ACCTFAX

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FASB PROPOSES TO IMPROVE AND EXPAND HEDGE ACCOUNTING

On May 5, 2021, the Financial Accounting Standards Board (FASB) issued a proposed Accounting Standards Update (ASU) intended to better align hedge accounting with an organization's risk management strategies. Stakeholders are encouraged to review and provide comment on the proposed ASU by July 5, 2021.

In 2017, the FASB issued a new hedging standard to better align the economic results of risk management activities with hedge accounting. The new standard increased transparency around how the results of hedging activities are presented, both on the face of the financial statements and in the footnotes, for investors and analysts when hedge accounting is applied.

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One of the major provisions of that standard was the addition of the last-of-layer hedging method. For a closed portfolio of fixed-rate prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, such as mortgages or mortgaged-backed securities, the last-of-layer method allows an entity to hedge its exposure to fair value changes due to changes in interest rates for a portion of the portfolio that is not expected to be affected by prepayments, defaults, and other events affecting the timing and amount of cash flows.

Since issuing the hedging standard, stakeholders have told the FASB that the ability to elect hedge accounting for a single layer is useful, but hedge accounting could better reflect risk management activities if expanded to allow multiple layers of a single closed portfolio to be hedged under the method.

The proposed ASU would expand the current single-layer model to allow multiple-layer hedges of a single closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments under the method. To reflect that expansion, the last-of-layer method would be renamed as the portfolio layer method.

Additionally, the proposed ASU would:

- Clarify eligible hedging instruments in a single-layer strategy
- Provide additional guidance on the accounting for and disclosure of fair value hedge basis adjustments that would be applicable to both the current single-layer model and the proposed multiple-layer model
- Indicate how fair value hedge basis adjustments should be considered when determining credit losses for the assets included in the closed portfolio.

The proposed ASU is available at www.fasb.org.

RECENT ACTIVITIES OF THE PRIVATE COMPANY COUNCIL

The Private Company Council (PCC) met on Tuesday, April 20, 2021. Below is a brief summary of issues addressed by the PCC at the meeting:

PCC Issue No. 2018-01, "Practical Expedient to Measure Grant-Date Fair Value of Equity-Classified Share-Based Awards": The PCC redeliberated issues for the proposed Accounting Standards Update, Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards. The PCC discussed how the practical expedient should reference the Treasury Regulations of Section 409A of the U.S. Internal Revenue Code—by direct reference to specific paragraphs, by a summarization of those paragraphs, or by a combination of those two approaches. The PCC also redeliberated the scope, application, transition method, and effective date of the practical expedient. After redeliberating those issues, the PCC unanimously determined that the practical expedient would achieve the project's intended objectives. At its June 2021 meeting, the PCC will discuss a draft of the final Update and consider whether to recommend that it be subject to the FASB endorsement process.

Agenda Consultation: A PCC member provided a summary of the financial reporting issues that the Board should consider adding to its technical agenda and the priority of those issues, which were discussed during the closed PCC meeting that took place on April 19, 2021. Those issues included debt modifications, troubled debt restructurings, disclosure materiality, liabilities and equity, variable interest entities, and financial performance reporting. PCC members discussed their views with FASB Board members and staff on those potential areas for the Board to prioritize. PCC members also expressed support for the FASB's goodwill and segment reporting projects.

Goodwill—Triggering Event Assessment Alternative for Private Companies and Not-for-Profit Entities: FASB staff highlighted Accounting Standards Update No. 2021-03, Intangibles—Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events, which provides an accounting alternative that allows private companies and not-for-profit organizations to perform a goodwill triggering event assessment, and any resulting test for goodwill impairment, as of the end of the reporting period, whether the reporting period is an interim or annual period. This accounting alternative is expected to reduce the complexity for private companies and not-for-profit organizations when performing the goodwill triggering event assessment. The Board thanked the PCC and private company stakeholders for their involvement in developing this standard.

Profits Interests and Their Interrelationship with Partnership Accounting: FASB staff summarized outreach with taxation and valuation specialists that has been conducted since the December 3, 2020 PCC meeting. Key discussion areas with specialists included (1) typical circumstances surrounding the grant of a profits interest award, (2) common terms of profits interests, (3) how the language in Revenue Procedure 93-27 (which defines a profits interest for tax purposes) influences the terms of profits interests, and (4) how valuation techniques used to measure profits interests compare to valuation techniques used to measure other types of equity interests issued as compensation. FASB staff noted that next steps involve performing additional outreach and research focused on some of the key accounting issues on profits interests and analyzing the FASB's agenda criteria as it relates to identified issues. PCC members briefly provided feedback on the research performed so far and next steps.

