Board Meeting Handout
Leases Implementation
November 10, 2021

Memo Purpose

1. The purpose of this meeting is to address an agenda request received on September 14, 2021, from the Pennsylvania Institute of Certified Public Accountants (PICPA). The PICPA is requesting an additional two-year deferral of Accounting Standards Update No. 2016-02, *Leases (Topic 842),* including any subsequent amendments made after the original issuance date (hereinafter referred to as Leases) for entities within the scope of paragraph 842-10-65-1(b) (generally certain not-for-profit organizations [NFPs] and private companies).

Question for the Board
1. Does the Board want to provide an additional deferral of Leases for entities within the scope of paragraph 842-10-65-1(b)?

Issue Background

2. The FASB issued Update 2016-02 in February 2016. The effective dates are provided in paragraph 842-10-65-1(a) and 1(b) as follows:

   (a) A public business entity, a not-for-profit entity that has issued or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market (with an exception for those entities that have not yet issued their financial statements or made financial statements available for issuance as described in the following sentence), and an employee benefit plan that files or furnishes financial statements with or to the U.S. Securities and Exchange Commission for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.

   Note: All of the entities subject to (a) have adopted Leases as of the date of this handout.

   (b) All other entities for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

   Note: The entities subject to (b) will hereinafter be referred to as nonpublic entities.

3. Following the issuance of Update 2016-02, no changes were made to the effective date for public business entities.[1] The effective dates for nonpublic entities were deferred twice. Those deferrals are described below.

First Deferral

4. In November 2019, the Board issued Accounting Standards Update No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates.* Update 2019-10 deferred the effective date for nonpublic entities by one year. Therefore, Leases was to be effective for those entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. The deferrals in Update 2019-10 responded to feedback from stakeholders and the Board's monitoring of the implementation of major Updates, which provides an understanding of the implementation challenges encountered by all types of entities when adopting a major Update.

5. The Board noted that challenges often are magnified for private companies, smaller public companies, and NFPs, primarily because of the following factors (not all-inclusive) that affect the severity of challenges encountered by those entities when transitioning to a major Update:

    (a) Availability of resources (both internal and external)

    (b) Timing and source(s) of education

    (c) Knowledge or experience gained from implementation issues encountered by larger public companies

    (d) Comprehensive transition requirements

    (e) Understanding and applying guidance from post-issuance standard-setting activities

    (f) The development or acquisition of:

        (i) Sufficient information technology and expertise in creating new systems or effecting system changes

        (ii) Effective business solutions and internal controls

        (iii) Better data or estimation processes.

[1] An alternate transition method requiring that an to reflect the amendments at the beginning of the period of adoption through a cumulative-effect adjustment was provided for all entities in Accounting Standards Update No. 2018-11, *Leases (Topic 842)—Targeted Improvements,* which was issued July 2018.

Second Deferral

6. In June 2020, the Board issued Accounting Standards Update No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities.* Among other things, that Update deferred Leases for an additional year for nonpublic entities. Therefore, Leases is now effective for nonpublic entities for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022.
7. Update 2020-05 was issued in response to concerns that the challenges highlighted in paragraph 5 above were significantly amplified by the business and capital market disruptions caused by the COVID-19 pandemic.
8. Furthermore, the Board postponed a roundtable discussion originally planned for May 2020 to address implementation by public companies, which would have assisted private companies in their efforts to implement and to determine whether additional practical expedients or other amendments were warranted as private companies prepared for final implementation because of the COVID-19 pandemic. That roundtable was held in September 2020.

2021 Agenda Request

9. The agenda request is provided in Appendix A of this handout. The PICPA is requesting an additional two-year deferral of Leases for nonpublic entities. If provided, Leases would then be effective for those entities for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024.
10. Broadly, the agenda request emphasizes that the COVID-19 pandemic continues to cause business disruptions and that some of the issues highlighted in paragraph 5 persist, particularly resource constraints in the labor markets. The request also cites concern about the time and resources needed to comply with critical aspects of the standard (for example, discount rate determination and embedded leases).
11. The PICPA stresses that because of the significant effect on nonpublic entity balance sheets, time will be needed to review the effect on debt covenants and to potentially work with lenders to waive or modify those covenants. They assert that waivers and modifications of debt covenants can be costly and more difficult because the pandemic has forced many nonpublic entities to obtain new sources of financing to survive.

