

Remarks of Russell G. Golden
Chair, Financial Accounting Standards Board
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Good morning. It's a pleasure, as usual, to be with you here today in Washington for the annual AICPA-SEC conference.

I listened with great interest to the remarks made yesterday by Mary Jo White, chair of the Securities and Exchange Commission; James Schnurr, the SEC's chief accountant; and James Doty, chair of the Public Company Accounting Oversight Board.

I was especially heartened to hear both Chair White and Chief Accountant Schnurr remind this audience about the importance of maintaining independence from the influence of politics and special interests as we work together to set financial accounting and reporting standards.

The FASB in its 42 years has had its independence challenged on a number of occasions. I'm reminded of the comments made by former SEC Chair Arthur Levitt after the dust settled in the first fight over the expensing of stock options—in the mid-1990s.

You'll recall that the FASB had proposed that companies should be required to record the value of outstanding stock option grants. In 1994, the U.S. Senate, led, of all people, by our Senator from Connecticut, sided with FASB critics in the business community and passed a resolution condemning the stock option proposal—by a vote of 88 to 9.

Said Levitt: "There was no question in my mind that campaign contributions played the determinative role in that Senate activity."

Concerned that moving forward with the proposal could ultimately threaten the FASB's existence, Levitt urged the Board not to proceed. The FASB acquiesced. In a 2002 interview with the PBS program "Frontline," Levitt called his action "the single biggest mistake I made in my years at the SEC."

That story is a reminder of the fragility of the FASB's independence—and the importance of our ultimate accountability to all—not just some—of our stakeholders. And that's why I was so impressed by the strong stand for independence taken yesterday by Chair White and Chief Accountant Schnurr. I'll come back to this theme at the end of my remarks.

Today, I'd like to spend my time talking to you about several topics that I believe you'll find of interest.

But before I begin, let me remind you that the thoughts that I'll express here today are solely my own and that I'm not speaking on behalf of the FASB.

First, I'd like to share with you my thoughts on the progress we've made implementing our revenue recognition standard.

Then I'd like to talk about what we've learned from that effort, and how it will inform our implementation efforts on another upcoming project—impairment of financial instruments.

I'll also note the challenges we face in delivering accurate information about the project to our stakeholders, given the torrent of misinformation that seems to be flooding the marketplace.

Then I'll take a quick look at some other important projects nearing completion—disclosure framework, hedging, definition of a business, and leases. Sue Cosper will explore these in more depth during her presentation.

From there, I'll move to a discussion of our future agenda.

And finally, I'll to return for a moment to the importance of maintaining independence in the standard-setting process.

Revenue Recognition

So let me begin with the revenue recognition implementation process. As you know, we created the Revenue Recognition Transition Resource Group to help us manage implementation issues for the new revenue recognition standard. The standard takes effect for public companies in 2018 and for private companies in 2019.

The FASB has experimented with different ways of handling implementation issues in the past, but we believed the formation of this group, jointly with the International Accounting Standards Board, would be the best way to proceed. We hoped that this process would limit the extent to which preparers disagree on how to interpret the standard prior to its effective date. As it turns out, I think we were right.

The TRG was successful in many ways. Most significantly, the TRG's creation permitted the continuation of our joint effort with the IASB to achieve global comparability in revenue recognition.

A wide spectrum of stakeholders around the globe were involved with the TRG effort, including preparers across industries, auditors, users, regulators, the Private Company Council, and the AICPA. Their input helped us quickly identify issues that might lead to diversity in practice—before the initial implementation of the standard.

In addition, our experience with the TRG helped us to find additional practical expedients that should reduce cost and complexity both at implementation and on an ongoing basis, without significantly changing the quality of the information reported to investors and other users of financial statements.

You'll recall that we issued three Exposure Drafts based on feedback from the TRG. We believe that those proposals will improve the standard's consistency of application and reduce its costs and complexity. Of the 87 implementation questions submitted to us by stakeholders, 98 percent already have been discussed with the TRG or resolved through discussions with the staff.

While most of the issues discussed at the TRG have not resulted in standard-setting action, the discussion has helped to educate stakeholders about the new standard. Publishing the minutes of the TRG meetings further aided our efforts to keep stakeholders informed about the prevailing thought process behind various issues.

Finally, the TRG process resulted in our posting nearly 50 staff papers about implementation questions to our website.

Although these papers are not authoritative, they are excellent educational tools and offer appropriate real world examples of how the new standard should be applied.

