extent of entities that disclose the transition tax liability. The FASB staff researched the SEC filings of eXtensible Business Reporting Language (XBRL) filers and noted that approximately 160 filers used the XBRL elements for the transition tax liability. However, because those elements were included in the *Development U.S. GAAP Financial Reporting Taxonomy*, many entities may not have been aware of the elements.

12. The staff also performed outreach with another user who is a member of a FASB advisory group who follows income taxes. That user indicated that they were able to determine the transition tax liability for 100 public business entities that have significant cash balances and cash-equivalent balances (primarily in the Fortune 500) and provided the FASB staff with those data. That user indicated that some of the information was not included in the notes to financial statements but it was included in other portions of the entity's SEC filing.

Government Assistance

13. The 2016 proposed Update included an amendment that would require an entity to disclose a description of a legally enforceable agreement with a government, including the duration of the agreement, the commitments made with the government under that agreement, and the amount of benefit that reduces or may reduce the entity's income tax burden. Under those agreements, the government determines whether an entity will receive assistance or how much assistance the entity will receive even if the entity meets applicable eligibility requirements. This disclosure would not apply to circumstances in which the entity meets the applicable eligibility requirements that are broadly available to tax payers without specific agreement between the entity and the government.

Stakeholder Feedback

14. Twenty-five respondents to the 2016 proposed Update commented on the proposed disclosure. Two-fifths of respondents were opposed to the proposed disclosure, two-fifths conditionally agreed only if certain changes to the proposed amendments were made, and the remaining one-fifth of respondents supported the proposed disclosure. Many of the comments raised by the respondents in paragraphs 15–19 of this handout are similar to those from the proposed Accounting Standards Update, *Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance*.

15. Eight preparers/preparer associations, one auditor, and one other respondent said that many government agreements contain confidentiality restrictions or are subject to laws that prohibit disclosure to third parties. Six of those respondents stated that the disclosure should be limited to information that does not violate those confidentiality agreements. Four of those respondents would support the proposed requirement if confidential agreements are scoped out. One preparer

association and an auditor suggested that a scope exception be provided similar to that in GASB Statement No. 77, *Tax Abatement Disclosures*,[1] and the proposed Update on Topic 832,[2] respectively, which allow for nondisclosure of specific provisions of an agreement due to legal prohibition and only require a description of the general nature of the agreement.

16. Two auditors, one preparer, and one accounting society that opposed the proposed requirement stated that the current rate reconciliation requirement in Topic 740 already provides adequate disclosure because any significant government assistance that reduces an entity's income tax rate would be disclosed in the rate reconciliation. The auditors said that the current disclosure requirement on government grants in paragraph 740-10-50-9(d) is adequate.

17. Eight preparers/preparer associations, five auditors, two accounting societies, and two other respondents stated that they would support the proposed disclosure if the Board clarifies or changes the scope of the proposed disclosure in one or more of the following ways:

    (a) Limit the scope of the disclosure to tax holidays, which is an existing SEC requirement.

    (b) Scope out advanced pricing agreements and private letter rulings because the primary purpose of those agreements is to confirm expected tax treatment with the taxing authority of a government, not to convey potential tax exposure to users.

    (c) Add clarification in the circumstance in proposed paragraph 740-10-50-23 that an "entity meets the applicable eligibility requirements that are broadly available to tax payers without specific agreement between the entity and the government." One auditor stated that the Board should remove the phrase "without specific agreement between the entity and the government" in proposed paragraph 740-10-50-23 so that an entity would not be required to disclose arrangements about government assistance that reduce its income taxes and that are broadly available but for which a specific agreement is still required.

    (d) Clarify the phrase *legally enforceable agreement* to reduce diversity in practice. One respondent said that the Board should remove the phrase *legally enforceable agreement* in its entirety. An accounting society stated that the scope should be expanded to include nondiscretionary

[1]Paragraph 9 of GASB Statement 77 states that "governments that are legally prohibited from disclosing specific information required by this Statement may omit that information, subject to the requirements of paragraphs 7f and 8e." Paragraphs 7f and 8e of GASB Statement 77 state that "if a government omits specific information required by this Statement because the information is legally prohibited from being disclosed, a description of the general nature of the tax abatement information omitted and the specific source of the legal prohibition" should be disclosed.