12. In the absence of a deferral, the PICPA believes that "many nonpublic entities will opt for GAAP exceptions, which could impact their ability to obtain capital" and PICPA goes on to state that "this is not a good outcome when most private companies are in a capital preservation mode."

September 2021 Private Company Council (PCC) Meeting

13. At its September 2021 public meeting, the PCC provided Board members with feedback on the deferral request. Broadly, preparer and practitioner PCC members were sympathetic to the concerns and issues provided in the agenda request and stressed that a significant amount of implementation assistance will be required from practitioners to nonpublic entities. Those members noted that a shortage of practitioners in the labor market exists and, furthermore, they do not expect that shortage issue to improve in the next few years. A practitioner member highlighted that some nonpublic entity stakeholders were questioning at the summer 2020 AICPA Engage Conference whether an additional deferral would be considered by the Board. Both financial statement user members of the PCC asserted a preference for no further delay, emphasizing that they do not wish to wait any longer for the information provided by Leases.

FASB Post-Implementation Review (PIR) and Implementation Activities

14. As part of its PIR process, the Board provides resources to monitor and assist stakeholders with their implementation and ongoing application of Topic 842 since the issuance of Update 2016-02. The FASB staff proactively engages with stakeholders in both formal and informal settings to solicit feedback. Meetings have been held with FASB advisory groups, regulators, users of financial statements, practitioners, the AICPA's Technical Issues Committee, industry groups, and individual public and private preparers. The FASB staff also actively monitors agenda requests and technical inquiries for pervasive implementation or ongoing application issues. Additionally, as part of the ongoing PIR process, the FASB hosted a public Leases roundtable in September 2020. Across two sessions, participants shared their views on several broad topics related to Topic 842.

15. The staff summarized all feedback received, including issues discussed at the roundtable and others raised through outreach at the December 2, 2020 Board meeting. At that meeting, the staff asked for the Board's direction on issues to prioritize in 2021 in addition to the staff's continued monitoring and assisting stakeholders with implementation and ongoing application. The Board directed the staff to undertake efforts on the following:

(a) Lessor accounting with leases with certain variable payments (Update issued July 2020)

(b) Risk-free practical expedient for NFPs and private companies (Update to be issued early November 2021)

(c) Lease modification accounting (waiting for results of agenda consultation process)

(d) Cost survey (implementation and ongoing) with public business entities (currently analyzing results and preparing materials).

16. On the basis of feedback received at the roundtable and other outreach, the Board decided not to undertake efforts to change certain key areas of Leases referenced in the agenda request that were discussed at the September 2020 roundtable.

Appendix A—Agenda Request

Pennsylvania Institute of Certified Public Accountants

Sept. 14, 2021

Richard R. Jones, Chair
Financial Accounting Standards Board
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Re: Deferral of the effective date of ASC 842, *Leases*

The Accounting and Auditing Steering Committee (the committee) of the Pennsylvania Institute of Certified Public Accountants (PICPA) appreciates the opportunity to provide feedback on the implementation of ASC 842, *Leases*. The PICPA is a professional CPA association of more than 20,000 members working to improve the profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. The committee is composed of practitioners from both regional and small public accounting firms, members serving in financial reporting positions, accounting educators, and peer reviewers. The PICPA administers the peer review program for firms in Delaware, New York, Pennsylvania, and the U.S. Virgin Islands.

The input provided here is not associated with a specific due process document. Rather, the committee would like to petition the FASB to delay the effective date of ASC 842, *Leases*, for nonpublic entities.

The COVID-19 pandemic has significantly affected nonpublic entities (including not-for-profit organizations), straining their viability and decimating their balance sheets. Practitioners in public practice also have been challenged by the added workload of managing government pandemic assistance, performing attest work remotely, and implementing ASC 606. In that regard, the committee would like to thank the FASB for its decision to defer implementation of ASC 606 for certain entities and ASC 842 for nonpublic entities. Businesses and not-for-profit organizations now face the difficult task of rebuilding while practitioners need to tackle their significant backlog of work.

