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Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116

Norwalk, CT 06856-5116

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The Accounting Principles Committee of the Illinois CPA Society (“Committee”) appreciate the opportunity to provide their perspective on the Invitation to Comment (“ITC”), *Agenda Consultation*. The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

We appreciate the Board’s efforts to seek input into its agenda now that it has completed many of its major projects and we are supportive of the goal to reduce complexities in financial reporting while improving financial reporting through more consistent standards that increase the value and relevance of financial reporting to stakeholders.

Of the issues identified in the ITC, we believe the Board should prioritize a project to address the accounting for internally-developed intangible assets. We do not believe the other issues identified in the ITC represent major financial reporting issues that the FASB should address. While not identified in the ITC, we believe that the FASB should add a project on accounting by joint ventures for assets and/or businesses received at formation to its agenda, as described at the end of this letter.

**Chapter 1 – Intangible Assets (including Research and Development)**

We believe that the accounting for internally-developed intangible assets is a major financial reporting issue that the FASB should address. We do not believe the Board should address internally-developed intangible assets broadly, but should focus on accounting for development costs. In that regard, we believe the FASB should align with the guidance in IAS 38, *Intangible Assets*. The guidance in IAS 38 has been applied for many years by companies complying with International Financial Reporting Standards. While the Board notes in the ITC that pharmaceutical companies have not generally capitalized significant development costs, we note that automakers *have* capitalized significant development costs. We understand that IAS 38 requires the application of judgment and that two entities in the same line of business may capitalize development costs starting at different points, but those differences should, in theory, be reflective of differences in the development process followed by the entities. The judgment involved in determining the point at which capitalization of development costs should begin under IAS 38 is certainly no more complex or subjective than the judgment reporting entities will be required to apply in order to comply with the FASB’s new financial instrument impairment guidance and, in fact, may be significantly less complex and subjective.

We are not in favor of recognizing internally-developed intangible assets at fair value. We believe a fair value approach would be needlessly complex and time-consuming, and we note that such an approach would be inconsistent with the Board’s proposed Accounting Standards Update to eliminate the requirement that a reporting entity perform a Step 2 analysis to determine if it should recognize an impairment of goodwill.

We believe the concerns on capitalization identified in paragraphs 1.5 and 1.21 of the ITC continue to be applicable to expenditures on research. Adopting IAS 38 would not lead to a change in accounting for research expenditures. However, we do not believe those concerns generally apply to development costs, at least at all phases of the development process. Paragraph 1.18 of the ITC concludes that “the financial reporting outcomes are not always significantly different because the threshold for recognizing development costs under IFRS is both high and subjective.” We do not believe requiring all reporting entities to expense development costs as incurred because some reporting entities would not capitalize significant amounts of development costs is a sufficient reason to not address the accounting for intangible assets. We note as examples that, in the period of adopting IFRS, BMW recognized a development cost asset of €3.0 billion (net of amortization), while Daimler recognized a development cost asset of €4.7 billion (net of amortization). In contrast, neither Ford Motor Company nor General Motors Corporation have recognized an asset for development costs, even though both have launched new models that likely required significant investments in the years since BMW and Daimler adopted IFRS. We believe that difference would matter to users, not because of the implications to future cash flows, but because those costs relate to the revenues the reporting entity will generate following the launch of the product.

**Chapter 2- Pensions and Other Postretirement Benefit Plans**

Our committee does not believe that pensions and other postretirement benefit plans are a major financial reporting issue at this time. The number of defined benefit plans has been in decline and impacts fewer companies each year. Many of the legacy plans still in existence are closed to new entrants or fully frozen. The users of the financial statements are well aware of the issues with pension accounting.

The one issue that could be improved might be the measurement of hybrid plans, such as cash balance plans. The current requirement to consider such plans to be measured as defined benefit plans is costly and does not provide the best information to the users of the financial statements. Hybrid plans could benefit from simplification.

**Chapter 3 – Distinguishing Liabilities from Equity**

We believe the accounting for distinguishing liabilities from equity is complex and costly to apply, but we do not view it as a major financial reporting issue that the FASB should consider for improvement. The complexity in this area of US GAAP is responsive to the complexity of financial instruments issued by entities in capital raising transactions. We observe that previous attempts to simplify this area of US GAAP have foundered, and we question whether the FASB’s agenda should be prioritized in a way to allocate significant time and resources to eliminating complexity that, arguably, is necessary to analyze and account for various components of complex financing and equity transactions.

