

**OVERSEEING THE STANDARD SETTERS: AN  
EXAMINATION OF THE FINANCIAL ACCOUNTING  
STANDARDS BOARD AND THE PUBLIC COMPANY  
ACCOUNTING OVERSIGHT BOARD**

---

**HEARING**

BEFORE THE

SUBCOMMITTEE ON INVESTOR PROTECTION,  
ENTREPRENEURSHIP, AND CAPITAL MARKETS  
OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTEENTH CONGRESS

SECOND SESSION

\_\_\_\_\_  
JANUARY 15, 2020  
\_\_\_\_\_

Printed for the use of the Committee on Financial Services

**Serial No. 116-77**



\_\_\_\_\_  
U.S. GOVERNMENT PUBLISHING OFFICE

42-747 PDF

WASHINGTON : 2021

## HOUSE COMMITTEE ON FINANCIAL SERVICES

MAXINE WATERS, California, *Chairwoman*

CAROLYN B. MALONEY, New York	PATRICK McHENRY, North Carolina,
NYDIA M. VELAZQUEZ, New York	<i>Ranking Member</i>
BRAD SHERMAN, California	ANN WAGNER, Missouri
GREGORY W. MEEKS, New York	FRANK D. LUCAS, Oklahoma
WM. LACY CLAY, Missouri	BILL POSEY, Florida
DAVID SCOTT, Georgia	BLAINE LUETKEMEYER, Missouri
AL GREEN, Texas	BILL HUIZENGA, Michigan
EMANUEL CLEAVER, Missouri	STEVE STIVERS, Ohio
ED PERLMUTTER, Colorado	ANDY BARR, Kentucky
JIM A. HIMES, Connecticut	SCOTT TIPTON, Colorado
BILL FOSTER, Illinois	ROGER WILLIAMS, Texas
JOYCE BEATTY, Ohio	FRENCH HILL, Arkansas
DENNY HECK, Washington	TOM EMMER, Minnesota
JUAN VARGAS, California	LEE M. ZELDIN, New York
JOSH GOTTHEIMER, New Jersey	BARRY LOUDERMILK, Georgia
VICENTE GONZALEZ, Texas	ALEXANDER X. MOONEY, West Virginia
AL LAWSON, Florida	WARREN DAVIDSON, Ohio
MICHAEL SAN NICOLAS, Guam	TED BUDD, North Carolina
RASHIDA TLAIB, Michigan	DAVID KUSTOFF, Tennessee
KATIE PORTER, California	TREY HOLLINGSWORTH, Indiana
CINDY AXNE, Iowa	ANTHONY GONZALEZ, Ohio
SEAN CASTEN, Illinois	JOHN ROSE, Tennessee
AYANNA PRESSLEY, Massachusetts	BRYAN STEIL, Wisconsin
BEN McADAMS, Utah	LANCE GOODEN, Texas
ALEXANDRIA OCASIO-CORTEZ, New York	DENVER RIGGLEMAN, Virginia
JENNIFER WEXTON, Virginia	WILLIAM TIMMONS, South Carolina
STEPHEN F. LYNCH, Massachusetts	VAN TAYLOR, Texas
TULSI GABBARD, Hawaii	
ALMA ADAMS, North Carolina	
MADELEINE DEAN, Pennsylvania	
JESUS "CHUY" GARCIA, Illinois	
SYLVIA GARCIA, Texas	
DEAN PHILLIPS, Minnesota	

CHARLA OUERTATANI, *Staff Director*

SUBCOMMITTEE ON INVESTOR PROTECTION, ENTREPRENEURSHIP,  
AND CAPITAL MARKETS

BRAD SHERMAN, California, *Chairman*

CAROLYN B. MALONEY, New York  
DAVID SCOTT, Georgia  
JIM A. HIMES, Connecticut  
BILL FOSTER, Illinois  
GREGORY W. MEEKS, New York  
JUAN VARGAS, California  
JOSH GOTTHEIMER, New Jersey  
VICENTE GONZALEZ, Texas  
MICHAEL SAN NICOLAS, Guam  
KATIE PORTER, California  
CINDY AXNE, Iowa  
SEAN CASTEN, Illinois  
ALEXANDRIA OCASIO-CORTEZ, New York

BILL HUIZENGA, Michigan, *Ranking  
Member*  
STEVE STIVERS, Ohio  
ANN WAGNER, Missouri  
FRENCH HILL, Arkansas  
TOM EMMER, Minnesota  
ALEXANDER X. MOONEY, West Virginia  
WARREN DAVIDSON, Ohio  
TREY HOLLINGSWORTH, Indiana, *Vice  
Ranking Member*  
ANTHONY GONZALEZ, Ohio  
BRYAN STEIL, Wisconsin



## CONTENTS

---

	Page
Hearing held on:	
January 15, 2020 .....	1
Appendix:	
January 15, 2020 .....	39

### WITNESSES

WEDNESDAY, JANUARY 15, 2020

Duhnke, William D. III, Chairman, Public Company Accounting Oversight Board (PCAOB) .....	6
Golden, Russell G., Chairman, Financial Accounting Standards Board (FASB) .....	5

### APPENDIX

Prepared statements:	
Duhnke, William D. III .....	40
Golden, Russell G. ....	43

### ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Wagner, Hon. Ann:	
Accounting Today article entitled, "CECL standard expected to make a major impact" .....	57



**OVERSEEING THE STANDARD SETTERS:  
AN EXAMINATION OF THE FINANCIAL  
ACCOUNTING STANDARDS BOARD AND  
THE PUBLIC COMPANY ACCOUNTING  
OVERSIGHT BOARD**

---

**Wednesday, January 15, 2020**

U.S. HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON INVESTOR PROTECTION,  
ENTREPRENEURSHIP, AND CAPITAL MARKETS,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Brad Sherman [chairman of the subcommittee] presiding.