The Exposure Drafts and final guidance we've issued to improve the revenue recognition standard were intended to make improvements that will save a lot of cost without impacting the quality of information provided to investors. We'll determine if and when to schedule additional TRG meetings based on additional issues submitted. To the extent there's still more to do, we'll do more.

Before we move on, let me say a word about how the FASB and IASB revenue recognition standards relate to each other.

First, and most importantly, the standards are converged in all significant areas. However, there are currently a few minor areas where they differ. For example:

- Collectability of consideration must be probable before an organization applies the revenue guidance. "Probable" has slightly different meanings under Generally Accepted Accounting Principles and International Financial Reporting Standards.
- Public companies applying GAAP will be required to make the quantitative disclosures on a quarterly basis. These disclosures include disaggregation of revenue, contract balances, revenue recognized in the current period that was included in the contract liability at the beginning of the period, revenue recognized in the current period for performance obligations satisfied in previous periods, and remaining performance obligations. Companies applying IFRS will apply the existing interim disclosure guidance to assess what disclosures about revenue may be necessary, without having specific interim revenue disclosure requirements, except for disaggregation of revenue.
- It currently is unclear whether the IASB will propose changes similar to what the FASB will propose as part of its Identifying Performance Obligations and Licensing and Narrow-Scope Improvements and Practical Expedients Exposure Drafts.

Impairment of Financial Instruments

Let me move on to a discussion of the impairment project. We intend to apply the lessons we learned on implementing the revenue recognition standard to the implementation of our upcoming project on impairment.

As you know, the new impairment standard will require a forward-looking "current expected credit loss"—or CECL—model instead of the "incurred loss" approach in effect today. The CECL model uses a single "expected credit loss" measurement objective for the allowance for credit loss.

The new standard will require that the balance sheet reflect the net carrying amount of a financial asset (net of allowance for credit losses) at the amount an organization expects to collect. The Board expects to publish a final ASU on credit losses in early 2016.

Public businesses that meet the definition of an SEC filer will be required to apply the guidance for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

As a result of the success we had with the revenue recognition TRG, we have created a transition resource group for impairment. The group, led by FASB Member Larry Smith, already has met to identify any significant issues requiring the FASB's attention before we issue the standard.

One of the **major issues** the TRG must deal with is the **cascade of misinformation about the impairment standard**. Some of that misinformation may be due to a lack of understanding of what the standard will require. But some may be due to...who knows?

Let me take just a moment to address the **most troubling misconceptions or concerns that are being circulated about the impairment standard**.

*One: The **new standard will require businesses to develop and install costly, complex new systems**.*

That's simply **not true**. In the underwriting process, most banks—including small community banks—already make some kind of lifetime loss assessments. I would find it very surprising to learn that any lending institution is not already making **some type of assessment**. Without this assessment how can management charge sufficient interest on a pooled basis to cover losses?

With this standard, the **FASB is saying** is: **"Continue to do what you're doing—just make sure your expectation of the future is included in your loan loss reserves."** We are **not asking banks to change their methods of estimating losses**, but we **are requiring banks to change the assumptions used**. Nor are we asking banks to look forward 20 or 30 years—we are **requiring assumptions only as long as there exists reasonable and supportable data about the future, generally two to three years**.

*Two: **Bank examiners will take a more conservative view**.*

We are working with banking regulators, with whom we meet regularly, to address these concerns. We've told the banking regulators about the volume of misinformation in the market place, and how we plan to deal with it.

Fed Chair Janet Yellen, in an address to community bankers last year, noted that the **Fed "has stressed to the FASB that its proposal should not require community banks to utilize complex modeling processes"** and that the Fed **"expect[s] that a final standard will permit loss-estimation techniques that build upon current credit-risk management techniques used by community banks."** The **new standard will be consistent with the approach outlined by Chair Yellen**.

In fact, we already are working on educational materials about the new standard that the banking regulators will be able to use to help educate their field examiners.

*Three: **The credit crisis involved only large banks**.*

In 2007, the FDIC closed three banks. In 2008, the FDIC closed 25 banks. In 2009, the FDIC closed 140 banks. Nearly all of those 168 banks were small, community banks. Clearly, community banks have been a major part of the problem. Based on these statistics, the FASB felt it was important that all lending institutions be included in the new guidance.

*Four: **The standard takes an unrealistic view of the economics of loan financing**.*

The FASB simply wants banks to reflect the true economics of their loans. We know—and they know—there are losses associated with the loans.