We are concerned that a foundational project to re-examine the distinction between liabilities and equity will fail to appreciably simplify the accounting guidance while providing relevant information to users about the economic characteristics and obligations associated with complex financial instruments.

Current guidance in ASC 480 and ASC 815-40 is difficult to apply, but when applied properly, generally produces information about the economic characteristics of complex financial instruments that is beneficial to financial statement users. That is, the current model generally requires separate accounting for components of a complex financial instrument when the fair value of the component is driven by different factors than the host instrument, alerting financial statement users to obligations and exposures not associated with a plain vanilla debt or equity instrument.

Given the difficulty of applying the current model, and the fact that it consists of several legacy accounting standards developed at different points in time, we believe that consistency of application could be improved by reorganizing the current guidance on distinguishing liabilities from equity or providing tools (such as flowcharts) that direct financial statement preparers through the analysis of various financial instruments.

However, if the FASB does decide to pursue a project on distinguishing between liabilities and equity, we encourage the Board to (1) perform outreach and analysis to identify the root cause(s) of restatements related to this area of US GAAP, and (2) consider a targeted-improvements approach rather than a full reconsideration of the existing accounting model that could result in its own host of issues.

**Chapter 4 – Reporting Performance and Cash Flows**

Income Statement

The Committee does not believe the income statement presentation, itself, is a major financial reporting issue the FASB should consider for improvement. The Committee considered that while it is true there are few general requirements under current GAAP regarding presentation requirements for the income statement, there are also few restatements resulting from classification errors in the income statement. The income statement classification errors that are publically reported generally result from classification errors between an expense category such as selling, general and administrative or R&D expense, and cost of goods/services sold or revenue. The Committee believes targeted guidance regarding gross vs. net included in ASU 2016-08, *Revenue Recognition – Principal versus Agent (reporting revenue gross versus net)* will help mitigate some of these classification errors in the future. We agree with the FASB and others that there are few concepts on which a principles-based standard could be developed to achieve consistent and comparable results for all industries when reporting performance. We also believe current GAAP provides an effective framework for reporting summarized consolidated results for stakeholders and that providing more disaggregated financial information within the income statement itself might make that statement more complicated to understand or dilute its value as a summary of an entity’s overall performance. The Committee believes if the FASB were to conclude there are concerns regarding the transparency of the nature and quality of earnings, or the sources and characteristics of earnings (which the Committee does not believe to be the case), the FASB should consider adding supplemental disclosure guidance rather than making wholesale changes to the income statement presentation itself to address those concerns. The supplemental disclosures could provide disaggregated quantitative information by segment, for instance, as well as identify any significant or unusual transactions. The additional supplemental disclosures could also improve an investor’s understanding of the individual lines in the income statement by modifying the limited disclosure guidance in provided in ASC 235-10-50, *Disclosure*, regarding significant accounting policies.

Segment Reporting

The Committee does not believe that ASC 280 (FAS 131), *Segment Reporting*, is broken. Consequently, we believe that segment reporting is not a major financial reporting issue that the FASB should consider for improvement. The Committee believes that if there is an issue with segment reporting, it is that entities are not reporting based on the requirements of the standard. The SEC staff has repeatedly discussed shortfalls in segment reporting in speeches since FAS 131 was issued. The staff discussion has resulted in better segment reporting. We do not believe that the SEC staff comments resulted from a problem with the standard itself. We believe that follow up by regulatory agencies such as the SEC is important for compliance with principles-based standards such as segment reporting.

For segment reporting, entities must use judgement to determine the discrete financial information that the CODM regularly reviews to make decisions about resources to be allocated to segments and to assess segments’ performance. The Committee believes that it is important for each entity to use its judgment for ASC 280 reporting purposes to report its financial performance in the manner in which it sees itself.

The Committee believes that the three alternatives suggested for additional disclosure requirements are unnecessary. We believe that the purpose of segment reporting is to represent the entity as the entity sees itself, not as the user believes it should be able to view the entity. The user has access to information regarding the entity’s performance through the consolidated GAAP information and the entity’s MDA that includes financial information by segment.

The Committee believes that while additional guidance for interpreting aggregation criteria and providing bright lines for aggregation would make it easier for entities to defend their segment reporting, the principles-based nature of segment reporting would be undermined. We believe that entities should be able to follow the aggregation guidance and examples in the standard.