For many nonpublic entities, implementing ASC 842 will result in a significant shift in accounting policies –and will have a material impact on financial statement presentations. Implementation will require businesses to invest considerable time and resources in gathering the information needed for the transition, establishing controls over the collection of leasing information, evaluating contracts, defining the components, searching for embedded leases, remeasuring initial direct costs, identifying the interest rate, determining the implementation method and which practical expedients to use, and devising processes for reassessing the lease period and interest rates, among other challenges.

Because the implementation of this standard will significantly affect financial statements, time will be needed to review the impact on debt covenants and to work with lenders to potentially obtain waivers of noncompliance caused by the implementation of the new standard or to modify debt covenants. These waivers and debt covenant modifications can be costly. This effort will likely be even more onerous due to the pandemic since many entities had to obtain new sources of financing to survive. The additional debt could challenge the entities' debt levels even before applying ASC 842. Starting a process now to

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renegotiate financial covenants could put the entities at risk of having existing debt called, reduced, or rescinded, potentially pushing many toward bankruptcy.
Training on the new standard is another concern. For many private companies, their auditors are a primary source of information about new accounting standards. Due to resource constraints (people and money) and COVID protocols, much of the training for this topic has been delayed. Without proper training, significant independence issues could occur.

Entities with a significant number of leases will need additional lead time to evaluate, select, and implement leasing software.

Given the significant effort needed to implement ASC 842 and the remaining financial burdens and labor shortages that nonpublic entities are facing, we believe an effective date of fiscal years beginning after Dec. 15, 2021 (Jan. 1, 2022), is untenable. The committee respectfully requests that the FASB approve a two-year deferral of the effective date of ASC 842 to help practitioners and businesses work through their remaining pandemic-related challenges and have a reasonable period of time for effective implementation.

In the absence of a deferral, we believe that many nonpublic entities will opt for GAAP exceptions, which could impact their ability to obtain capital. This is not a good outcome when most private companies are in a capital preservation mode. Others may simply abandon U.S. GAAP for other special purpose frameworks, which we believe reduces the relevance of GAAP and harms the overall economy and capital markets. Peer reviewers also will be challenged and will likely identify many nonconforming engagements, further straining the accounting ecosystem.

We appreciate your consideration of our requested deferral of ASC 842. We are available to discuss any of these comments with you at your convenience.

Sincerely,

Vanessa Zang

Vanessa A. Zang, CPA
Chair, PICPA Accounting and Auditing Steering Committee

CC: Candace Wright, Chair - Private Company Council

FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout
Fair Value Hedging—Portfolio Layer Method
November 10, 2021

Meeting Purpose

1. The Board will discuss redeliberation issues arising from stakeholders' comment letters received on the proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Fair Value Hedging—Portfolio Layer Method,* benefits and costs of the proposed amendments, and whether to proceed to drafting a final Update for vote by written ballot.

Questions for the Board
Redeliberation Issues
Scope
1. Which alternative does the Board prefer for assets and liabilities eligible for portfolio layer method (PLM) hedging?
Attributes of Assets in the Closed Portfolio
2A. If the Board decides to retain the prepayable requirement, which alternative does the Board prefer for that requirement?
2B. Which alternative does the Board prefer for the contractual maturity requirement?
Fair Value Hedge Basis Adjustments
3A. Which alternative does the Board prefer for accounting for PLM fair value hedge basis adjustments?
3B. Which alternative does the Board prefer for considering PLM fair value hedge basis adjustments in credit losses determinations?
Breaches
4A. Which alternative does the Board prefer for dedesignation sequencing and partial dedesignation for actual breaches?
4B. Which alternative does the Board prefer for the recognition and presentation of the fair value hedge basis adjustment associated with an actual breach?

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.

Disclosures

5A. Which alternative does the Board prefer for the disclosure of basis adjustments in disclosures required by areas of GAAP outside hedge accounting?

5B. Does the Board affirm its previous decision on multiple layer hedge accounting disclosures?

Transition and Effective Date

6A. Which balance sheet transition application method does the Board prefer?

6B. Which disclosure transition application method does the Board prefer?

6C. Does the Board want to affirm its previous decision on transition disclosures?

6D. Which alternative does the Board prefer for held-to-maturity (HTM) to available-for-sale (AFS) reclassifications in transition?