Members present: Representatives Sherman, Maloney, Himes, Foster, Meeks, Gottheimer, Gonzalez of Texas, Porter, Axne, Casten, Ocasio-Cortez; Huizenga, Stivers, Wagner, Hill, Mooney, Davidson, Hollingsworth, and Steil.

Also present: Representatives Luetkemeyer and Gonzalez of Ohio.

Chairman SHERMAN. The Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Also, without objection, members of the full Financial Services Committee who are not members of the subcommittee are authorized to participate in this hearing.

Today's hearing is entitled, "Overseeing the Standard Setters: An Examination of the Financial Accounting Standards Board and the Public Company Accounting Oversight Board."

I now recognize myself for an opening statement.

I was honored recently to be elected Chair of this subcommittee. There was a contest. Most in the audience believe that I won on the basis of my good looks. That is not the case. I promised every member of the committee that, since I was a CPA, I would focus a lot of attention on accounting principles and the auditing process. And I was overcome with the wave of support that came from a decision to focus this subcommittee on the two gentlemen here before us today.

If you write the rules of the game, you control what the players and the teams do. If the Major League Baseball accounting standards board decreed that every ball hit over the outfield fence was an out instead of a home run, you would change the whole game.

The most powerful economic engine in history is the American private sector. The game is to push your stock price up. The most important element of that is earnings per share. When the titans of industry, the most important men and women in business, are told that they can increase reported earnings per share by jumping, their only question is, "How high?" Those who control the rules by which corporations are evaluated and stocks rise and fall control the behavior of the American private sector.

So, Chairman Golden, you are the most powerful, totally anonymous person in the country.

The Financial Accounting Standards Board (FASB) and the Public Company Accounting Oversight Board (PCAOB) tell us they are not government agencies, which is good because now they can be compensated at private-sector rates. But the fact is that if you deliberately violate FASB pronouncements, you go to jail; if you don't pay the FASB tax or fee, you go to jail. And the pronouncements of the FASB have a greater economic impact on the country than perhaps any other government agency. I have yet to find a political theorist who would say that FASB and the PCAOB are not government.

FASB is protected from scrutiny, from oversight, and from democratic input by a wall that is more impregnable than the mighty stones that protected Constantinople for a thousand years. It is the wall of boredom. With the exception of accounting theory enthusiasts, everyone is convinced that accounting standards are simply too boring and too intricate for anyone to pay attention to.

The most controversial action taken by FASB over the last 20 years was on stock options, the decision saying you have to recognize an expense. No one fought harder on this committee to support that decision, because it was good accounting theory. When officers and employees receive something of value and it dilutes the interest of equity holders, that is an expense.

My greatest concern on FASB has been FASB No. 2, issued many decades ago, under which research results cannot be listed as an asset on a balance sheet when the company does the research itself, and they cannot be listed no matter how clear it is that those research results have continuing value. This is a rejection of centuries of accounting theory. It is a rejection of what our profession stands for. And, without objection, I will enter into the record an article by NYU Professor Joshua Ronen explaining why.

Without objection, it is so ordered.

Now, what we see the FASB doing is doing things that are popular with accountants. And this mistake on research and development was popular with many accountants because it made their life simpler, or popular with stock analysts, who, after all, want accountants to project the future rather than just report historical facts.

Today, the hot issue is Current Expected Credit Losses (CECL), where the stock analysts want to force the accountants to verify not the past but the future.

I know that CECL is defended as causing banks to have higher reserves. Whether higher reserves are bad for America because they reduce lending and fuel our economy or whether they are good because they provide greater soundness and security for the bank-



ing system is not a decision that should influence what goes on at the FASB. That is a decision for bank regulators operating under our oversight here at this committee.

And, finally, I think it is important that FASB go beyond providing standards for what goes in the three historical accounting statements. For example, old-fashioned retail stores often go up or down in value based on same-store sales. It would be useful if FASB would publish a definition—what is a same store? What counts as a sale?—so that we could get audited and consistent and comparable information from different retailers even though that isn't in the income statement or the balance sheet.

Finally, we have the PCAOB. I think the issue I want to delve into is how China is not letting you do your job with regard to certain companies that are listed on American exchanges.

With that, I want to recognize the ranking member of the subcommittee, Mr. Huizenga, for his opening statement.

Mr. HUIZENGA. Thank you, Mr. Chairman.

First, congratulations to you on becoming our newest Chair of the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets. And you have given me a new phrase in our first hearing already that I will try to work in “liberally,” with a small “L”—the “wall of boredom.” I love that picture. That is a great word picture, and I will be using it.

So it is not a surprise, with your background, that this is our first hearing out of the gate, overseeing the accounting industry.

Chairman SHERMAN. The first of many.

Mr. HUIZENGA. The first of many, okay. And I cannot get to your level of proficiency, but I have been boning up on my accounting.

Today's hearing, overseeing the standards, will examine these activities of FASB and PCAOB. And while FASB was established in 1973, we have seen the PCAOB being a bit more of a recent creation. But both of them have a common theme in there about the U.S. Securities and Exchange Commission, and at some point I want to touch on that.

But as you had mentioned, and one of the issues that I would like to have addressed today—and I had a chance to meet with Mr. Golden earlier to touch base on this—are those Current Expected Credit Loss (CECL) standards.

FASB's 2016 accounting standards update introduced CECL methodology for calculating loan loss reserves by changing the incurred-loss approach to an expected-loss approach and will apply to all financial institutions issuing credit.

Large banks that are SEC filers were required to be in compliance with the new standards by January 1, 2020. However, smaller banks and credit unions will have until 2023 to convert. Mr. Golden had explained how that 3-year threshold was reached, and maybe he can touch base on that later.