The Committee believes that the CODM perspective is key and is the one used to make decisions regarding the use of resources and performance of the segments in the business entity. Consequently, we believe that the Board of Directors view of the business should not replace the view of the CODM for segment reporting purposes. We have found in our experience that the Board of Directors may request additions to or modifications of performance reporting, but do not drive it. We believe that segment reporting should be based on the perspective of those who are responsible for business performance.

Other Comprehensive Income

The Committee does not believe the presentation of other comprehensive income is a major financial reporting issue the FASB should consider for improvement. The Committee believes the income statement and reported net income currently provides financial statement users the best information regarding an entity’s performance for a reporting period because it excludes items in other comprehensive income. Under current GAAP, other comprehensive income captures only some of the items impacting an entity’s overall economic performance. For instance, foreign currency translation adjustments due to the movement of foreign currency rates represent changes in the amounts that the parent company would realize on liquidation of the foreign subsidiary if the proceeds were repatriated. However, since a parent company does not generally mark its investment in a subsidiary to fair value, recognizing foreign currency translation adjustments in measuring the reporting entity’s performance for the period would not result in useful information to users. Even if items recognized in other comprehensive income captured all of the factors impacting an entity’s overall economic performance, presenting those items in other comprehensive income would still be appropriate because they do not affect the reporting entity’s current period performance. Rather, those are items that may or may not be realized in future periods.

The Committee also does not support changing the manner in which other comprehensive income is reported nor does the Committee believe it is important for the FASB to take measures such as requiring a single performance statement inclusive of both net income and total comprehensive income in order to improve the relevance of total comprehensive income. Statement No. 130, *Reporting Comprehensive Income*, issued in 1997, which required entities to report other comprehensive income, and ASU 2011-05, which required entities to report other comprehensive income at the bottom of the statement of comprehensive income or in its own statement immediately following the income statement, have been in existence for some time. The Committee believes users of financial statements have had significant time to understand other comprehensive income and incorporate it into their analysis of an entity’s overall financial position and liquidity. If the FASB has assessed that total comprehensive income is not sufficiently relevant as a performance measure after the extensive period of time that both FAS 130 and ASU 2011-05 have been effective, then such matter is not a major financial reporting issue.

Statement of Cash Flows

We do not believe the presentation of cash flows is a major financial reporting issue that the FASB should consider for improvement. As noted in the Invitation to Comment, the EITF recently addressed several targeted cash flow presentation issues to promote consistent presentation of cash flows among reporting entities. In our view, this method of making targeted improvements provides substantial benefit to financial statement users in terms of consistent presentation at a relatively small cost. Accordingly, we support the “Acknowledge the Limitations but Promote Greater Comparability” approach described in paragraph 4.76 of the Invitation to Comment.

**Potential additional project**

The Committee believes the FASB should consider adding to its agenda accounting applied by a joint venture for assets and/or businesses received on its formation. In today’s increasing global market place, companies are often forming or entering into new arrangements with unrelated parties to manage risk or enter new markets. These transactions are generally referred to as a “joint venture” (JV), a term that is defined in current GAAP which has accounting implications for the JV venture itself. The accounting for JVs has evolved since the adoption of FASB Statement No. 160, *“Noncontrolling Interest in Consolidated Financial Statements – an Amendment to ARB No. 51,”* (FAS 160). Venturers now initially recognize their equity investments in JVs at fair value when they contribute a “business” and, as a result, the SEC now believes it may be more appropriate for the JV itself to measure contributed businesses at fair value (see remarks made by Josh Forgione, SEC staff member at the 2009 AICPA National Conference on Current SEC and PCAOB Developments on December 7, 2009). Lastly, JVs can be formed in transactions other than a contribution of a business to a newly formed entity, although those transactions may not be viewed as a JV under ASC 323-10-20, or would result in carry over versus fair value basis due to the nature of the formation and/or the types of assets contributed (e.g. assets versus a business). For the reasons stated above, it would be helpful if the FASB considered adding to its agenda accounting by JVs, reconsider the definition of a joint venture in ASC 323-10-20 to which such accounting applies, and consider whether such accounting should be limited to joint ventures as defined.

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We appreciate the opportunity to provide our comments and observations on the ITC and would be pleased to discuss them at your convenience.

Sincerely,

**Ryan Brady, CPA**
Chair, Accounting Principles Committee

**Brian Kot, CPA**
Vice Chair, Accounting Principles Committee

APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE

ORGANIZATION AND OPERATING PROCEDURES

2016-2017

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee’s comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

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