6E. Which alternative does the Board prefer for effective date and early adoption?

Cost-Benefit Analysis and Permission to Ballot

7A. 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?

7B. Does the Board give the staff permission to draft a final Update for vote by written ballot?

Comment Letter Demographics

Type of Respondent	Number of Respondents
Practitioners	9
Preparers	8
State CPA Societies	1
Trade Group Representatives	5
Consultants	2
Total Respondents	25

Comment Letter Feedback and Redeliberation Issues

Issue 1: Scope

2. Under current GAAP for the last-of-layer method, only prepayable financial assets are eligible to be hedged. Thus, an entity must designate portfolio hedges of nonprepayable assets

separately from portfolio hedges of prepayable assets because nonprepayable assets do not qualify for last-of-layer hedging.

Comment Letter Feedback

3. Several practitioners and a consultant supported the Board's decision to limit the scope of the PLM multiple-layer model to prepayable financial assets. However, all preparers and trade group representatives, in addition to some practitioners and a consultant, recommended expanding the scope of the PLM. Most respondents who supported expanding the scope said that any scope expansion that could significantly delay the issuance of a final standard should be addressed as a separate project. The comments can be categorized as supporting expanding the scope of the proposed Update to include the following:

   (a) Nonprepayable financial assets

   (b) Financial liabilities.

Nonprepayable Financial Assets

4. Many respondents recommended that financial assets should be eligible for the PLM regardless of whether the assets are prepayable and said that there is no conceptual basis to limit the portfolio to prepayable assets. Those respondents cited that nonprepayable financial assets have no substantive interest rate risk differences from prepayable financial assets eligible for hedge accounting under the current model because the current model excludes prepayment risk for the stated amount of prepayable assets hedged. In addition, some respondents asserted that expansion would ease operability and potentially reduce the cost of hedging.

Financial Liabilities

5. Most respondents supported expanding the PLM to include prepayable financial liabilities. Some of those respondents recommended expanding beyond prepayable financial liabilities to all financial liabilities generally. They said that expanding the scope would better support risk management objectives, and they see no conceptual reasons why the PLM should exclude portfolios of financial liabilities.

6. Some respondents addressed issues related to hedging insurance liabilities, noting that while various strategies can be utilized for economically hedging interest rate risk of long-dated insurance liabilities, most do not qualify for hedge accounting due to mortality risk (death), morbidity risk (injury or disability), and lapse assumptions. They indicated that those

prepayment-like risks make hedging insurance liabilities challenging for the same reasons as prepayable financial assets before creation of the current model, particularly because insurance liabilities can be very long dated (over several decades). They asserted that expanding the scope to include prepayable financial liabilities would make hedge accounting more accessible for entities with insurance liabilities, reflect the risk management activities of those entities, and provide users of insurance company financial statements with decision-useful information.

Alternatives

7. The staff has identified the following alternatives for the Board's consideration:

   (a) Alternative A: Affirm the Board's proposal that allows prepayable financial assets and one or more beneficial interests secured by a portfolio of prepayable financial instruments to be included in a PLM hedge.

   (b) Alternative B: Expand the scope of instruments that qualify for PLM hedging to all financial assets.

   (c) Alternative C: Expand the scope of instruments that qualify for PLM hedging to all financial assets and financial liabilities.

Issue 2: Attributes of Assets in the Closed Portfolio

8. The amendments in the proposed Update related to the attributes of the assets in the closed portfolio in a multiple-layer strategy were intended to increase flexibility in the hedge accounting model. Those amendments were that all the assets in the closed portfolio must:

   (a) Have a contractual maturity date on or after the end of the earliest-ending hedge period of hedges associated with the closed portfolio.

   (b) Be or become prepayable by the end of the latest-ending hedge period of hedges associated with the closed portfolio.

Issue 2A: Prepayable Requirement

Comment Letter Feedback

9. Many respondents recommended that the prepayable criterion—to have financial assets become prepayable by the end of the latest-ending hedge period of hedges associated with the closed portfolio—should be removed. Some respondents recommended that if the Board decides not to remove the criterion, the condition should be changed to require that the

assets in the closed portfolio become prepayable only at some point during their contractual lives.

