FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout

Reference Rate Reform: Facilitation of the Effects of the Interbank Offered Rate Transition on Financial Reporting

June 19, 2019

Meeting Purpose

1. The June 19, 2019 Board meeting is the first decision-making meeting to deliberate issues associated with reference rate reform. The topics for this meeting are as follows:

   (a) The scoping criteria for determining whether a contract modification may qualify for relief

   (b) The recognition and measurement relief for contract modifications that meet the scoping criteria.

Questions for the Board
Issue 1: Scope
1. What contracts should qualify for relief?
2. What changes to critical terms should be permitted to be modified?
Issue 2: Relief Guidance
3. Does the Board want to provide relief from the following?
(a) The assessment to determine whether a modification to a loan or debt instrument is a troubled debt restructuring, modification, or extinguishment pursuant to Subtopics 310-20, Receivables—Nonrefundable Fees and Other Costs, 310-40, Receivables—Troubled Debt Restructurings by Creditors, 470-50, Debt—Modifications and Extinguishments, and 470-60, Debt—Troubled Debt Restructurings by Debtors
(b) The lease modification accounting requirements pursuant to Topics 840 and 842, Leases
(c) The reassessment of embedded derivatives pursuant to Topic 815, Derivatives and Hedging.

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4. Does the Board want to provide a principle that would provide relief from contract modification requirements in other Topics not explicitly specified?

Issue 3: Option to Apply Relief

5. Should there be an option to apply relief on a Topic-by-Topic basis?

Issue 1: Scoping Criteria

2. On the basis of stakeholder outreach, the staff identified the following key concepts for the scoping criteria:

   (a) Permissible reference rates to be replaced—that is, what ***contracts*** should qualify for relief?

   (b) Permissible critical term changes—that is, what ***terms*** can change?

Permissible Reference Rate to Be Replaced

3. The Board will consider the following alternatives:

   (a) **Alternative A:** Allow only contracts that reference an interest rate identified by the Board (that is, a prescriptive approach).

   (b) **Alternative B:** Allow only contracts that reference an interest rate that has been discontinued or is anticipated to be discontinued (that is, a principles-based approach), supplemented with an example of how certain interest rates anticipated to be discontinued already meet the principle (for example, the London Interbank Offered Rate).

Permissible Critical Term Changes

4. The Board will consider the following alternatives (changes to noncritical terms would be permissible under both alternatives):

   (a) **Alternative A:** Allow only critical term changes that are ***essential*** to the replacement of an interest rate.

   (b) **Alternative B:** Allow critical term changes that are either ***essential*** to or ***related*** to the replacement of an interest rate and provide examples of eligible and ineligible changes.

Issue 2: Relief Guidance

5. On the basis of stakeholder outreach, the staff identified the following areas for which the Board may consider providing relief for contract modifications:

Loan or Debt Modification

6. For contract modifications that are within the scope of Subtopics 310-20, 310-40, 470-50 and 470-60 and that meet the proposed scoping criteria, the contract modifications would be accounted for as a continuation of the contract rather than as a troubled debt restructuring or as an extinguishment and new issuance.

Lease Modification

7. For contract modifications that are within the scope of Topics 840 and 842 and that meet the proposed scoping criteria, no modification would be deemed to have occurred.

Embedded Derivative Reassessment

8. Contract modifications that meet the proposed scoping criteria would not require an embedded derivatives assessment under Topic 815.

Principle for Other Contract Modifications

9. The Board will consider providing a principle that would allow contract modifications that meet the proposed scoping criteria to be considered a continuation of the contract for the purposes of the relevant Topic.

Issue 3: Option to Apply Relief

10. The Board will consider the following alternatives:

    (a) **Alternative A:** Provide the option for an entity to determine whether it wants to apply the proposed relief on a Topic-by-Topic basis.

    (b) **Alternative B:** Require an entity to apply all the proposed relief.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout

Distinguishing Liabilities from Equity (Including Convertible Debt)

June 19, 2019

Meeting Purpose

1. At the September 20, 2017 meeting, the Board added a project to its agenda to improve the understandability and operability of the liabilities and equity guidance and reduce the complexity (without loss of information for users) of the guidance. The project's scope includes guidance on indexation and settlement (in the context of the derivative scope exception for contracts in an entity's own equity), convertible instruments, disclosures, and earnings per share (EPS).

2. As of the date of this meeting, the Board has made the majority of the technical decisions on the project. The June 19, 2019 Board meeting is a decision-making meeting for the Board to discuss the results of the external review of the staff draft of the proposed Update, sweep issues, comment period, cost-benefit analysis, and permission to issue a proposed Accounting Standards Update for vote by written ballot.