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Current Issues in Financial Reporting: PCC and FASB members discussed practice issues arising from the current business environment under the COVID-19 pandemic. Topics discussed included disclosures related to COVID-19 and Paycheck Protection Program loan classification. The PCC also thanked the FASB for issuing certain educational documents in response to the current environment. Those documents include the FASB Staff Educational Paper, "Topic 470 (Debt): Borrower's Accounting for Debt Modifications," and the FASB Staff Q&A, "Topic 842 and Topic 840: Accounting for Lease Concessions Related to the Effects of the COVID-19 Pandemic."

Revenue—Post-Implementation Review: FASB staff solicited feedback from PCC members on their implementation experience with Topic 606, Revenue from Contracts with Customers, and on the post-implementation review plan for private companies. PCC members commented about their usage of the implementation resources provided by the FASB and discussed challenges and issues related to the adoption of Topic 606.

Disclosure of Supplier Finance Programs Involving Trade Payables: FASB staff summarized the features of supplier finance programs, provided an overview of the project, and solicited feedback from PCC members on the use of those programs by private companies. Although PCC members generally had not encountered the arrangements from the perspective of the entity for which the Board is evaluating potential disclosures, certain PCC members discussed their experience in accounting for the programs and with factoring transactions more broadly. The PCC chair offered to perform outreach with private company stakeholders during upcoming PCC Town Halls to further gauge the use of the programs among private companies.

Leases (Topic 842)—Discount Rate for Lessees That Are Not Public Business

Entities: FASB staff provided the PCC with an overview on this FASB project, which was added to the FASB agenda on April 14, 2021. This project seeks to amend the accounting policy election for lessees that are not public business entities to elect to use the risk-free rate as the discount rate by asset class. A PCC member offered preliminary feedback and volunteered to discuss further with the FASB staff at a later date.

Simplifying the Balance Sheet Classification of Debt: FASB staff provided the PCC with an update on this FASB project. At its April 14, 2021 meeting, the Board discussed comments received on and redeliberated the proposed amendments in its January 2017 proposed Accounting Standards Update and its September 2019 proposed Accounting Standards Update (Revised), Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). At that meeting, the Board removed this project from the FASB technical agenda.

The next PCC meeting is scheduled for Monday, June 21, and Tuesday, June 22, 2021.

FASB ABANDONS PROJECT TO SIMPLIFY THE BALANCE SHEET CLASSIFICATION OF DEBT

On April 14, 2021, the FASB removed the project to simplify the balance sheet classification of debt from its agenda.

Objective:

The objective of this project was to provide guidance that would reduce the cost and complexity of determining the current versus noncurrent balance sheet classification of debt.

Background:

The project on simplifying the balance sheet classification of debt was added to the technical agenda in August 2014 as part of the Board's Simplification Initiative. The objective of that initiative was to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity could have been reduced while maintaining or improving the usefulness of the information required to be reported by an entity.

Stakeholders told the Board that the guidance on determining whether debt should be classified as a current liability or a noncurrent liability in a classified balance sheet is overly complex. To reduce complexity, the current narrow-scope guidance would have been replaced with principles-based guidance.

On January 10, 2017, the FASB issued the proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). In the 2017 proposed Update, the Board proposed replacing the existing narrow-scope, fact-specific guidance in Topic 470 with an overarching, cohesive principle for debt classification. The due date for comment letters was May 5, 2017.

During re-deliberations on the 2017 proposed Update, the Board added proposed requirements to preclude the consideration of unused long-term financing arrangements and to allow the consideration of grace periods. No other significant changes to the 2017 proposed Update were made. There also were clarifications and revisions made to several aspects of the 2017 proposed Update, including scope, debt settled in equity, debt-covenant waiver conditions, and disclosures.

On September 12, 2019, the FASB issued a revised proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). The purpose of re-exposure was to raise awareness of the revisions with all entities, including private company and not-for-profit organization stakeholders, and to identify unintended consequences of the proposed guidance. The due date for comment letters was October 28, 2019.