10. Some respondents additionally noted that the prepayable criterion is unnecessarily restrictive and entities may enter into nonsubstantive long-dated hedges solely to meet the criterion.

Alternatives

11. The prepayable requirement no longer would be relevant if nonprepayable financial assets could be included in the closed portfolio based on the scoping decision (Issue 1). Thus, if the Board decides that all financial assets are eligible for PLM hedging (Issue 1, Alternative B), the prepayable requirement would be removed in its entirety and the Board would not need to further decide between the alternatives below that relate to the prepayable requirement.

12. If the Board decides to retain the prepayable requirement, the staff has identified the following alternatives for the Board's consideration:

    (a) Alternative A: Affirm the Board's proposal that all assets in the closed portfolio are or become prepayable by the end of the latest-ending hedge associated with the closed portfolio.

    (b) Alternative B: Assets that are or become prepayable at any point during their lives may be included in the closed portfolio.

Issue 2B: Contractual Maturity Requirement

Comment Letter Feedback

13. A consultant noted similar concerns about the contractual maturity criterion, indicating that an entity may designate a nominal, short-dated hedge solely to ensure that all assets in the closed portfolio have a contractual maturity date on or after the end of the earliest-ending hedge and qualify for hedge accounting. However, some respondents said that they supported the proposed contractual maturity date criterion.

Alternatives

14. The staff has identified the following alternatives for the Board's consideration:

    (a) Alternative A: Affirm the Board's previous decision that all assets in the closed portfolio must have a contractual maturity date on or after the earliest-ending hedge period.

    (b) Alternative B: Remove the contractual maturity requirement, thereby allowing any qualifying financial asset to be included in a closed portfolio regardless of maturity date.

Issue 3: Fair Value Hedge Basis Adjustments

15. The amendments in the proposed Update indicated that the fair value hedge basis adjustment associated with a hedged layer should not be allocated to the individual assets or beneficial interests in the closed portfolio or those removed from the portfolio during the hedging relationship. Instead, the fair value hedge basis adjustment should be maintained on a closed portfolio basis with changes in that amount recognized currently in earnings.

Issue 3A: Fair Value Hedge Basis Adjustments at the Closed Portfolio Level

Comment Letter Feedback

16. Nearly all respondents supported the Board's decision to maintain basis adjustments at the closed portfolio level rather than at the individual asset level. However, one practitioner recommended that the Board allow entities to make an accounting policy election to maintain basis adjustments at the closed portfolio level or allocate them to the individual loan level based on their internal system capabilities, processes, and internal controls.

Alternatives

17. The staff has identified the following alternatives for the Board's consideration:

    (a) Alternative A: Affirm the proposal to require that an entity maintain fair value hedge basis adjustments at the closed portfolio level for currently designated hedges.

    (b) Alternative B: Allow an entity to make an accounting policy election to either maintain fair value hedge basis adjustments at the closed portfolio level or allocate those basis adjustments to all assets in the closed portfolio for currently designated hedges.

Issue 3B: PLM Fair Value Hedge Basis Adjustments in Determining Credit Losses

Comment Letter Feedback

18. With respect to excluding PLM fair value hedge basis adjustments from credit loss calculations, a few practitioners supported the approach while no comment letter respondents opposed it.

Alternatives

19. The staff has identified the following alternatives for the Board's consideration:

    (a) Alternative A: Affirm the proposal to prohibit an entity from considering PLM fair value hedge basis adjustments on a currently designated hedge in its determination of credit losses.

    (b) Alternative B: Require that an entity consider allocated PLM fair value hedge basis adjustments on a currently designated hedge in its determination of credit losses.

Issue 4: Breaches

20. A breach occurs when the amount outstanding in the closed portfolio falls below the amount of the hedged layer (also referred to as an "actual" breach). An anticipated breach occurs when the amount outstanding in the closed portfolio is anticipated to fall below the amount of the hedged layer in the future. In the proposed Update, the Board decided to establish separate dedesignation guidance for actual and anticipated breaches, with more flexibility provided for anticipated breaches.