We're just trying to get them recognized today before the bank goes "belly up" tomorrow. The CECL model was developed based on extensive feedback from stakeholders.

In fact, this issue was brought to the FASB's attention by a group of financial statement preparers who were concerned about the high threshold for recognizing loan losses and requested that the FASB change the existing incurred loss model.

During a meeting, they told us that they knew there were losses within these assets, but the high probability threshold in current GAAP prevented them from booking losses—even when there's a substantial amount of risk in those loans. In other words, current GAAP was prohibiting banks from looking forward.

The credit crisis of 2008 underscored the need for a more forward-looking model—one that gives preparers the opportunity to recognize losses that exist in the loan portfolio, and recognize them up front. Many aspects of the CECL model in its current form were developed in direct response to bank stakeholders, who provided feedback intended to reduce the cost and complexity of implementation.

Other Projects

Now I'll turn to a discussion of some of the other projects that are in various stages of development.

Disclosure Framework

One recent project that has attracted a lot of attention is our project on materiality, which is part of our overall disclosure framework project. The FASB on September 24 issued for public comment two Exposure Drafts related to this project.

One Exposure Draft would amend FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*. A second Exposure Draft is the proposed Accounting Standards Update (ASU), *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures are Material*.

This proposed ASU is intended to clarify the process that companies and other filers of financial reports follow in assessing the materiality of information included in their notes to financial statements.

Let me be very clear: In neither of these Exposure Drafts is there any attempt to change the accepted, working definition of materiality. The amendment to Concepts Statement 8 would conform the FASB Conceptual Framework—which helps guide the FASB's standard-setting process—to the existing definition of materiality that is used by the SEC—and the PCAOB.

The proposed amendment would not change the legal definition of materiality—the FASB does not have that authority. The amended Concepts Statement would apply only to the Board's observation of materiality as part of its standard-setting process. The proposed amendment would not apply to preparers and auditors.

The proposed ASU would clarify, but would not change what we understand to be the predominant current practice related to the assessment of materiality by companies and other filers.

The ASU states that the concept of materiality is applied to both quantitative and qualitative disclosures individually and in aggregate. It refers to materiality as a legal concept and it clarifies the concept currently included by indicating that omission of immaterial information in disclosures is not an accounting error.

Stakeholders have stated often that certain disclosures may be relevant to other organizations, but that they do not provide relevant information in their circumstances. They also requested that GAAP specifically address assessments of materiality.

The ASU clarifies a longstanding provision of GAAP that companies need not apply FASB standards to immaterial items. Specifically, the proposed clarification indicates that companies need not include immaterial information in their financial report disclosures. Put another way, failure to disclose immaterial information is not an accounting error.

As I mentioned, the two Exposure Drafts related to materiality are components of a broad, three-phase project that seeks to improve the effectiveness and relevance of disclosures in notes to financial statements.

The disclosure framework project includes three phases, each comprising multiple elements.

In Phase One, the Board's decision process, we will outline how the FASB conceptually should think about disclosures. The Concepts Statement is important because historically the Board's approach regarding disclosures has been inconsistent. In some areas, the Board has required many disclosures; in others, very few.

In Phase Two, the entity's decision process, we will look at how the reporting organization decides what are or are not appropriate disclosures. The ASU on the process that reporting organizations undertake to assess materiality falls into this category.

Finally, in Phase Three, we will re-examine existing disclosure requirements in certain accounting standards in the context of the disclosure framework.

Those areas include income taxes—where some investors believe there are not enough disclosures, fair value, and pensions—where some preparers believe there are too many disclosures. We issued the Exposure Draft on fair value last week.

As part of this look-back, the FASB expects to increase disclosures that are relevant to investors and remove disclosures that are irrelevant.

To date, the Board has made preliminary decisions to add disclosures on income taxes (including disclosures related to domestic and foreign tax exposure), fair value (including disclosures related to unrealized gains and losses included in other comprehensive income and earnings), and pension plans (including disclosures related to plan descriptions and the reasons for significant gains or losses).

The Board is considering removing some disclosures on fair value and pension plans generally viewed by investors as irrelevant.

Hedging

A few years ago, the FASB initiated a project to improve hedge accounting. Both investors and preparers told us they believe that the current hedge accounting rules do not appropriately

reflect potential risk-mitigation strategies into which companies have entered, because they are rule-oriented and fairly rigid.