I, along with several of my colleagues here today, have continued to express some concerns that the CECL accounting standard may adversely impact the cost and availability of credit once fully implemented. Financial institutions of all sizes have outlined the implications this new accounting standard will have on popular consumer products, especially during economic downturns. Nevertheless, FASB and the prudential regulators have been reluctant, de-

spite some congressional pressure, to study the likely economic impacts of CECL.

And I think that was something that you had talked about as well.

The other standard setter that we are examining today, the Public Company Accounting Oversight Board, or PCAOB, is a nonprofit corporation that Congress established to oversee the audits of public companies. The PCAOB's responsibilities include: one, registering public accounting firms; two, establishing auditing, quality control, ethics, independence, and other standards relating to public company audits; three, conducting inspections, investigations, and disciplinary proceedings of registered accounting firms; and four, enforcing compliance with the Sarbanes-Oxley Act of 2002.

Pursuant to Sarbanes-Oxley, Congress created the PCAOB in response to the various accounting scandals in the late 1990s, such as Enron, WorldCom, and the collapse of Arthur Andersen. Prior to the PCAOB's creation, the accounting profession was self-regulated. Sarbanes-Oxley gave the SEC the authority to oversee the PCAOB's operations, to appoint or remove its members, to approve the PCAOB's budget and rules, and to entertain appeals of any PCAOB inspection reports or disciplinary actions.

Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 established the current funding regime for the PCAOB, which is done primarily through annual accounting support fees which are assessed on public companies on broker-dealers.

As I mentioned, through the Office of the Chief Accountant, the SEC not only has oversight of the PCAOB but also approves its rules, standards, and budgets.

We had a discussion in this committee last term about the need for a whistleblower in this space and whether that was redundant with the whistleblower protections with the SEC. And it just seems to me that some of these redundancies may be a very inefficient use of resources in both of those organizations.

It has been nearly 2 decades since Congress passed Sarbanes-Oxley and created the PCAOB. I believe that it is now time for Congress to holistically examine Sarbanes-Oxley, as well as the role and structure with the PCAOB, with the goal of furthering investor protection and making government as efficient as possible for American taxpayers. And I look forward to beginning this conversation today.

With that, Mr. Chairman, I yield back.

Chairman SHERMAN. Thank you.

Today, we welcome the testimony of Russell G. Golden, chairman of the Financial Accounting Standards Board, and William D. Duhnke III, chairman of the Public Company Accounting Oversight Board.

Witnesses are reminded that your oral testimony will be limited to 5 minutes. And without objection, your written statements will be made a part of the record.

Mr. Golden, you are now recognized for 5 minutes.

**STATEMENT OF RUSSELL G. GOLDEN, CHAIRMAN, FINANCIAL  
ACCOUNTING STANDARDS BOARD (FASB)**

Mr. GOLDEN. Thank you, Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee. Good afternoon. My name is Russell Golden, and I am the chairman of the Financial Accounting Standards Board, also known as the FASB. Thank you for the opportunity to appear before you today.

I will provide a brief overview of the FASB and our standards-setting process and discuss the importance of stakeholder engagement and feedback to our work.

The FASB is subject to oversight by the Financial Accounting Foundation, a private-sector, not-for-profit organization, as well as the U.S. Securities and Exchange Commission. The SEC recognizes the FASB as the designated accounting standards setter for public companies, consistent with the SEC's congressionally-granted authority.

The FASB also establishes financial accounting and reporting standards for private companies and not-for-profit organizations that follow U.S. Generally Accepted Accounting Principles (GAAP).

Investors, creditors, donors, and other users of financial reports need credible, concise, and understandable financial information to make informed decisions about how to deploy their capital. The FASB carefully develops U.S. GAAP to present financial information neutrally and accurately. The FASB's approach has made U.S. GAAP essential to the U.S. and global economies.

To create fair and robust standards, the FASB actively gathers input from all stakeholders, which is central to the FASB's standards development process. We proactively reach out to and meet with a wide range of investors, auditors, financial statement preparers, and academics, among others. We supplement this direct outreach by meeting often with our advisory councils and committees, whose members represent a broad cross-section of stakeholder interests. We also meet frequently with the SEC, the Public Company Accounting Oversight Board, and banking agencies, among other regulators.

Through broad consultation, the FASB can hear essentially all stakeholder views, identify potential unintended consequences of proposed changes to its standards, and improve acceptance and understanding of our standards.

To further these goals, the FASB has completed several significant projects during my tenure as chairman that have improved the transparency and usefulness of information found in financial reports.

One of the new standards, the Current Expected Credit Losses, or CECL, took effect on January 1st for larger, publicly traded banks, representing the vast majority of total bank assets in the United States. Based on the feedback we have received from the industry, we believe these institutions are ready to implement CECL.

The process used by the FASB to develop and support the implementation of CECL was consistent with the process used for other notable improvements in financial reporting for the capital market. I know the appropriations bill passed by Congress last month directs the Treasury Department to study and report to Congress on

the impact of CECL on bank capital. If asked, we stand ready to support the regulators in their work.

Quality standards require quality implementation. With that goal in mind, we work hard to educate our stakeholders, to help preparers and practitioners understand the standards, and to solicit advice for ways to clarify or improve our standards. This is an important example of the results of continuous reevaluation of our work in response to stakeholder feedback, and it symbolizes the commitment that we have created at the FASB.

The development of U.S. GAAP by the FASB reflects a deep and consistent dialogue with stakeholders from the earliest days of research through implementation and beyond. Not every stakeholder agrees with every decision, but all have a seat at the table.

In closing, I would like to thank the subcommittee's members for the many opportunities I have had as the FASB chairman to work with you on behalf of your constituents and for your ongoing support of the FASB's mission. My written testimony provides more detailed information about our projects and activities, and I would be pleased to answer your questions at any time.

Thank you, Mr. Chairman.

[The prepared statement of Chairman Golden can be found on page 43 of the appendix.]