21. The proposed Update specified that if an actual breach has occurred, an entity would be required to sequence the order that hedging relationships would be discontinued based on the hedging relationship with the shortest remaining period until the hedged item's assumed maturity date that would cure the breach. If there are multiple hedged layers with the same assumed maturity date, an entity would be required to discontinue hedging relationships using a "last-in, first-out" approach.

Issue 4A: Dedesignation Sequencing and Partial Dedesignations

Comment Letter Feedback

22. Respondents were mixed in their comments about the proposed amendments when an actual breach has occurred. Most practitioners, a state CPA society, and a consultant supported the Board's decision on hedge dedesignation sequencing in an actual breach, while nearly all preparers, trade group representatives, a practitioner, and a consultant recommended alternative approaches to dedesignation in an actual breach. Some respondents noted that the proposed amendments may be complex to apply and appear inconsistent with the enhanced flexibility in the model. Those respondents said that it is unclear if an entity should first look to minimize the number of dedesignations required or simply follow a sequence of shortest duration when multiple hedges need to be dedesignated in an actual breach.

23. One practitioner, one preparer, one trade group representative, and one consultant recommended that the Board align the dedesignation guidance for actual breaches with the guidance for anticipated breaches and voluntary dedesignations to provide an entity with the ability to elect which hedged layer or layers to dedesignate and the ability to partially dedesignate a hedged layer in the event of an actual breach. Those respondents said that aligning the two models would reduce operational and audit complexity.

24. Some respondents noted that the proposed amendments for dedesignation sequencing upon an actual breach may not align with an entity's risk management objectives. They noted that the proposed amendments may necessitate dedesignating an entire layer and then redesignating the portion of the breached layer that is still expected to remain outstanding. They highlighted that the ability to partially dedesignate selected hedge layers until the breach is remediated, like the accounting for an anticipated breach, would avoid those issues and align with risk management objectives.

25. Several preparers, a couple of trade group representatives, and a consultant recommended that the Board consider an alternative that would allow an entity to define a dedesignation sequence in the event of an actual breach at hedge inception and update the sequence when a new hedge is added. If an entity failed to define a sequence at inception, the default guidance from the proposed Update would be applicable. Respondents who supported an alternative dedesignation sequencing noted that the current proposed amendments are unnecessarily stringent and may not align with an entity's risk management objectives. The respondents who supported the proposed amendments said that the amendments are practical and operable.

Alternatives

26. The staff has identified the following alternatives for the Board's consideration:

    (a) Alternative A: Change the proposed actual breach guidance to require that an entity strictly dedesignate the hedged layer with the shortest remaining period until maturity in the instance of a breach. There would be no circumstances in which an entity could dedesignate a layer other than the one with the shortest-remaining period until maturity. That layer would be fully dedesignated.

    (b) Alternative B: Change the proposed actual breach guidance to align with the anticipated breach guidance, with the addition of the following disclosures for each actual breach:

        (i) The amount of the fair value hedge basis adjustment recognized in current period earnings because of the breach

(ii) The line item or items in which that fair value hedge basis adjustment was recognized

(iii) The circumstances that led to the breach.

(c) Alternative C: Same as Alternative A but add the following disclosures for each actual breach:

(i) The amount of the fair value hedge basis adjustment recognized in current period earnings because of the breach

(ii) The line item or items in which that fair value hedge basis adjustment was recognized

(iii) The circumstances that led to the breach.

(d) Alternative D: Align the dedesignation requirements in the event of an anticipated breach and an actual breach to allow partial dedesignation and require an entity to follow an approach that aligns with its risk management objectives. In addition, require the following disclosures for each actual breach:

(i) The amount of the fair value hedge basis adjustment recognized in current period earnings because of the breach

(ii) The line item or items in which that fair value hedge basis adjustment was recognized

(iii) The circumstances that led to the breach.

Issue 4B: Follow-the-Asset Method

Comment Letter Feedback

27. Most respondents opposed the Board’s decision to use the follow-the-asset method for recognition and presentation of the proportion of the fair value hedge basis adjustment associated with assets no longer in the closed portfolio in the case of an actual breach, under which recognition and presentation would be based on the nature of the most recent event that caused the breach (for example, default or prepayment). A few practitioners supported the follow-the-asset method. Those respondents who were opposed said that applying that method may be operationally challenging and require incremental costs that do not justify the related benefits. They asserted that entities do not have existing processes in place to identify which assets caused a breach because the current last-of-layer method does not prescribe a specific approach to account for the income statement effect of a breach.