Final Project Update:
In April 2021, the Board discussed comments received on and redeliberated the proposed amendments in its January 2017 proposed Accounting Standards Update and its September 2019 revised proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent).

Some Board members preferred to move forward with finalizing the project, noting that the proposed classification principle was operable and would have provided decision-useful information to financial statement users. However, the majority of the Board members noted that the proposed amendments would not achieve the objective of the project and would replace the current cost and complexity with new cost and complexity. Therefore, the Board removed the project from its technical agenda.

PROJECTS THE FASB IS WORKING ON RIGHT NOW

As of May 17, 2021, the FASB is working on the following projects:

- Identifiable Intangible Assets and Subsequent Accounting for Goodwill
- Accounting by a Joint Venture for Nonmonetary Assets Contributed by Investors
- Codification Improvements (formerly Technical Corrections and Improvements)
- Codification Improvements (formerly Technical Corrections and Improvements)
- Codification Improvements – Financial Instruments – Credit Losses (Vintage Disclosure: Gross Write-offs and Gross Recoveries)
- Codification Improvements—Hedge Accounting
- Consolidation Reorganization and Targeted Improvements
- Distinguishing Liabilities from Equity Phase 2
- Effect of Underwriter Restrictions on Fair Value Measurements
- Fair Value Hedging—Portfolio Layer Method
- Improving the Accounting for Asset Acquisitions and Business Combinations (Phase 3 of the Definition of a Business Project)
- EITF Issue No. 19-C, "Issuer's Accounting for Certain Modifications of Freestanding Equity-Classified Written Call Options"
- Leases (Topic 842)—Discount Rate for Lessees that are Not Public Business Entities
- Leases (Topic 842): Lease Modifications
- Leases (Topic 842): Lessors—Leases with Variable Lease Payments
- PCC Issue No. 2018-01, Practical Expedient to Measure Grant-Date Fair

Value of Equity-Classified Share-Based Awards

- Recognition and Measurement of Revenue Contracts with Customers under Topic 805

- Reference Rate Reform

- Disclosure Framework—Disclosure Review: Income Taxes

- Disclosure Framework—Disclosure Review: Inventory
- Disclosure Framework: Disclosures—Interim Reporting

- Disclosure Improvements in Response to the SEC's Release on Disclosure Update and Simplification

- Disclosure of Supplier Finance Programs Involving Trade Payables

- Disclosures by Business Entities about Government Assistance

- Financial Performance Reporting—Disaggregation of Performance Information

- Segment Reporting

Details on each project can be found on the FASB's website under the PROJECTS/ Technical Agenda tab at www.fasb.org.

PROPOSED NEW AUDITING STANDARD ENHANCES COMMUNICATION BETWEEN PAST AND POTENTIAL NEW AUDITORS

On February 25, 2021, the American Institute of CPAs (AICPA) Auditing Standards Board (ASB) issued the exposure draft (ED) Proposed Statement on Auditing Standards (SAS) Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations (NOCLAR) to amend SAS No. 122, as amended, section 210, Terms of Engagement.

The standard requires immediate past auditors and presumed successor auditors, once management consents to the past auditor responding, to communicate about potential NOCLAR situations. Examples of NOCLAR situations include, but are not limited to, noncompliance with tax or pension laws and regulations.

"The Board's overall objective is to help auditors properly understand potential issues in determining whether to accept an engagement," said Jennifer Burns, CPA, AICPA Chief Auditor. "The proposed standard is designed to further the public interest by enhancing communication between past and potential new auditors. A refusal to consent by the client would be a significant red flag that the auditor would consider in determining whether to accept the engagement."

The proposed SAS aligns with the International Ethics Standards Board of Accountants (IESBA) standards which became effective on July 15, 2017. It narrowly amends AU-C section 210 in AICPA Professional Standards to require an auditor, once management approves communication between auditors, to inquire about suspected fraud and matters involving NOCLAR.

Interested parties are encouraged to submit their feedback to the ASB at CommentLetters@aicpa-cima.com by June 30, 2021. Readers are encouraged to also consider and comment on the AICPA Professional Ethics Executive Committee's (PEEC) exposure draft of proposed interpretations and definitions on this topic (comments also due by June 30, 2021).

You can find more information on the NOCLAR ED at www.aicpa.org.