We issued an exposure document on this subject a number of years ago. We put the project on hold because we wanted to finish classification and measurement, and impairment. In 2015, we returned to the project and conducted substantial redeliberations.

To date, we have received positive feedback that the proposed amendments will allow companies to better reflect their risk-mitigation strategies and enable users to better understand them. We expect to issue an exposure draft sometime during the first half of 2016.

Definition of a Business

Last month, we issued a proposed ASU that would clarify the definition of a business. The object is to add guidance to assist reporting organizations with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The comment deadline is January 22, 2016.

The definition of a business affects many areas of accounting, including acquisitions, disposals, goodwill impairment, and consolidation. However, many stakeholders have said that the current definition of a business is applied too broadly, requiring many transactions to be treated as businesses when they should be treated as assets.

They also noted that analyzing such transactions is costly and complex—concerns that also were raised in connection with the Post-Implementation Review Report on FASB Statement No. 141 (revised 2007), *Business Combinations* (Statement 141(R)).

The guidance in this proposed ASU would address these concerns by providing a more robust framework for determining when a set of assets and activities is a business. The framework would provide more consistency in the application of the guidance, reduce the costs of its application, and make the definition of a business more operable. We encourage you to review and comment on our proposal.

Leases

Finally, I'll say a few words about our leases project, which has been in the news lately. We plan to issue our final leases standard early in the new year.

Since embarking on this project a decade ago, the FASB actively sought and received broad input from stakeholders. That input includes more than 1,740 comment letters from a wide variety of industries on multiple documents, including a 2009 Discussion Paper, a 2010 Exposure Draft, and the 2013 Exposure Draft.

Those industries include financial services, transportation, extractive industries, retail, real estate, manufacturing, telecommunications, information technology, power and utilities, consumer products, professional services, insurance, engineering and construction, and diversified companies.

Let me note here that, given the extensive input we have received on this project over a number of years, we are not planning to create a Transition Resource Group for leases.

That said, we will carefully monitor our discussions with stakeholders during the implementation process and stand ready to further ramp up our education efforts if we believe it will be helpful.

Returning to the project history, feedback from the May 2013 Exposure Draft confirmed that the overwhelming majority of stakeholders believe that leases should be recognized on the balance sheet. However, stakeholders did not agree on how operating leases should be reflected in the income statement or the statement of cash flows.

As a result, during redeliberations, the FASB decided to retain existing GAAP in the income statement with respect to the distinction between leases that are accounted for as an in-substance purchase and those that are accounted for as operating leases. The FASB believes that this decision will enable companies to leverage existing systems and processes and mitigate against significant cost increases for preparers.

The FASB also heard concerns about the impact that additional liabilities on companies' balance sheets will have on debt covenants and on accounting judgments. The FASB undertook extensive research and outreach with lenders to understand the issue more fully. Academic papers on debt covenants indicated that covenant violations caused by mandated accounting changes are not typical in practice.

Further, discussions with lenders have shown that recording lease assets and liabilities in the financial statements will not significantly impact a company's ability to borrow. This is because most lenders currently adjust financial statements to recognize lease liabilities when making lending decisions.

As a result, lenders told the FASB that the addition of lease liabilities to a company's balance sheet will not alter a lender's view of the organization's financial position. Lenders often estimate a far greater liability for leases than will be capitalized under the FASB's proposals.

To further mitigate concerns, the FASB has decided that most lease liabilities should be characterized as operating obligations in the financial statements rather than obligations that are equivalent to debt. This decision recognizes that most lease obligations are not treated like debt in situations such as bankruptcy of the lessee.

Based on research the FASB performed with private company financial statement users, this decision will address issues for many smaller companies that have debt covenants based principally on debt-to-tangible net worth ratios, because lease liabilities will not factor into that calculation.

Last month, the Board decided that for public companies, the upcoming standard will be effective for fiscal years (and interim periods within those fiscal years) beginning after December 15, 2018; for private companies, the standard will be effective for annual periods beginning after December 15, 2019. Early adoption will be permitted for all companies and organizations upon issuance of the standard.

Let me add that an assessment of the costs imposed by the new leases standard and the benefits the standard is expected to provide will be included in the basis for conclusions in the final Accounting Standards Update.

The assessment will include detailed information from the FASB's meetings with several hundred stakeholders representing public, private, and not-for-profit organizations, which reflected the perspectives of both lessees and lessors.

In these meetings, stakeholders specifically discussed the costs, such as additional personnel, time, or accounting systems, and relevance of various lease accounting models under consideration.