[2]On June 8, 2016, the Board tentatively decided that if an entity omits specific information required by the final Update on Topic 832 because the information is legally prohibited from being disclosed, the entity should disclose a description of the general nature of the information omitted and the specific source of the legal prohibition.

assistance programs because government assistance is essentially the same whether it is under a legally enforceable agreement or nondiscretionary.

18. Nine respondents noted that the proposed disclosure on government assistance is not operable or auditable for the reasons discussed in paragraphs 15–17 of this handout. One auditor and preparer association noted that the requirement would be practically difficult for entities to apply without limiting the scope. Another auditor said that most companies do not have the systems and processes to track all their government agreements.

19. Seven respondents said that the proposed disclosure on government assistance would be overly costly for the reasons discussed in paragraphs 15–17 of this handout. One preparer stated that entities should disclose agreements in the aggregate because disclosing individual agreements would be difficult and costly. However, an auditor stated that it is unclear how an entity could provide meaningful disclosure of agreements in the aggregate given that there are dissimilar terms and conditions.

Considerations for Finalizing Previously Exposed Disclosure Requirements

20. At its November 14, 2018 meeting, the Board indicated that it would consider whether all the tentative decisions made at that meeting should be included in a revised proposed Update or whether certain previously proposed amendments should be separated and included in a final Update. The Board will consider whether certain previously proposed amendments should be separated and included in a final Update at this meeting.

Board Meeting Handout

Simplifying the Balance Sheet Classification of Debt

January 23, 2019

Meeting Purpose

1. The January 23, 2019 meeting is a decision-making meeting. At its October 24, 2018 meeting, the Board continued its redeliberations on the amendments in the proposed Accounting Standards Update, *Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent)*. The central issue discussed at that meeting relates to unused financing arrangements.

2. During that discussion, the Board directed the staff to conduct additional research, focusing on a potential alternative that considers the contractual linkage between certain debt arrangements and unused long-term financing arrangements in place at the balance sheet date.

3. This handout is organized as follows:
   (a) Issue background—unused financing arrangements
   (b) Structure of redeemable debt arrangements
   (c) Contractual linkage: potential conditions
   (d) Approach to Codification amendments.

Questions for the Board
1. Does the Board want to affirm its previous decision that an unused long-term financing arrangement in place at the balance sheet date should be disregarded in determining the classification of debt? 2. If the Board does not want to affirm its previous decision in Question 1, does the Board want to require an approach that considers the contractual linkage between certain debt arrangements and unused long-term financing arrangements by requiring conditions that are consistent with the Board's tentative decisions?

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

3. If the Board wants to require a contractual linkage approach, which alternative for amending the *FASB Accounting Standards Codification*® does the Board support?

4. On the basis of Board decisions made after the September 13, 2017 Board meeting, does the Board think that the expected benefits of the changes would justify the expected costs of the changes? If not, is there additional information that the Board needs to make that determination?

Issue Background—Unused Financing Arrangements

Current Generally Accepted Accounting Principles (GAAP) That Would Be Superseded

4. Under the current guidance, most short-term obligations are included in current liabilities. However, there are limited ways in which a short-term obligation could be excluded from current liabilities:

    (a) First, an entity could currently consummate a post-balance-sheet-date issuance of a long-term obligation or equity securities after the date of the balance sheet but before that balance sheet is issued or is available to be issued. (The Board's tentative decision on post-balance-sheet refinancing would eliminate this guidance.)

    (b) Second, an entity could enter into a financing agreement and classify short-term debt as a noncurrent liability if certain conditions are met. (The Board's tentative decision on unused financing arrangements would eliminate this guidance). To summarize those conditions, the financing agreement must:

        (i) Extend for more than one year

        (ii) Not be cancellable by the lender (for example, it cannot contain any subjective acceleration clauses [SACs])

        (iii) Have no violations of any provision at the balance sheet date

        (iv) Be in place with a lender that is expected to be financially capable of honoring the agreement.