28. Many respondents additionally asserted that the follow-the-asset method would not provide users of financial statements with decision-useful information. Several respondents noted that there could be multiple events that cause the outstanding amount of the closed portfolio to fall below the stated hedged amount and, in a case in which multiple events occur on the date that a breach occurs, presentation based on the most recent event would not provide information that is necessarily relevant.

29. Many respondents recommended that the Board allow entities to make an accounting policy election to account for the basis adjustments related to the breached portion of the hedged layer. Some of those respondents suggested that the Board allow entities to account for basis adjustments related to the breached portion of the hedged layer as interest income or to use the follow-the-asset method. One of those respondents noted that an election is somewhat akin to the option provided in Topic 326, Financial Instruments—Credit Losses, for the writeoff of an uncollectible interest receivable as either interest income or provision for credit losses, depending on the policy election. Some respondents recommended that the Board allow entities to make an accounting policy election for where to record breach basis adjustments on the income statements and to disclose the amounts in the footnotes to the financial statements.

30. Some respondents also offered alternatives to the follow-the-asset method. One practitioner recommended that the Board require that the income statement presentation be consistent with the major contributing factor to the breach. Another practitioner suggested that the Board allow entities to adopt a "systematic and rational method" to account for the breach on the income statement if they did not wish to adopt the follow-the-asset method as their policy. One preparer recommended that the Board consider a cumulative approach to capture the holistic view of the portfolio, such as tracking the entire portfolio's payment activities and allocating the basis adjustments pro rata.

Alternatives

31. The staff has identified the following alternatives for the Board's consideration:

    (a) Alternative A: Affirm the proposal to require that the recognition and presentation of the basis adjustment associated with a breach follow the recognition and presentation of the asset or assets that caused the breach (that is, the follow-the-asset method).

    (b) Alternative B: Require that an entity make an accounting policy election to select the line item in which to present the basis adjustment associated with a breach. An entity could choose interest income, credit losses, or a combination of both. If an entity chose a combination of both, it would need to establish an accounting policy to systematically and rationally determine which amounts would be allocated to each line item. After the election is made, it would apply to all PLM hedges.

(c) Alternative C: Require that an entity present the basis adjustment associated with a breach in interest income.

Issue 5: Disclosures

32. The amendments in the proposed Update would require that PLM fair value hedge basis adjustments be disclosed as reconciling items in disclosures outside hedge accounting. With respect to hedge accounting disclosures, the proposed amendments would indicate that disclosures applicable to the single-layer model would be required for the multiple-layer strategies.

Issue 5A: Disclosures Outside Hedge Accounting

Comment Letter Feedback

33. Comment letter respondents supported the proposed amendments related to disclosures outside hedge accounting.

Alternatives

34. The staff has identified the following alternatives for the Board's consideration:

(a) Alternative A: Affirm the Board's proposal to require that PLM fair value hedge basis adjustments related to currently designated hedges be disclosed as reconciling items in disclosures outside hedge accounting.

(b) Alternative B: Require that PLM fair value hedge basis adjustments related to currently designated hedges be allocated to the lowest level necessary to meet the disclosure requirements outside hedge accounting.

Issue 5B: Multiple-Layer Disclosures

Comment Letter Feedback

35. Comment letter respondents supported the proposed amendments related to hedge accounting disclosures. They did not suggest incremental hedge accounting disclosures unique to the multiple-layer PLM strategy.

Alternative

36. The staff has identified a single path, that is, to affirm the Board's proposal to require the same hedge accounting disclosures for multiple-layer PLM hedges as are required for single-layer last-of-layer hedges in current GAAP.

Issue 6: Transition and Effective Date

37. Transition provisions would require that the amendments in the proposed Update that are related to fair value hedge basis adjustments be applied on a modified retrospective basis, whereas the effect of applying the fair value hedge basis adjustment amendments would be recorded as a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption. For disclosures outside hedge accounting, the proposed amendments would allow entities to choose between prospective or full retrospective application. In addition, an option was provided for an entity to reclassify from HTM to AFS debt securities that would be eligible for PLM hedging.