Questions for the Board
Sweep Issues 1. Does the Board want to modify the scope of Section 815-40-50, Derivatives and Hedging—Contracts in Entity's Own Equity—Disclosure, to apply only to freestanding instruments (that is, embedded features would not be subject to Section 815-40-50 requirements, consistent with current practice)? (Issue 1) 2. Does the Board want to require, for publicly traded companies (as defined in Topic 270, Interim Reporting), interim disclosures about accounting effect and significant events or changes in circumstances occurred in the reporting period for convertible debt instruments and convertible preferred stock? (Issue 2) 3. Does the Board want to clarify that the average share price should be used when calculating the diluted EPS denominator for contracts if there is variability? (Issue 3) 4. Does the Board want to reverse its prior decision to make a technical correction to paragraph 470-20-25-2 that would have clarified that Topics 480, Distinguishing Liabilities from Equity, and 815, Derivatives and Hedging, should be considered for the classification of the detachable stock purchase warrant? (Issue 4)

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5A. Does the Board confirm the staff's understanding that the remote threshold applies to the likelihood of contingent events and not to the overall likelihood of a contract settling in cash? (Issue 5A)

5B. Does the Board want to clarify that penalty payments if the entity fails to make timely filings with the U.S. Securities and Exchange Commission (SEC) does not preclude equity classification under paragraph 815-40-25-10(d)? (Issue 5B)

Comment Period, Benefits and Costs, and Permission to Ballot

6. 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?

7. Does the Board believe that the expected benefits justify the expected costs of the amendments included in the final Update? If not, why?

8. What comment period does the Board select for the amendments in this proposed Update?

9. Does the staff have permission to proceed to a proposed Update for vote by written ballot?

10. Are there any Board members that plan to dissent to the issuance of the amendments in the proposed Update? If so, why?

Supplemental Outreach Plan

11. Do Board members have any feedback on the staff's plan to perform additional outreach during the comment period that will supplement the feedback that the Board receives from comment letters?

External Review

3. The staff distributed a draft of the proposed Update to external reviewers in May 2019 and has subsequently addressed the comments received. External reviewers included practitioners, financial services industry representatives, a member of the Private Company Council, and staff members at regulatory agencies.

Sweep Issues

4. The staff identified five sweep issues for the Board's discussion at this meeting. The first two issues were identified by the staff during the drafting process. The other sweep issues relate to comments raised by external reviewers. The following are a summary of the issues identified for the Board's consideration:

   a. **Issue 1: Scope of Section 815-40-50**—Current guidance is unclear whether embedded features that qualify for the derivatives scope exception are required to follow the disclosure requirements in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity.

   b. **Issue 2: Interim versus Annual Disclosure Requirements for Convertible Instruments**—The current guidance in paragraphs 470-20-50-4 and 470-20-50-6 require certain information about convertible instruments be disclosed as of each date for which a statement of financial position is presented or for each period for which a statement of financial performance is presented. However, it is not quite clear about whether those disclosures are required only at annual periods or also at interim reporting periods. In addition, the interim disclosure guidance in Topic 270 does not include any requirements for convertible instruments.

   c. **Issue 3: EPS Denominator Calculation**—Diversity in practice exists about the price to be used in the diluted EPS calculation if there is variability (either variability in pricing or variability in the number of shares that would be issued). This issue relates to application of both the treasury stock and the if-converted methods of calculating diluted EPS. Topic 260, Earnings Per Share, does not explicitly address how to determine either the proceeds or the number of common shares issuable under the contract if those inputs are variable. Although the treasury stock method (which is the prescribed method in current guidance) requires the use of average share price, in practice, both the share price as of the end of the period (analogized to contingently issuable shares guidance in paragraph 260-10-45-52) and the lowest exercise price of any day during the reporting period are also used in the calculation. Therefore, practice has interpreted that there is an accounting policy election about which price is used for the diluted EPS calculation denominator for instruments that have variability.

   d. **Issue 4: Technical Correction—Debt with Detachable Warrants**—The current guidance in paragraph 470-20-25-2 requires that (i) proceeds from the sale of a debt instrument with detachable warrants be allocated between the debt instrument and the warrants based on the relative fair value allocation method and (ii) the portion of the proceeds allocated to the warrants be accounted for as paid-in capital. At the April 3, 2019 Board meeting, the Board decided to amend paragraph 470-20-25-2 by clarifying that Topics 480 and 815 also should be considered for the classification of the warrants. However, some external reviewers were concerned that the proposed amendment to paragraph 470-20-25-2 would indicate that the relative fair value allocation method should always be applied no matter if the warrants are classified as equity under Subtopic 470-20, Debt—Debt with Conversion and Other Options, or as liability under Subtopic 480-10, Distinguishing Liabilities from Equity—Overall, or 815-15, Derivatives and Hedging—Embedded Derivatives, and, therefore, cause a potential change in practice.

