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October 17, 2016

Via email to [director@fasb.org](mailto:director@fasb.org)

Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 2016-290, Agenda Consultation

Dear Ms. Cospers:

We are pleased to respond to the Board's invitation to comment on the future of its technical standard-setting agenda. With the recent issuance of several major standards, we agree it is a natural point for the Board to reevaluate the areas on which it should focus moving forward. In this light, we discuss a number of important topics below that warrant the Board's attention.

However, we believe the Board can also effectively serve the financial reporting community by moderating the pace of its standard-setting activity.

In 2007, we addressed the pace of change in accounting standards in our comments to the SEC's advisory committee on improvements to financial reporting. At that time, we cited a steady stream of new FASB Statements, Interpretations, and Staff Positions, new EITF Consensuses, and new SEC Staff Accounting Bulletins. We also noted the introduction of comprehensive management and auditor reporting on internal control and numerous other SEC rule changes adopted to implement the Sarbanes-Oxley Act. In addition, there were significant changes in auditing standards. Further, all this change occurred at the same time that the SEC accelerated filing deadlines. While the individual new requirements often have been complex, the burden of complexity is magnified by the sheer number of new requirements.

This trend has continued, and even accelerated. Since the Accounting Standards Codification became the single source of authoritative GAAP in 2009, there have been more than 125 Accounting Standards Updates, including three of the most important standards ever—revenue recognition, credit impairment and leases.

We believe that standards setters and regulators should explicitly consider this problem when deciding whether standards and rules really need to be changed and, if so, when. In this context, the absence of a single comprehensive standard for revenue, the delayed recognition of incurred losses for loans and the enormous amount of off-balance sheet financing all represented compelling cases for those standards. However, few of the remaining ASUs addressed such pressing matters.

The pace of change could be managed by "bunching" the implementation dates of new standards, providing reasonable periods of stability in between. For example, all new accounting standards

issued from 2017 through 2019 would be effective for fiscal years beginning after December 15, 2020, and all standards issued from 2020 through 2022 would be effective for fiscal years beginning after December 15, 2023. Private companies would typically have an additional year. This would allow three years of stability between required accounting changes, and would allow preparers to implement groups of accounting changes at one time.

We believe this would be less disruptive for constituents than the continual introduction of new requirements. In the near term, it would also allow companies with limited resources to devote their time and attention to all of the recently issued standards that have not yet taken effect, especially revenue, leases and credit impairment. To the extent the FASB can contribute to effective implementation efforts by allowing preparers and auditors to focus on the current slate of new standards, users and regulators will benefit from the resulting financial reporting improvements.

Beyond these points, we've responded to the ITC's primary questions in the Appendix to this letter.

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We would be pleased to discuss our comments with the FASB staff. Please direct questions to Adam Brown, National Director of Accounting at (214) 665-0673 or Christopher Tower, National Managing Partner - Audit Quality and Professional Practice at (714) 668-7320.

Very truly yours,

A handwritten signature in blue ink that reads "BDO USA, LLP". The letters are cursive and slightly slanted.

BDO USA, LLP

**Question 0.1: Are there major financial reporting issues that are not considered in this ITC that should be addressed by the FASB before any of the issues discussed in the ITC are addressed? What are the considerations or criteria that you used to identify these issues? Please describe any of those issues and your perspective about how the FASB should resolve the issues.**

We believe the list of issues contemplated in the ITC is reasonably complete. We commend the FASB in its outreach efforts to identify potential areas for improvement, which included a cross-section of financial reporting constituents.

While we do not feel it necessarily needs to be addressed before the ITC projects, we believe the Board should consider adding a major project on when the reporting entity should adopt a new basis of accounting. This subject was raised in deliberations related to the project on pushdown accounting,<sup>1</sup> but was beyond its scope. However, there are common transactions in practice today for which little or no guidance exists, such as whether a joint venture should record the receipt of its initial contributions at fair value or carryover basis. And while guidance exists for certain loss of control transactions, such as a spinoff or an initial public offering, there are diverse views on whether fair value or carryover basis *should* apply in those situations. We suggest addressing new basis for these reasons, which are both practical and conceptual.

As an initial step to aid the Board in addressing this project, we recommend revisiting the underlying discussion material for projects related to the question of new basis, such as the projects related to pushdown accounting, fresh-start accounting, and the liquidation basis of accounting. That said, we acknowledge this project would be a significant undertaking.

In addition, we are supportive of the FASB's work to clarify the definition of a business, particularly Phase 3 with the potential to align the accounting for acquisitions and dispositions of businesses and assets.