Chairman SHERMAN. Mr. Duhnke, you are now recognized for 5 minutes.

**STATEMENT OF WILLIAM D. DUHNKE III, CHAIRMAN, PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB)**

Mr. DUHNKE. Thank you, Mr. Chairman, Ranking Member Huizenga, and distinguished members of the subcommittee. Thank you for the opportunity to appear before you today to discuss the work of the Public Company Accounting Oversight Board.

I joined our five-member board in early 2018 along with four other members of the new board. Not since the PCAOB was first founded in 2003 have five new board members joined the organization at roughly the same time. With such a significant change in the board's composition came a significant opportunity. We had the chance to reflect on lessons learned over the prior 15 years, to innovate, and to improve how we approach audit oversight.

In 2018, we used the opportunity to perform a comprehensive assessment of the PCAOB. To help our assessment, we engaged in significant public outreach. We sought input from our core stakeholders on what we were doing well, what we needed to improve, and how we could best improve audit quality. We heard from the SEC, investors, audit committees, financial statement preparers, audit firms, academics, and others.

The message we received back was loud and clear: The PCAOB was ripe for change. The PCAOB had, in many respects, lost the public's trust. The organization was out of touch with market developments and stakeholder needs. It had not matured significantly since opening its doors in 2003. During that time, it developed a culture that lacked internal accountability. And its integrity had been compromised in 2017 by employees leaking confidential inspections information to those we are charged to regulate.

With that as our starting point, we set the PCAOB back on the path envisioned by Congress when it passed Sarbanes-Oxley. We published a new 5-year strategic plan in November 2018. That plan emphasizes the need for us to transform the PCAOB into a trusted leader and promotes high-quality auditing through forward-looking, responsive, and innovative oversight.

It articulates five specific goals and identifies core values we expect our people to demonstrate as they work towards those goals: integrity; excellence; effectiveness; collaboration; and accountability.

In 2019, we began the work necessary to implement our vision and execute our strategic goals. Doing so has required substantial change. That change has permeated the entire organization and has touched nearly every aspect of our work. Change is never easy, but the board collectively believes the changes we are pursuing are necessary to fulfill our mandate.

We are grateful to those at the PCAOB who have embraced our current path. Because of their efforts, we have made substantial progress. Let me highlight a few examples.

First, we have focused on improving the effectiveness of our oversight. That oversight involves inspections of audit firms, enforcing of audit standards and related securities laws, and standards setting for the audit profession.

With respect to our inspections, we have begun a multiyear transformation of how we plan for, conduct, and report on our inspections. We have significantly increased our emphasis on audit firms' systems of quality control. We have also developed and will soon roll out publicly a revised inspection report. Our revised report will reflect incremental progress towards providing stakeholders with more timely, relevant information from our inspections. Further, we have begun to report not only audit deficiencies but also successful practices we have observed.

In enforcement, where we share concurrent jurisdiction with the SEC, we have placed a renewed emphasis on investigating significant audit failures. We also have issued settled orders and decisions in numerous significant matters covering violations related to substantive auditing standards, auditor independence rules, audit documentation and alterations, and noncooperation with our inspections. Our investigative pipeline remains consistent with recent years.

With regard to standards setting, we have been active in improving existing auditing standards. In late 2018, we adopted significant changes to the standards related to auditing accounting estimates, which are at the core of many public companies' reported financial results. We also adopted important changes to the standards governing auditors' use of the work of specialists.

First, in 2019, we began the process of modernizing our standards that govern audit firm quality controls. Strong systems of quality control provide the foundation for audit firms to execute consistent, high-quality audits. Last month, we issued a concept release seeking input on how best to update our current quality control standards.

Second, we have placed an increased focus on innovation and technology. We have met with numerous groups to explore tech-

nologies affecting both auditing and reporting standards. We must ensure that our work does not inhibit those innovations that support audit quality.

Third, we have greatly expanded our engagement and outreach to stakeholders. We hosted numerous roundtables with investors and audit committees. And for the first time in the PCAOB's history, we invited every audit committee Chair for the U.S. audits we inspected to speak with us.

Finally, we have launched significant process and cultural changes within the PCAOB: we recently stood up our Office of Enterprise Risk Management; hired our first chief risk officer, chief information security officer, chief compliance officer, and chief data officer; and reorganized our research and analysis function. We also drafted our first-ever human capital strategic plan.

These are just a few of the changes we have pursued recently. As we continue to push forward with our core strategic priorities throughout 2020, we welcome feedback from our stakeholders, and we welcome feedback from the subcommittee, as well as investors, audit committees, preparers, and others, on our oversight efforts.

Thank you, and I am pleased to answer your questions.

[The prepared statement of Chairman Duhnke can be found on page 40 of the appendix.]

Chairman SHERMAN. Thank you.

Chairman Duhnke, I hope I get a chance to ask you about China not letting you do your job. But I want to focus on something else, and that is, how good a job are our auditing firms doing?

The number of financial report restatements has been used as a metric to determine whether the auditors are doing a good job. Financial statement restatements have been in a steady decline for the last 4 years. In addition to the decline in restatements, surveys show that Main Street investors have a high degree of confidence in the quality of financial statements.

In 2018, audit restatements reached an 18-year low. Does this indicate that there has been an improvement in audit quality?

Mr. DUHNKE. Mr. Chairman, I believe it does. And I think that is something that can be observed through the work of the PCAOB, through our inspections report and also our enforcement efforts.

Those who wish can go back to the beginning of the PCAOB and look at the inspection reports. It would tell a story of severe deficiencies in the beginning of the PCAOB's inspections process and enforcement process. And what they will see over the years is a gradual improvement, although fits and starts when it comes to total deficiencies, about the severity and significance of those deficiencies.

For example, the beginning of the process would show things like not even auditing revenue. And now, we are talking about deficiencies that are as less significant as missing one particular documentation for a factor in an internal control, for example.