Issue 6A: Balance Sheet Transition Method

Comment Letter Feedback

38. Most respondents generally supported the transition amendments in the proposed Update.

Alternatives

39. The staff has identified the following alternatives for the Board's consideration:

    (a) Alternative A: Affirm the Board's proposal to require:

        (i) That the effect of applying the fair value hedge basis adjustment amendments would be recorded as a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption (that is, a modified retrospective transition method)

        (ii) Prospective application of multiple-layer PLM strategies.

    (b) Alternative B:

        (i) Change the Board's proposal to instead provide an option for prospective application in addition to the proposed modified retrospective application of the fair value hedge basis adjustment amendments.

        (ii) Affirm the Board's proposal to require prospective application of multiple-layer PLM strategies.

Issue 6B: Disclosure Transition Method

40. The staff has identified the following alternatives for the Board's consideration:

   (a) Alternative A: Affirm the Board's proposal that an entity may elect to apply the amendments related to disclosures on either a full retrospective basis (that is, for all periods presented) or prospective basis (that is, in the period of adoption and every period thereafter).

   (b) Alternative B: Require that an entity apply the amendments related to disclosures on a full retrospective basis (that is, for all periods presented).

Issue 6C: Transition Disclosures

41. The staff has identified a single path, that is, to require that an entity disclose the nature of and reason for the change in accounting principle in transition and the cumulative effect of the change on the opening balance of each affected component of equity or net assets on the balance sheet as of the date of adoption.

Issue 6D: HTM to AFS Reclassification

Comment Letter Feedback

42. Some preparers noted that the election to reclassify debt securities from HTM to AFS in transition may require some additional timing flexibility to improve operability.

Alternatives

43. The staff has identified the following alternatives for the Board's consideration:

   (a) Alternative A: Affirm the Board's proposal to allow an entity to reclassify debt securities from HTM to AFS upon adoption of a final Update only if the securities would qualify for hedge accounting under the PLM. The decision of which securities to reclassify would have to be made within 30 days after the date of adoption.

   (b) Alternative B: Allow an entity to reclassify debt securities from HTM to AFS upon adoption of a final Update only if the entity intends to apply PLM hedging to those debt securities. The decision of which securities to reclassify would have to be made within 30 days after the date of adoption. The securities also would have to be included in a closed portfolio that is designated in a PLM hedge within that 30-day period.

   (c) Alternative C: Do not allow a reclassification of debt securities from HTM to AFS upon adoption of a final Update.

Issue 6E: Effective Date and Early Adoption

Comment Letter Feedback

44. Most respondents stated that none of the amendments in the proposed Update would require special accommodations for private companies that are not financial institutions and for not-for-profit entities. However, some practitioners and a state CPA society recommended that the Board consider a one-year delayed effective date for nonpublic business entities, with early adoption permitted, so that those entities can benefit from the learning cycle provided by public business entity implementations, if desired. Other practitioners and preparers stated that that the proposed amendments would not add significant complexity or time-intensive implementation efforts, largely because single-layer hedging is already allowed under GAAP and introducing multiple-layer hedging would not require significant incremental effort to operationalize. Many respondents additionally noted that applying hedge accounting, including the PLM, is optional. Nearly all respondents supported allowing early adoption for both public and nonpublic business entities.

Alternatives

45. The staff has identified the following alternatives for the Board's consideration:

    (a) Alternative A: Entities that are required to adopt the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* for fiscal years beginning after December 15, 2019, would be required to adopt the amendments in a final Update for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. All other entities would be required to adopt the amendments in a final Update for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. Early adoption would be permitted on any date on or after issuance of a final Update for an entity that has adopted Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* for the corresponding fiscal and interim period (if applicable).

    (b) Alternative B: Public business entities would be required to adopt the amendments in a final Update for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. All other entities would be required to adopt the amendments for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. Early adoption would be permitted on any date on or after issuance of a final Update for an entity that has adopted Update 2017-12 for the corresponding fiscal and interim period (if applicable).

(c) Alternative C: All entities would be required to adopt the amendments in a final Update for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early adoption would be permitted on any date on or after issuance of a final Update for an entity that has adopted Update 2017-12 for the corresponding fiscal and interim period (if applicable).