**Question 0.2: What is your view about the priority of addressing the major financial reporting issues addressed in this ITC? In other words, is addressing one or more of the issues more critical than others? Please describe your assessment criteria and why you prioritized certain issues above others.**

We rank the four topics listed on page two of the ITC from 1-4 as follows, with 1 being the most important:

1. Distinguishing liabilities from equity
2. Intangible assets (including research and development)
3. Reporting performance and cash flows (including income statement, segment reporting other comprehensive income and statement of cash flows)
4. Pensions and other postretirement benefit plans

Our perspective on the relative importance of these projects is largely a function of the companies and markets we serve. Capital-raising is a central and ongoing characteristic of middle-market companies, both public and private. However, it is not limited to those companies. For instance, the 2008 timeframe included the issuance of preferred stock and warrants by some of the very

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<sup>1</sup> ASU No. 2014-17, *Pushdown Accounting*

largest issuers as part of the Troubled Asset Relief Program (TARP). In that context, staff from the FASB and SEC reasonably concluded certain provisions in GAAP that would have negatively impacted public policy should not be applied in an overly-stringent matter.<sup>2</sup> That scenario highlights one example of the counterintuitive results that are common in accounting for instruments with characteristics of both liabilities and equity.

Further, the difficulty of correctly navigating and applying the literature in this area contributes to a high volume of restatements, compared to other parts of the accounting standards. Indeed, errors related to accounting for debt and equity have been the single most frequent cause of restatements for the past decade, according to a recent study by Audit Analytics.<sup>3</sup> While the contractual features of these instruments create a certain amount of unavoidable complexity, the lack of a cohesive accounting framework contributes significantly to the challenges that practitioners routinely face using today's patchwork of individual standards.

These factors—a large number of entities raising capital, questionable accounting outcomes in certain situations and persistent restatements—lead us to conclude the Board should place this project near the top of its technical agenda.

With respect to intangible assets, we note that topic encompasses a broad range of transactions, technology and business activities that have evolved significantly since the issuance of Statement No. 2<sup>4</sup> in 1974. As a result, the market capitalization of some companies is driven almost entirely by items that are not recorded on their balance sheets. Historically, concerns about the ability to estimate the fair value of intangible assets have contributed to this situation. With the implementation of Statement 157<sup>5</sup> and developments in the valuation community since then, we agree this subject is ready to be reconsidered by the FASB. In this light, we also support the FASB's current efforts to simplify the goodwill impairment model, for both public and private entities.

Reporting financial performance and cash flows is obviously a key area since it directly impacts how financial statement users perceive and analyze companies. However, we are not optimistic that substantial improvements can be made while at the same time maintaining a consensus across stakeholder groups that the changes, are in fact, positive. Whatever its inherent limitations (such as the lack of a principle for the collection of items recorded in other comprehensive income), the basic set of financial statements is generally understood by most constituents. A major change in the presentation that has been used for decades will likely be met with confusion. For example, using multiple columns, or perhaps a matrix, in the income statement to disaggregate different types of changes in the same reporting period (e.g., fair value vs. all other items affecting net income; or "operating" vs. "non-operating" expenses) may confuse users. We also note institutional investors make use of technology to quickly process and identify key areas in the financial statements and footnotes; that is, they do not necessarily read the complete set of financial statements from front-to-back. To be clear, we do not oppose the Board's consideration of this

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<sup>2</sup> In an October 24, 2008 letter to the US Department of Treasury, the staff indicated it would not object if certain warrants were classified as equity instead of liabilities, despite an initial lack of "sufficient authorized but unissued shares of the class of stock that may be required upon settlement and any other necessary shareholder approvals... If an issuer does not have required shareholder approval, including shareholder approval for sufficient authorized but unissued shares of the class of stock that may be required for settlement, we would also not object to classification of such warrants as permanent equity provided that the issuer takes the necessary action to secure sufficient approvals prior to the end of the fiscal quarter in which such warrants are issued."

<sup>3</sup> *2015 Financial Restatements, a Fifteen Year Comparison* issued April 2016.

<sup>4</sup> *Accounting for Research and Development Costs*

<sup>5</sup> *Fair Value Measurements*

area. We simply question whether the benefits will ultimately justify the costs associated with an overhaul of the basic financial reporting model.

We do not support adding a major project to address pension and other postretirement benefit plans because we observe a trend in which fewer companies are using them, while defined contribution plans and other forms of deferred compensation are becoming more common. We acknowledge there is a significant amount of money concentrated in a small number of plans, but we believe the number of entities and financial statement users that would benefit from a major project would be disproportionately small. We recommend limiting changes in this part of GAAP to specific, targeted improvements, such as eliminating the corridor method.