Chairman SHERMAN I want to move on to other questions, but, yes, not only has there been a decline in the restatements, many of those restatements now are merely revision statements, which are the lowest level of a restatement.

I want to go on. I know Chairman Golden wouldn't be happy if I didn't ask him about FASB No. 2.

It is bad accounting. With unanimous consent, I will enter into the record the statement of an NYU professor for 45 years of accounting, Joshua Ronen. And I will supplement this record with numerous other accounting theory statements. Without objection, it is so ordered.

It's a departure from what our profession did for the 100 years prior to the FASB, but it also adversely affects the country. Research is important. It is so important that we in Congress spend billions of dollars, through the Tax Code, providing tax credits to encourage research. That is money we can't spend on education or cancer research because we have to spend the money encouraging the private sector to do research. I would venture to say that FASB No. 2 does more to discourage research than our billions of dollars encourage.

Since it is bad accounting theory, it is a departure of the idea of matching revenues and costs, I know it is simpler for the accountants, but have you taken a look at reversing FASB No. 2? And have you done any economic analysis on its effects?

Mr. GOLDEN. The last time I had an opportunity to meet with this subcommittee, I described an invitation to comment that the FASB had put out to ask our stakeholders, what are the future accounting improvements that the FASB should do? One of those projects was looking at accounting for internally developed intangible assets, including research and development.

While we have not taken on that aspect of the project, we have taken on a project to potentially align the accounting for purchased, in-process research and development.

Today, under U.S. GAAP, the purchase of in-process research and development in a business combination is capitalized, but the purchase of in-process research and development in an asset acquisition is not. That causes confusion to many—

Chairman SHERMAN. I am glad you are focusing on that small detail of what is a problem that, no doubt, has hobbled our economy in competing with China, and led to us not developing cures for various cancers, et cetera. FASB No. 2's effect is enormous.

Now, with regard to CECL, you did no economic analysis of the effect because, you said, that is not your job. You just thought it was good accounting. But now that you are called upon to defend CECL, many of those defending it say, oh, we should defend it because it has a good effect on the economy, because it might reduce the number of loans that a bank makes and, therefore, cause the bank to be more solvent.

Are you defending CECL on the basis that it is good for the economy or good for bank prudential standards, or are you just defending it as a good accounting methodology and you haven't done the economic study?

Mr. GOLDEN. We believe CECL provides greater transparency to those who use the financial statements. It helps investors have a better understanding about the expected—

Chairman SHERMAN. Please answer the question. Are you here to defend it because you think that the effect it has on the decisions made by banks and the size of their reserves is helpful to the economy?

Mr. GOLDEN. We believe it gives investors better information.

Chairman SHERMAN. So, the answer to my question is, no? Or you just don't want to give me a yes or a no?

Mr. GOLDEN. I am trying to explain to you why we did what we did on CECL.

Chairman SHERMAN. I would hope you would clarify your answer.

And I will now move on to the ranking member of the subcommittee, Mr. Huizenga.

Mr. HUIZENGA. Thank you, Mr. Chairman.

First, I would like to ask unanimous consent to insert the opening statement of the ranking member of the full Financial Services Committee, Mr. McHenry, into the record.

Chairman SHERMAN. This certainly improves the record. Without objection, it is so ordered.

Mr. HUIZENGA. Thank you. This is going to be an easier job than I thought, working with you.

Along those lines, Mr. Golden, the final House and Senate Fiscal Year 2020 FSGG appropriations agreement included bipartisan report language requiring a new study outlining any potential negative impacts of the CECL accounting standards on consumer credit and the economy to be completed and reported back to Congress in 2020.

Given this development—and maybe this falls in line with something that the chairman was going after—don't you agree it would be prudent to impose a moratorium of some sort on the implementation of CECL until Congress has a better understanding of the negative impacts and, frankly, you all have a better understanding of the negative impacts on consumer credit? And doesn't FASB support a thorough assessment of the impacts of those standards on consumers and the economy and various communities affected?

Mr. GOLDEN. The report in the appropriations talks about understanding the impact of regulatory capital that comes from CECL. We believe that CECL improves the information to our capital markets, and—

Mr. HUIZENGA. I understand that. We have gone over that.

Mr. GOLDEN. Yes.

Mr. HUIZENGA. What I am asking is, don't you believe that you should have this study done and have those results before it is actually implemented?

Mr. GOLDEN. We don't. We believe CECL should be implemented, and we believe the data that will come from implementation will help improve the study.

Mr. HUIZENGA. And you still intend to do the study?

Mr. GOLDEN. The study, I think, is done by the U.S. Treasury Department.

Mrs. WAGNER. By whom?

Mr. HUIZENGA. Could clarify who is actually doing the study?

Mr. GOLDEN. I thought you directed Treasury to do the study.

Mr. HUIZENGA. Okay. I will allow my colleague, Mrs. Wagner, to use her time to ask that.

In an effort, Mr. Duhnke, to not let you feel left out of this hearing, I have a suspicion that there will be a number of things that will continue to be discussed regarding the FASB situation.



We have been talking about PCAOB examinations and enforcement a bit at the hearing. The chairman brought that up. Is that what you would consider to be the core role of the PCAOB?

Mr. DUHNKE. Yes, the core functions of the PCAOB are inspections, enforcement, and standards setting, I would argue.

Mr. HUIZENGA. Okay.

Mr. DUHNKE. And it is reflected in our structure. Our biggest part is our inspections.

Mr. HUIZENGA. Okay. And am I correct in understanding that the SEC has oversight not only of your agency but also any specific enforcement action that the PCAOB undertakes?

Mr. DUHNKE. They are involved as an appellate authority, yes.

Mr. HUIZENGA. Okay. And as I understand it, the SEC itself has an examinations program and an enforcement arm. Is that correct?