e. **Issue 5: Derivatives Scope Exception Settlement Guidance:**

   i. **Issue 5A: Likelihood of Net Cash Settlement**—Under the existing guidance in Section 815-40-25, Derivatives and Hedging—Contracts in Entity's Own Equity—Recognition, any contract provision that requires cash settlement upon a contingent event will preclude equity classification. The Board decided at the February 3, 2019 meeting to remove the requirement for an entity to evaluate those provisions that are remote of occurring. External reviewers requested clarification of whether the remote threshold applies to the *likelihood of a contract settling in cash* or whether the remote threshold applies to the *occurrence of a contingent event* that could cause the contract to be settled in cash. The proposed amendments in this area were not entirely clear because certain proposed amendments described the remote threshold applied to the likelihood of net cash settlement and other proposed amendments described the remote threshold applied to the likelihood of contingent events.

   ii. **Issue 5B: Penalty Payments**—Paragraph 815-40-25-10(d) precludes equity classification if there are required cash payments if an entity fails to file timely. External reviewers asked for clarification of whether penalty payments preclude equity classification because a penalty payment would not be considered settlement of a contract. That is, it is unclear whether the condition is referring to (1) a cash payment required to settle the contract because of the untimely filing, (2) cash penalty payments because of the untimely filing, or (3) some combination of both (1) and (2). Those reviewers observed that there is diversity in current practice about whether a penalty payment constitutes the cash payment that is contemplated in paragraph 815-40-25-10(d) and, therefore, whether the requirement to pay a penalty would preclude equity classification (if the payment has a likelihood of occurring that is more than remote under the proposed amendments).

FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout
Conceptual Framework—Elements
June 19, 2019

Meeting Purpose

1. At the June 19, 2019 decision-making Board meeting, the Board will discuss whether (a) an identifiable notion should be included in the explanatory paragraphs of the asset definition and (b) the term *control* should be included in the definition of an asset. Resolution of those issues will conclude the Board's deliberations on the definition of an asset.

Questions for the Board
1. Do Board members think that the identifiable notion should be included in the explanatory paragraphs of the asset definition? 2. Do Board members think that the term *control* should be included in the definition of an asset?

Existing Definition of an Asset

2. FASB Concepts Statement No. 6, *Elements of Financial Statements,* defines an asset in paragraph 25 as follows:

> Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. [Footnote reference omitted.]

3. The following terms have caused confusion:

   (a) *Probable*

   (b) *Future economic benefit*

   (c) *Past transaction or event*

   (d) *Control*.

Working Definition

4. The Board has agreed on the following working definition of an asset:

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

5. Under this working definition, the three essential characteristics of an asset include the following:

   (a) A right to the economic benefit

   (b) An economic benefit

   (c) The right must be present.

6. This definition of an asset addresses what have been the problematic terms in the existing definition in the following ways:

   (a) *Probable*: To avoid the continued misinterpretation of this term, it is not used in the staff's working definition.

   (b) *Future Economic Benefits*: To avoid misinterpretation, the working definition replaces *future economic benefits* with *present rights to economic benefits*. The use of *present* rather than *future* indicates that the right must presently exist.

   (c) *Past Transaction or Event*: To avoid undue emphasis on seeking out a past transaction or event, the working definition focuses on what is necessary for an asset to exist "at present" (that is, a *present* right to a *present* economic resource). The advantage to this is that the right to the economic benefit and access to that right must currently exist. This excludes economic resources or access to those economic resources that either will not arise until the future or that existed in the past but no longer exist at the balance sheet date. Eliminating the term *past transaction or event* also eliminates the redundancy that exists in the current definition.

   (d) *Control:* To avoid misinterpretation, the working definition introduces a requirement for an entity to have "present rights." Control is presumed when rights exist. Eliminating the term *control* allows the Board to explain that what is controlled is the existing right that gives rise to economic benefits, or potential economic benefits, rather than the economic benefits themselves.

7. The Board supported the staff's working definition and directed the staff to further analyze whether the term *control* is necessary in the definition of an asset. If included, the revised working definition would be:

   An asset is a present right controlled by the entity to an economic benefit.

8. If an entity has a present right, that would seem to be sufficient to establish the fact that the right (asset) is a right (asset) of that entity. Indeed, if an entity has exclusive rights, it presumably can deny or regulate access to that benefit by others and does not add anything significant to the definition of an asset. The term *control* may be unnecessary in the working definition. However, it is not always clear what is meant by the term *present right*.

9. For an entity to have a right, it would seem that the entity would need to control that right and, therefore, control access to the economic benefit that it represents. Inserting the term *control* in the definition may continue the confusion that the asset is the result of having the right to an economic benefit rather than the right itself.