    Additionally, current GAAP requires the amount of current maturities to be reduced by a long-term financing arrangement to be decreased if the funds under the financing agreement will be unavailable to liquidate the short-term obligation.

5. Under the Board's tentative decisions, the guidance summarized in paragraph 4 above would be superseded when the new guidance is issued.

Proposed Guidance

6. The amendments in the proposed Update issued for public comment included the following debt classification principle:

> **470-10-45-22** Debt arrangements and other instruments within the scope of this Subtopic (see paragraph 470-10-15-3 through 15-4) shall be classified as noncurrent liabilities in a classified balance sheet if either of the following criteria is met as of the balance sheet date:
>
> a. The liability is contractually due to be settled more than one year (or **operating cycle**, if longer) after the balance sheet date.
> b. The entity has a contractual right to defer settlement of the liability for at least one year (or operating cycle, if longer) after the balance sheet date.
>
> An exception to this principle is described in paragraph 470-10-45-23.

7. The proposed Update issued for public comment also included amendments to an existing illustrative example in which an unused financing arrangement exists at the balance sheet date:

> **> > Example 2: Classification by the Issuer of Redeemable Instruments That Are Subject to Remarketing Agreements**
>
> **470-10-55-7** This Example illustrates the guidance for the appropriate classification by the issuer of debt if all of the following conditions exist:
>
> a. The debt has a long-term maturity (for example, 30 to 40 years).
> b. The debt holder may redeem or ~~put~~demand repayment of the bond on short notice (7 to 30 days).
> c. The issuer has a remarketing agreement that states that the third-party agent will make its best effort to remarket the bond when redeemed.
> d. The debt is secured by a short-term letter of credit that provides protection to the debt holder in the event that the redeemed debt cannot be remarketed. (Amounts drawn against the letter of credit are payable back to the issuer of the letter of credit by the issuer of the redeemable debt instrument~~ on the same day that the drawdown occurs~~.) The borrower obtains the letter of credit at the inception of the debt arrangement.
>
> **470-10-55-8** Debt agreements that allow a debt holder to redeem (or ~~put~~demand payment of) a debt instrument on demand (or within one year, or **operating cycle**, if longer) should be classified as short-term liabilities because none of the criteria for noncurrent classification in paragraph 470-10-45-22 have been met~~despite the existence of a best-efforts remarketing agreement. That is, unless the issuer of the redeemable debt instrument has the ability and intent to refinance the debt on a long-term basis as provided for in paragraph 470-10-45-14, the debt should be classified as a current liability~~.
>
> **470-10-55-9** In this Example, the obligation would be classified by the issuer as noncurrent only if the letter-of-credit arrangement allows the borrower to defer the payment for a period of at least one year (or operating cycle, if longer)~~meets the requirements of paragraph 470-10-45-14(b)~~. The fact that the letter of credit

<u>provider is with a different party than the original debt holder is not relevant when determining the classification of the debt.</u>

August 2018 Board Decision—Unused Financing Arrangements

8. At the August 2018 meeting, the Board decided that an unused long-term financing arrangement in place at the balance sheet date should be disregarded in determining the classification of debt.

9. The Board reached that conclusion for the following reasons:

   (a) Disregarding unused long-term financing arrangements when determining the classification of other debt would increase the transparency and relevance of financial information for users because debt classification would better reflect the contractual maturities of the debt arrangement.

   (b) Debt classification would be consistent with criteria (a) of the classification principle (referenced in paragraph 6 of this handout) because principal payments of debt that are contractually due within 12 months from the balance sheet date would be classified as a current liability.

   (c) Disregarding unused long-term financing arrangements would simplify the guidance on determining the classification of debt, which would meet the objective of the project to reduce the cost and complexity for preparers and auditors when determining the classification of debt while providing more consistent and transparent information to financial statement users.

10. As a result of this decision, paragraph 470-10-55-9 in Example 2 (see paragraph 7 of this handout) would be amended to make it clear that the debt would be classified as current *even if* the letter-of-credit arrangement in place at the balance sheet date allows the borrower to defer the payment for a period greater than one year from the balance sheet date.