Mr. DUHNKE. They do.

Mr. HUIZENGA. Would you say that the SEC's program and setup in that regard is similar to that of the PCAOB except that your organization only examines accountants?

Mr. DUHNKE. If we examine audits, yes, it is similar.

Mr. HUIZENGA. The audits? Okay.

Mr. DUHNKE. Yes.

Mr. HUIZENGA. I guess I am asking these questions because I am wondering if we are not seeing a duplication and some overlap between the PCAOB and the SEC, not to mention that redundancy on that side, but, also, I think we have a responsibility to ask what are those additional costs that are put onto public companies and broker-dealers and if we could reduce those costs?

This committee has talked about IPOs and the challenges that we have had in growing this economy and making sure that it is not just unicorn companies. By the way, if there is a herd of them, I think we can no longer call them unicorns. But, at some point, we need to have a robust growth within our public-sector company area.

And when this committee was considering the PCAOB whistleblower legislation, there was not a single person here opposed to whistleblowers and having them have the ability to go and expose wrongdoing. But I was opposed to creating a redundant whistleblower program, given the existence of the SEC Whistleblower Office that was created under Dodd-Frank. Additionally, the added costs associated with setting up a new whistleblower program only forced the PCAOB to divert precious resources from other projects in order to get this duplicative program off the ground.

That is the sort of thinking I am puzzling about, and what I am trying to look at is, if we have the courage to have a good, hard examination of Sarbanes-Oxley and a number of the other things that are interconnected with this.

I want to make sure that your work is not duplicative and that those that you are regulating aren't getting cross-answers, that they are not getting two different sets of enforcement. It may not be intentionally, but—I know I am a little over. I know the chairman had gone a little bit over. Maybe if you could just wrap up and address that quickly.

Mr. DUHNKE. The short answer to your question is there are a number of similarities and redundancies between the PCAOB's

mission and the SEC's just by the nature of its setup. It is unavoidable.

Mr. HUIZENGA. Okay.

Well, with that, my time has expired, and I appreciate it.

Chairman SHERMAN. It is my understanding that the gentleman from Connecticut would like me to skip him and go on to the gentlelady from Iowa, who is recognized for 5 minutes.

Mrs. AXNE. Thank you, Chairman Sherman. And congratulations, by the way.

Thank you so much for our witnesses for being here today. I very much appreciate it.

Chairman Golden, I have a couple of questions for you about tax disclosures.

Thanks to OECD and other agreements, tax authorities throughout the world are now collecting and exchanging reports from multinational corporations with information about their operations on a country-by-country basis. Despite that, though, we had a report last month that found that U.S. companies paid an average tax rate of only 11 percent, so, effectively, half the statutory rate of 21 percent.

That kind of gap really drives home how critical this issue is. And we need better information to understand the causes to make sure that every single organization is paying their fair share. If it were public, investors could use that information to assess companies' exposure to tax havens and then the risk it represents to their value.

Now, I know FASB is still reviewing their tax disclosure standards, but the latest proposal, which I think was from March, didn't include country-by-country disclosures. A growing number of analysts and investors see this information, though, as crucial for their analysis, and they are going to call on FASB to deliver that information.

I believe, if I am correct, 100 percent of the investors who commented on the proposal, who represent more than \$2 trillion in assets, called on the board to make it mandatory to have those country-by-country disclosures. So, given that strong feedback, are you now considering including country-by-country reports in your reporting standards?

Mr. GOLDEN. You are correct, we do have a project on our agenda, and we have received substantial feedback about doing that. And that will be brought to the board in the first quarter of 2020.

Mrs. AXNE. So, you will be bringing to the board specifically a question to include mandating country-by-country disclosures?

Mr. GOLDEN. We will have a specific debate about that, and board members will be able to articulate their views as to whether or not that is an improvement to financial reporting, yes.

Mrs. AXNE. Okay. Can you tell me a little bit about your opinion on that?

Mr. GOLDEN. I would like to hear the debate of my board members and see all the research before, but I can tell you what I have learned today is that, you are correct, there are many investors who would find that information very valuable. There are many companies that would say it is very costly to prepare. I question that cost.

Mrs. AXNE. Thank you, Chairman. I appreciate that.

Moving on, the Global Reporting Initiative (GRI) released their voluntary standards for tax disclosures just last month. And while voluntary GRI standards are followed by 78 percent of the companies on the Dow Jones Industrial Average, further, Royal Dutch Shell voluntarily disclosed this information last month.

Has FASB reviewed GRI's tax standards? And are you considering incorporating it into the GAAP income tax disclosures?

Mr. GOLDEN. I am not sure. I will have to get back to you. But we did review the Royal Dutch Shell disclosure information.

Mrs. AXNE. Okay. When would you be able to get us some information on that?

Mr. GOLDEN. I will need to talk to the staff about that project and get back to you.

Mrs. AXNE. Okay.

Mr. GOLDEN. Later this week.

Mrs. AXNE. I appreciate that. Perfect.

Well, that answers my questions. Thank you again for being here.

And I yield back the balance of my time, Mr. Chairman.

Chairman SHERMAN. My God. That is the first time I have seen that happen. Thank you for your questions.

And now, I will recognize the gentlelady from Missouri, Mrs. Wagner.

Mrs. WAGNER. Thank you, Mr. Chairman, and congratulations to you.

Chairman Golden, members of this committee have expressed concern that CECL accounting standards will adversely impact the cost and availability of credit once fully implemented. We have heard banks of all sizes—and let me underscore, all sizes of banks—outline the implications this new accounting standard will have on very popular consumer products, especially during economic downturns.

Chairman Golden, after hearing concerns from both financial institutions and Congress, has FASB taken the time to study the likely economic impacts of CECL? And I am not talking about Treasury; I am talking about FASB.

Mr. GOLDEN. We have not done an economic analysis.