Generally, the FASB's assessment of benefits and costs includes clearly identifying the need for a change to GAAP and reasonable alternatives, understanding and assessing the expected benefits and costs of each possible alternative, and evaluating and comparing the cost effectiveness of reasonable alternatives.

This analysis considers the relevance, significance, and accuracy of the information to financial statement users; effects on the comparability of reported financial information domestically and internationally; and the effort and cost involved in implementing the change, including collecting, preparing, distributing, and using the information.

With regard to the potential economic impact and behavioral effects, the proposed leasing standard, like all accounting standards, is intended to reflect—not drive—economic activity and behavior and to promote reporting that neutrally reflects in the financial statements a company's activities.

Our aim is to create a neutral playing field that enables investors, lenders, and other users of financial statements to make their own independent judgments about where to invest, based on the best possible information available.

To that point, the FASB is not a government agency, accounting standards are not regulations, and the FASB does not make economic policy decisions. The FASB recognizes that accurate financial reporting can have economic consequences, both positive and adverse.

The FASB's objective in analyzing those concerns is to determine, to the best of its ability, whether those potential consequences are the natural result of more relevant and neutral financial information or the consequence of unintentional bias resulting from the proposed standard.

In other words, the FASB constantly assesses and re-assesses the neutrality of the information that would result from a proposed accounting standard.

If an analysis reveals that proposed financial reporting outcomes are representationally faithful and neutral, complete in all material respects, and presented in a way that allows users to comprehend its meaning and significance, then the perceived adverse consequences would be the result of a better-informed realignment of capital.

In this case, the Board does not attempt to alter financial reporting to mitigate such effects, because doing so would be to bias the reporting in favor of a particular company or organization, which could reduce its usefulness.

Future Agenda

Let me move on to a discussion of our future agenda.

Last spring, the FASB’s principal advisory group, the Financial Accounting Standards Advisory Council—or the FASAC—conducted a survey of its members, as well as members of our other advisory groups, who represent a cross section of our stakeholders.

The survey respondents were asked to weigh in on the following questions:

- What are the most needed financial reporting improvements and why?
- Related to that, what is the problem and what are feasible alternatives?
- When is the solution needed, and for whom?

Those surveyed ranked the following five projects as top priorities for the Board:

- Financial performance reporting
- Improving cash flow classification
- Pensions and other post-retirement benefits
- Liabilities and equity
- Intangible assets

Segments was voted #1 for investors, yet last by preparers.

The survey results will be summarized in a FASB discussion paper to be issued in early 2016. The discussion paper will afford all of our stakeholders an opportunity to tell us whether they agree or disagree on areas of improvement we have identified—and why.

We’ll also want input on other potential issues, possible standard-setting solutions, and prioritization. In other words, what do our stakeholders consider our most important, “big-ticket” items?

I believe that identifying the issues we should be working on—that is, those issues that can be addressed through standard setting—brings us more than halfway toward a successful conclusion.

To develop the right solutions, we must first identify the right problems. And that means listening—carefully—to our stakeholders’ experiences, input, and concerns. This feedback will help us better understand what concerns dovetail with those of our international counterparts—and whether there’s an opportunity to work toward converged solutions. This will be your opportunity to share your views on our agenda, and we want to hear from you.

Conclusion

In conclusion, let me return to some thoughts on the importance of independence in standard setting.

You’ll note that I’ve discussed a number of projects—impairment, leases, and materiality, to name a few—about which there has been substantial disagreement among our stakeholders, and in some cases, among members of the Board.

It’s our job to sort through all of those conflicting opinions and to take the action that we believe will best meet the needs of investors and others who use financial reports.

Our mission at the FASB is to set standards that accurately reflect economic transactions, and provide investors and other users of financial reports with the information they need to make decisions about how to invest their capital.

It is our duty as we work through the standard-setting process to take into account all points of view, including those of the investors and other financial statement users, as well as preparers and auditors.

Our independence from political and special interest influence is important because, in the end, we are not in the business of picking winners and losers. Our job is to set standards that promote the reporting of useful information to those who make the decisions that drive our capital markets.

In a coda to the stock option story I shared earlier, I would point out that the FASB, with its independence strengthened, revisited the stock option issue—after the collapse of Enron—and adopted the lion’s share of the standard it had originally considered in the early 1990s.

Without the interference, perhaps that standard would have been adopted sooner. Who knows what the result of that might have been?

Thank you very much for your time. I’m happy to take a few questions.

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