October 2018 Board Meeting—Unused Financing Arrangements

11. At the October 2018 meeting, there were mixed views expressed by some Board members about whether a contractual right to defer settlement exists (that is, whether criteria (b) of the proposed debt classification principle in paragraph 470-10-45-22 has been met) in situations in which there is contractual linkage between debt arrangements and unused financing arrangements. As such, the Board directed the staff to conduct additional research, focusing on a potential alternative that considers the contractual linkage between certain debt arrangements and unused long-term financing arrangements in place at the balance sheet date. That research also would consider the need to include other conditions within or surrounding that financing arrangement, such as the financial capability of the lender, the

existence of a SAC, the required use of the proceeds, and the timing and terms of the arrangements.

Structure of Redeemable Debt Arrangements

12. The most common debt arrangements in question are municipal securities called variable rate demand obligations (VRDOs). Making up approximately three-quarters of the total U.S. municipal money market as of 2018,[1] these arrangements are floating rate obligations that typically have a long-term maturity of 20–30 years with an interest rate that is reset periodically (daily, weekly, monthly, semiannually, or flexible). When VRDOs are issued, the issuer typically selects a remarketing agent, or tender agent, who will resell the securities through a negotiated offering at the interest rate reset date. VRDOs are generally attractive to issuers when long-term interest rates are high and when short-term interest rates are low relative to long-term rates, with the objective of realizing lower interest costs than if fixed-rate debt were to be issued at a higher rate.

13. VRDOs include a demand feature that allows bondholders to *put* or *tender* the bonds back to the issuer on the interest reset date and often requires a form of liquidity in the event of a failed remarketing (that is, when a remarketing agent is unable to resell the securities). For this reason, some issuers of VRDOs utilize a liquidity facility such as a letter of credit or a standby bond purchase agreement (SBPA) to provide liquidity for the put or tender feature. Therefore, if a bondholder exercises its put option, the issuer will first seek to sell the put bonds to another investor through its remarketing agent using the proceeds of the resale to pay the original bondholder. If another investor cannot be found and the remarketing fails, the issuer is required to pay the bondholder unless the issuer has a liquidity facility that can advance the funds needed to pay the bondholder. At this point, the bonds would become bank bonds, the interest rate would convert to the rate stipulated in the liquidity facility agreement, and efforts to remarket the bond for the period stipulated by the liquidity facility continue. If another bondholder is found within that period, the proceeds generally are used to pay off the liquidity facility and the interest rate returns to the terms in the original bond agreement.

14. There is an important difference between a letter of credit and an SBPA—a letter of credit is unconditional, whereas an SBPA has termination provisions. A letter of credit provides an unconditional commitment by a bank to pay investors the principal and interest on the VRDOs, even in the case of default, bankruptcy, or downgrade of the issuer. The SBPA does not guarantee that principal and interest will be paid but provides only that tendered securities will

[1]Morgan Stanley, *Variable Rate Demand Obligations (VRDOs)* (2018). https://www.morganstanley.com/im/publication/insights/education/education_variableratedemandobligations_us.pdf

be purchased so long as the SBPA remains in effect. Unlike a letter of credit, the SBPA contains termination event provisions (for example, bankruptcy or insolvency of the issuer, liquidation or dissolution of the bonds' insurer, or a downgrade of the bonds below investment grade), which would cause the bank's obligation to purchase the bonds to be suspended or terminated. These termination provisions are not necessarily SACs because the provisions can be objectively determinable and measurable. For this reason, if an SBPA is in place as liquidity support, sometimes the issuer also will secure its bonds with a municipal bond insurance policy to further enhance the long-term credit rating of the VRDO.

15. As a result, when a letter of credit serves as the liquidity facility, the long- and short-term credit ratings of the VRDOs are based on the liquidity facility provider's credit rating. This differs under SBPAs where the VRDO generally receives the short-term credit rating of the bank that provides the liquidity facility and the long-term credit rating of the issuer, unless the VRDOs are insured, in which case the long-term credit rating of the bond is based on the insurer.