Mrs. WAGNER. Stunning.

Did you study how CECL would affect lending or access to credit for consumers before issuing this new accounting standard?

Mr. GOLDEN. We did a cost-benefit analysis in connection with our mission, which is to provide better, more decision-useful information to the capital markets and other users, including regulators.

Mrs. WAGNER. Lending and access specifically is what I asked about.

Mr. GOLDEN. No, we did not.

Mrs. WAGNER. No, you did not. Again, stunning.

I would like to submit for the record the following article by Accounting Today, which estimates loan loss reserves under CECL—again, Accounting Today—loan loss reserves under CECL could range from, are you ready for this, \$50 billion to \$100 billion, according to public disclosures made by various financial institutions.

Chairman Golden, would you care to comment on this estimate of \$50 billion to \$100 billion?

Mr. GOLDEN. We plan to closely monitor the progression of the CECL implementation to ensure that it has been performing with our expectations as to what is the actual—

Mrs. WAGNER. So, you don't study anything, and now you are telling me you are going to closely monitor something like this—\$50 billion to \$100 billion, according to public disclosures on loan loss revenues?

Mr. GOLDEN. We do study the impact of our proposals on the capital markets and other users. We think that the information provided to investors is consistent with how they analyze financial institutions. They will be able to make more informed decisions that will help our capital markets, and we think that is a good thing.

We also think the banking regulators will have better and more refined information, and they can make changes. And we think that is a good thing as well.

Mrs. WAGNER. A new accounting standard that affects the economy this much should have significant studies backing it, wouldn't you agree?

Mr. GOLDEN. I think that is why it is important that we work with the Treasury in consultation with the banking regulators as they perform their—

Mrs. WAGNER. Okay. But you haven't studied it at all. And we are talking about—

Mr. GOLDEN. We have studied, in connection with our mission, that this will provide additional and better information to the capital markets.

Mrs. WAGNER. Chairman Golden, what percentage of institutions will be able to comply with CECL efficiently and effectively?

Mr. GOLDEN. Based on our discussions with our stakeholders, those that are required to apply in the beginning, we believe are ready.

We recently deferred the effective date for private financial institutions, not-for-profits, which includes all credit unions and smaller public financial institutions, so they have 3 years—

Mrs. WAGNER. What percentage of institutions will be able to comply with CECL efficiently and effectively? It has already—the date has passed. It is in.

Mr. GOLDEN. We believe all those that are required to apply will be able to apply.

Mrs. WAGNER. Chairman Golden, a number of commentators have suggested that CECL could have a procyclical effect. Can you please describe what impact CECL would have in a recession?

Mr. GOLDEN. There have been many studies that have been performed. Most recently, the Federal Reserve staff did a study that said leading up to the recession it would dampen lending and it would accelerate lending during a recession and, therefore, it would be less procyclical than the current model.

Mrs. WAGNER. I couldn't disagree more. These new accounting standards will have—what it does to popular consumer products, especially during an economic downturn, products that matter to my constituents in Missouri's Second Congressional District—mortgages, credit cards. Again, I am just stunned.

I have some questions about LIBOR and SOFR, but I will leave it at that.

You are compelled, I think, sir, to study this further, about what impact this is going to have on real people, and for the institutions and the small, especially, size banks that are going to be affected.

I am out of time, Mr. Chairman. I yield back.

Chairman SHERMAN. I would just quickly comment that all the better information, transparency, information for analysts could have been provided in footnotes. I would call that good accounting, and the gentlelady from Missouri would be happy because it wouldn't have any of the economic effects we are talking about.

Without objection, the article from Accounting Today referred to by the gentlewoman from Missouri will be entered in the record.

And I now recognize for 5 minutes the gentleman from Texas, Mr. Gonzalez.

Mr. GONZALEZ OF TEXAS. Thank you.

I am here to ask a few questions for the independently owned and operated businesses throughout my district. These businesses will need to access capital several times over their lifetime. Whether it is start-up capital or simply because cash flow has a downturn, we depend on our local banks and credit unions to provide access to this capital. And this is the first kind of capital to tighten in response to regulation or accounting risk.

I am very concerned about the consequences of CECL. The CECL standard leaves many questions unanswered, even for those who have already implemented it.

The Financial Accounting Standards Board has an important role, obviously, to our nation's standards. Their accounting standards carry the force of the law for SEC filers, and their independence is an important aspect of the checks and balances necessary for the smooth running of our nation.

I see several concerns with CECL. By its definition, it anticipates expected losses and relies on a predictive model for forecasting deficits. In practice, we are now expecting our banks to accurately predict the future and account for it.

CECL seems to be too little too, much too late. The financial crisis peaked in 2006. For a crisis response to take 13 years and leave us with so many questions and loopholes is beyond my understanding. Quite frankly, we could have had a financial crisis and recovered from it in the time that CECL was developed.

Ultimately, the problem is not with the accounting standards but that these standards are going to affect banks' capital retention in a way that accounts and regulators cannot predict. Less capital means fewer small loans. It will be even harder for mortgages of under \$100,000, many in my district, at a time when we need to incentivize lending at this level. My concern is that CECL will make lending more expensive in the short term. Lending is lowest in low- and moderate-income areas. Ultimately, we have a problem in our country getting mortgages under \$100,000, and my concern is that CECL is bound to make that problem even worse.

Credit unions face challenges on their own in obtaining additional capital retention because of their structure and the way new members are acquired. What would a credit union have to do to generate additional capital to meet a retention rule or regulation?

Mr. GOLDEN. My understanding is that a credit union would have to retain their income. One of the things about allowing additional time is it gives credit unions additional time to retain their income such that they will have additional capital. I agree with you that the FASB does not set the capital requirements for credit unions.

Mr. GONZALEZ OF TEXAS. How does the retention of too much capital affect a bank?