**Question 0.3: Is it necessary to resolve one or more of the issues before resolving others? In other words, is the resolution of any of the issues dependent upon the resolution of one or more other issues? Please identify any of the projects that should be completed before others and why.**

We recommend completing the conceptual framework first. The framework will assist the Board in setting long-term objectives and priorities to guide individual projects and provide consistency over time.

That said, we believe it is important to bear in mind that the conceptual framework reflects compromises among differing views of seven Board members. Therefore, conclusions reached in the conceptual framework are not immutable. If an existing accounting standard is inconsistent with the conceptual framework, that is not, in and of itself, a sufficient reason to change the existing standard. Existing standards that are inconsistent with the conceptual framework should be changed only if they are associated with an existing, identified practice problem or there is another compelling reason to change them.

The framework should assist the Board by “keeping the ball in the fairway” as particular projects are developed. If and when a conflict arises between an individual project and the framework, it should prompt a reconsideration by the Board, similar to the requirement in business combination accounting that requires double-checking valuations before recognizing a bargain gain. This would leave room for the Board to evaluate and conclude that a deviation from the framework is justified, based on the particular set of facts and circumstances. As such, we believe it is appropriate for the framework to continue residing outside of the Codification in a non-authoritative status.

### **Simplification Initiative**

We strongly support the FASB’s Simplification Initiative to make narrow-scope modifications and improvements to accounting standards through a series of short-term projects. As the Board also considers broad projects, we agree it should continue fine-tuning existing standards, as needed, to mitigate unnecessary cost and complexity. However, as mentioned in our cover letter, we believe all new standards should be aggregated for purposes of their effective dates to provide periods of stability. For many companies, even narrowly focused standards can require significant time and effort to implement. With that mind, we offer the following items for consideration:

- Addressing so-called “profits interests” - It is not unusual for private entities to issue contracts with varying features as a form of compensation to employees, which may or may

not represent a substantive class of equity for accounting purposes. It is often unclear whether particular instruments are within the scope of the share-based payments literature, deferred compensation literature or derivatives literature. The SEC staff highlighted the difficult judgments that are required in these scenarios, citing superseded guidance that was not incorporated within the Codification.<sup>6</sup> A project to establish a framework for evaluating the characteristics of these instruments and, therefore, the related accounting treatment would be helpful, particularly for pre-IPO companies.

- Eliminating the corridor method - As we indicated in our recent comments on the presentation of pension and postretirement benefit plans,<sup>7</sup> we believe pension accounting could be simplified by eliminating the corridor method. While this will lead to increased volatility, we believe most users will find it understandable, similar to considerations raised during the deliberations for ASU No. 2016-09,<sup>8</sup> which eliminated the “APIC pool” and requires an entity to record the tax-effects of stock compensation awards in earnings.
- Simplifying aspects of income tax accounting - We believe opportunities exist to simplify areas in Topic 740, such as the intraperiod allocation rules, the measurement of uncertain tax positions (e.g., using a best estimate approach), and additional examples of reassessing the valuation allowance. We would be pleased to discuss these matters in detail with the FASB staff.
- Providing real-time interpretive guidance - As the Board is aware, the large accounting firms, the AICPA and others regularly issue interpretive guidance to address detailed questions for which GAAP is silent or unclear. These publications arise due to market demand, which stems in part from the difficulty of reading amendments to the Codification (with underlines, strike-through font, etc.), as discussed below. Interpretative guidance can have the unintended effect of creating diversity in practice and the formation of so-called “shadow standard-setting.” If the Board redirected a substantial amount of its resources to increase the capacity and speed of staff responding to technical inquiries, some of these concerns could be mitigated by reaching a single FASB-staff view, which should be published on the FASB’s website and available to the general public.

## Concluding Comments

While we understand the Codification centralizes authoritative GAAP, it is less “user-friendly” than the prior FASB statements and related publications that employed a more plain-English narrative format. The Codification’s style has the unintended effect of making GAAP less legible than it should be. As such, we would be supportive of potential changes to simplify the style in which GAAP is currently promulgated. We believe this will enhance the effectiveness of the Board’s primary vehicle for communicating with its audience, which can only improve financial reporting in general.

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<sup>6</sup> See remarks of Joseph Ucuzoglu before the 2006 AICPA National Conference on Current SEC and PCAOB Developments, which referred in part to EITF Issue 00-23.

<sup>7</sup> See our comment letter at <https://www.bdo.com/getattachment/4e9fe264-34f0-490b-a84a-2baf15291edc/attachment.aspx?BDO-Comment-Letter-Presentation-of-Pension-Costs-2016-200.pdf>.

<sup>8</sup> *Improvements to Employee Share-Based Payment Accounting*