Application Issues

10. The most difficult application of the proposed asset definition is to intangibles, particularly internally generated intangibles. Whether an intangible meets the definition of an asset should be indifferent to whether the intangible was purchased, acquired in a business combination, or internally developed. The Board discussed this point in July 2018. Board members had somewhat divergent views on what is meant by the terms *right* and *economic benefit* in the working definition and whether the notion of *identifiability* is helpful in determining if intangible items meet the definition of an asset.

11. The Master Glossary definition of the term *identifiable* is as follows:

    An asset is identifiable if it meets either of the following criteria:

    a. It is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability, regardless of whether the entity intends to do so.
    b. It arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

12. Many intangible assets arise from rights conveyed legally by contract, statue, or other means. For example, trademarks may be registered with the government. Contracts often are negotiated with customers or suppliers. The fact that an intangible asset arises from contractual or other legal rights seems to be an important characteristic that would require recognition of an intangible asset. If an item can be sold, transferred, licensed, or exchanged, it seems to be indictive that a right exists and that the entity controls access to that right. If the item arises from a contractual or other legal right, it appears reasonable that there would be evidence that a right exists and that it is to an economic benefit.

13. Certain expenditures for research and development, advertising, training, start-up, and pre-operating activities are examples of the kinds of items for which the assessments of *right* and *economic benefits* may be especially uncertain. However, some intangible items that do not arise from rights conveyed by contract or other legal means are nonetheless capable of being separated and exchanged for something of value. Other intangibles cannot be separated from the entity and sold or otherwise transferred. If an item is capable of being separated and

exchanged for something of value, it appears reasonable that there would be evidence that a right exists and that it is to an economic benefit.

14. Even with the explanation of the terms *right* and *economic benefit*, there is still difficultly in determining whether some internally generated intangible items meet the definition of an asset.

FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout

Conceptual Framework—Measurement

June 19, 2019

Meeting Purpose

1. At the June 19, 2019 non-decision-making Board meeting, the Board will discuss a different approach to its project on a measurement chapter of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*. The Board also will discuss some of the issues on measurement yet to be resolved by that project.

Questions for the Board
1. Are there other issues relating to the staff's approach that Board members would like to share with the entire Board? 2. Are there other key issues that must be addressed regarding the staff's approach? 3. Does the Board have any additional suggestions about developing concepts related to measurement?

Background Information

2. In April and May 2019, the staff asked Board members to review a staff approach to a proposed measurement chapter of Concepts Statement 8. To identify what measurements could be relevant for assets and liabilities in different contexts, the staff's approach would leverage the concepts in Chapter 1, *The Objective of General Purpose Financial Reporting*, of Concepts Statement 8 that describe how users of the financial statements use financial information.

3. The objective of financial reporting is to provide information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. How well a measurement base meets the objective depends on how one views the objective and which aspects of the objective are most important in particular standards-setting decisions.

4. Chapter 1 of Concepts Statement 8 states that financial information may be useful in doing the following:

   (a) Assessing prospects for cash flows of the entity

   (b) Assessing the effectiveness and efficiency of management

(c) Valuing the entity

(d) Assessing liquidity and solvency.

5. In addition, the enhancing characteristics—comparability, verifiability, timeliness, and understandability—should be considered in enhancing the information provided to users who incorporate all the aspects of the objective above when assessing whether to provide their resources.

Issues to Address

6. In review of the staff's approach, Board members raised certain views that require additional analysis and discussion before the approach can be developed further.

7. An analysis of priority and payment of claims (paragraph OB13 of Chapter 1 of Concepts Statement 8) and past performance and past cash flows (paragraph OB17 of Chapter 1 of Concepts Statement 8) could be considered and discussed for completeness in analyzing Chapter 1.

8. Measurement concepts could prioritize assessing cash flow prospects of an entity ahead of all other ways in which resource providers use financial information. Assessments of the efficiency and effectiveness of management, as described in the current Conceptual Framework, could be regarded as a means to adjust expectations about future cash flows of the entity and not to make resource allocation decisions on the basis of something other than assessing cash flows. In fact, all the ways that Chapter 1 of Concepts Statement 8 states that users use financial information could be analyzed within the scope of assessing cash flows.

9. Although previous Board decisions indicate that there are three measurement bases to consider (exit price, entry price, and estimates of cash flows), it may be necessary to expand that list. An expanded discussion of estimates of cash flows and definitions of potential additional measurement bases could be helpful. There are other ways in which numbers are assigned to assets and liabilities beside exit price and entry price. Expanding that discussion may lead to more precise terminology and facilitate better analysis when setting standards.