16. The official statement, which is a document prepared in connection with a new issue of municipal securities, often includes a reference to and a description of the terms and provisions of the liquidity facility that is concurrently executed with the bond issuance.

17. Other details about VRDOs include:

    (a) VRDOs, remarketing agreements, and long-term financing arrangements are typically entered into at the same time; however, the stated maturity dates of the VRDOs typically do not match the expiration dates of the financing arrangements. For example, stated bond maturity dates typically have a longer term such as 30–40 years; whereas, letters of credit and SBPAs typically have a shorter term such as 1–5 years. If the bank does not renew or extend the letter of credit or SBPA, the borrower must obtain a letter of credit or SBPA from another bank. If the borrower cannot find another bank to provide a new liquidity facility, the VRDOs would be subject to mandatory tender, with a draw upon the existing liquidity facility to pay off the holders.

    (b) Generally, the linkage between the VRDO and the liquidity facility is predetermined from the outset of the debt arrangement and is not affected by the issuer's intentions.

    (c) Some entities are not required to maintain a liquidity facility for satisfying puts or tenders of redeemable debt although they could choose to enter into such an arrangement.

Pollution Control Bonds

18. Another common type of redeemable debt arrangement is a pollution control bond (PCB). PCBs can be structured as VRDOs or can be structured in another form and are largely utilized by utility companies and petrochemical companies. PCBs (also referred to as pollution control revenue bonds) are municipal securities issued by a state or local authority that are used to

finance the acquisition of pollution control equipment or the construction of air or water pollution control facilities. Typically, the governmental agency issuing the bonds acts as a conduit issuer, or intermediary, between the entity seeking financing (hereafter referred to as the "issuer") and the bondholders. Ultimately, the guarantee of repayment falls upon the issuer rather than the municipality. Repayment of the bonds is generally guaranteed through one of three of the following methods:

(a) Issuer's overall financial resources: This method is effective if the issuer is financially sound, with a strong investment-grade rating.

(b) Letter of credit/third-party credit enhancement from a highly rated bank: This method is used in situations in which the issuer's balance sheet is weak, or the issuer is not rated, in which case it would be very difficult to obtain investors in the bond market that are looking for secure investments.

(c) Project financing: If neither of the first two methods is feasible, the issuer will pledge the project assets and revenues as the sole security for the bonds.

19. Even when a PCB is structured as a VRDO, the proceeds of the entity's liquidity facility may provide a broader liquidity function to the issuer; those proceeds could be used to pay down the pollution control bond but also could be used to support other arrangements. Moreover, entities often repurchase and hold PCBs because of various market conditions.

Contractual Linkage: Potential Conditions

20. The Board could consider requiring certain conditions in support of an approach that would evaluate the contractual linkage between debt arrangements and other financing arrangements in determining the classification of debt. Those conditions assume that the Board decides not to affirm its previous decision that an unused long-term financing arrangement in place at the balance sheet date should be disregarded in determining the classification of debt.

21. In applying those conditions, an entity would evaluate the contractual terms of both arrangements when there is a debt arrangement and a contractually linked unused financing arrangement to determine the classification of the debt arrangement. Those conditions would be required to be met to classify a debt arrangement as a noncurrent liability when a contractually linked financing arrangement/liquidity facility is in place as of the balance sheet date.

22. Conditions that could be considered by the Board include the following:

(a) Timing of obtaining the financing arrangement—at the inception of the debt arrangement and as of the balance sheet date.

(b) The financing arrangement does not expire within one year from the balance sheet date.

(c) No violation of any provision exists at the balance sheet date.

(d) The lender is financially capable of honoring the agreement.

(e) The amount of proceeds available under the financing arrangement must be in an amount sufficient to repay the outstanding principal amount of the associated debt.

(f) Rights to draw down on an existing financing arrangement must be exercised when repaying the contractually linked debt.

(g) Within the debt arrangement and the financing arrangement, there are specific references to each other.

(h) The financing arrangement includes a provision that its proceeds only can be used for repayment of the debt.

Approach to Codification Amendments

23. If the Board decides to require certain conditions in the evaluation of the contractual linkage between debt arrangements and other financing arrangements, there are a couple of alternatives for Codification amendments that the Board could consider:

(a) Alternative A: Incorporate the conditions in the Other Presentation Matters Section of Subtopic 470-10, Debt—Overall, and amend the fact pattern in Example 2 (see paragraph 7 of this handout).

(b) Alternative B: Incorporate the conditions into Example 2 by amending its fact pattern.

Board Meeting Handout

Financial Instruments—Credit Losses—Targeted Transition Relief

January 23, 2019

Meeting Purpose

1. The purpose of this decision-making Board meeting is to discuss external review feedback on the proposed Accounting Standards Update, *Targeted Transition Relief for Topic 326, Financial Instruments—Credit Losses.* The Board will address the following issues that were raised during the external review process:
   (a) Issue 1—Scope of the Proposed Alternative
   (b) Issue 2—Transition Guidance for Held-to-Maturity Securities.

2. The Board also will discuss cost-benefit analysis and ask for permission to proceed with drafting a proposed Accounting Standards Update for vote by written ballot.

Questions for the Board
Issue 1: Scope of the Proposed Alternative
(1) Does the Board want to include debt securities classified as held-to-maturity within the scope of the proposed Accounting standards Update, *Targeted Transition Relief for Topic 326, Financial Instruments—Credit Losses*? If so, which alternative does the Board select for transition?
Issue 2: Transition Guidance for Held-to-Maturity Securities
(2) If the Board selects Alternative A for Issue 2 (require debt securities classified as held-to-maturity to be reclassified to trading upon the election of the fair value option), does the Board want to clarify that the reclassification of the held-to-maturity debt security does not call into question an entity's remaining held-to-maturity debt classification?
Cost and Benefits, Permission to Ballot
(3) Has the Board received sufficient information and analysis to make an informed decision on the perceived costs of the changes? If not, what other information or analysis is needed?

(4) Does the Board think that the benefits justify the costs? If so, does the Board authorize the staff to proceed to drafting a proposed Accounting Standards Update for vote by written ballot?

Background

3. At its November 14, 2018 meeting, the Board decided that, upon the adoption of Topic 326, an entity may irrevocably elect the fair value option in accordance with Subtopic 825-10, Fair Value Measurement—Overall, for eligible financial assets within the scope of Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost, on an instrument-by-instrument basis. At the same meeting, the Board also granted the staff permission to proceed to draft a proposed Update incorporating that decision.

4. During drafting of the proposed Update, the staff shared a draft of the proposed Update with certain stakeholders for confidential external review. Several stakeholders raised a question related to the transition guidance when an entity elects the fair value option on a held-to-maturity debt security.

5. As a result of the feedback received, the staff decided that the scope and the transition guidance for held-to-maturity debt securities warranted additional Board discussion before the issuance of the proposed Update.

Issue 1—Scope of the Proposed Alternative

6. In light of stakeholders' feedback, the staff has identified the following two alternatives for the Board's consideration:

   (a) **Alternative A:** Exclude debt securities classified as held-to-maturity from the scope of the proposed Update.

   (b) **Alternative B:** Include debt securities classified as held-to-maturity within the scope of the proposed Update.

Issue 2—Transition Guidance for Held-to-Maturity Securities

7. If the Board decides that held-to-maturity debt securities will be within the scope of the proposed Update (Alternative B of Issue 1), the staff has identified the following two transition alternatives for the Board's consideration:

   (a) **Alternative A:** Require that all held-to-maturity securities for which the fair value option is elected under the proposed Update be reclassified to trading even if an entity's "intent and ability" to hold the security to maturity has not changed.

(b) **Alternative B:** Require all held-to-maturity debt securities for which the fair value option is elected under the proposed Update retain their classification unless there has been a change to an entity's "intent and ability" to hold the security to maturity.

8. If the Board decides to pursue Alternative B of Issue 2, the staff prepared Question 2 to ask if the Board wants to clarify that the reclassification of the held-to-maturity debt security does not call into question an entity's remaining held-to-maturity debt classification.