Mr. GOLDEN. I would have to get back to you on that.

Mr. GONZALEZ OF TEXAS. Would you oppose a cost-benefit analysis of the impacts of CECL on the affected industries, but especially on community banks and credit unions?

Mr. GOLDEN. We did a cost-benefit analysis as to whether or not this was additional information, more transparent information, at a reasonable cost. We have explained that in our basis for conclusion and other areas, and we are willing to defend that.

Mr. GONZALEZ OF TEXAS. What sort of questions would you like to see answered?

Mr. GOLDEN. Regarding what?

Mr. GONZALEZ OF TEXAS. Anything on CECL.

Mr. GOLDEN. I think it is very important that we study the judgments that are being made, to make sure there is not recency bias, that there is not conservatism. I have seen recent concerns that banks will, as they anticipate a downturn, over-reserve and then they will not appropriately adjust the reserves as the economy gets better.

CECL does not allow for conservatism. It does not allow for recency bias. It requires management's best estimate based on the expected life of the loan. It does that by looking at historical information, adjusted for current conditions, and then a reasonable and supportable forecast period. We are not asking for companies to forecast over the life of the loan, just as far as they think that they can, and then you revert back to historical information.

Mr. GONZALEZ OF TEXAS. Ultimately, the new standard has produced many concerns that CECL will have the opposite effect than intended, and rather than produce a safer financial outlook in a downturn, CECL could be procyclical and, indeed, cause problems for us during a downturn by tightening credit too much.

Would you share with the committee the studies that your agency has conducted to evaluate how CECL would work in a significant economic downturn?

Mr. GOLDEN. I would be happy to share with the committee the analysis that the board has gone through to determine that this is a better financial reporting solution.

Mr. GONZALEZ OF TEXAS. We would like to see that. Thank you. And I yield back.

Chairman SHERMAN. Thank you.

Without objection, I would like to enter into the record an October 2019 report from the Center for Responsible Lending, a public interest group, which indicates that CECL creates a significant disincentive for lenders to originate loans to low- and moderate-income families and communities of color. Without objection, it is so ordered.

And the gentleman from Arkansas, Mr. Hill, is recognized for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman. Congratulations on becoming chairman. This has to be like a “Jeopardy” competition day for you, watching the world championships. We will take FASB for \$600.

Chairman SHERMAN. Alex Trebek is a constituent, and a friend of mine.

Mr. HILL. Yes. God bless him.

Mr. Golden, part of the accounting tradition is recognizing revenue and expense. Revenue recognition and expense matching is such an important concept, and it seems like CECL is not at all in keeping with that, in my view.

And I want to echo my friend from Missouri’s concept that the economic policy implications, the true cost-benefit analysis, not just to issuers versus users of the financial statements, but the big picture, is essential. It is a gap. To me, that should be a fundamental obligation of adopting an accounting standard. And based on your testimony here today, it doesn’t exist.

We look forward to what Treasury says, but I think Mr. Luetkemeyer and all of us here, on a bipartisan basis, would say the SEC and the bank regulators were not ahead of this issue. We have been talking about this since the spring of 2015, and yet only in the last year have people started recognizing what a problem I think that this will be.

Consistency also is a fundamental tenet of accounting. Would you agree? And would you say that an operating lease at Dillard’s department store is treated the same way under GAAP that an operating lease at JPMorgan Chase is? Does GAAP treat an operating lease the same for any business in the United States?

Mr. GOLDEN. Yes, it does.

Mr. HILL. Yes. Okay, it does.

So by having not a good plan on this FASB issue, credit unions are now exempt from it, banks under \$750 million are exempt from it, and public companies, no matter how big they are, are all fully responsible to comply with it.

Now, that may be in keeping with how we all worry about our small community banks, but the point is, now you have a major difference in accounting standards. And I think that is a problem.

I do think it is procyclical. I think it will enhance bank losses in a downturn. And I think it could also shorten terms of loans, since the way you calculate expected losses—people may now avoid making intermediate-term loans and make shorter loans so the financial accounting standards treatment is different. Is that a possibility?

Mr. GOLDEN. I don’t think so. I recognize that point, but the way we have developed the model, the reasonable and supportable forecast is just over the period in which one can forecast. You are not required to forecast over 5 years.

Mr. HILL. Mr. Duhnke, turning to you for 600, I wanted to talk to you about an interesting point an issuer brought up to me, which was PCAOB’s inspection of an accounting firm’s loan loss reserve papers at a client and that the Public Accounting Standards

Board inspection was very much in conflict with the bank regulators.

Have you heard about this issue, that an exam of one of your public accounting firms looking at loan losses is in conflict with the bank regulators? Has that topic come up?

Mr. DUHNKE. Conflicts are not news to me, but that specific issue is.

Mr. HILL. Yes. And it also seems this question concerns the use of qualitative factors in determining the allowance for loan losses. And the PCAOB auditors to the accounting firm were disputing those, saying they shouldn't be counted and that the bank in question had a loan loss reserve that was far too high. And in my 40 years of banking, there has never been a loan loss reserve that was too high, probably.

So I would ask you to look into that, if you would.

Mr. DUHNKE. I would be happy to do so.

Mr. HILL. Thank you.

Also, Chairman Duhnke, we have talked about the small broker-dealers, and we have had numerous letters back and forth and with Chairman Clayton at the SEC. Is that still an issue? Do you think you can find relief for our small broker-dealers under the Sarbanes-Oxley requirement?

Mr. DUHNKE. We are currently in the middle of our process of addressing the fate of our broker-dealer program. The aspiration is to wrap something up by this year, so, hopefully, those questions will be answered.

Mr. HILL. Well, I hope you will bring relief to our small broker-dealers, whom I think deserve that relief in this inspection relief. And we have worked in the Senate and the House on that issue.

Nobody has asked you a China question directly yet. And China, as I understand it, besides Belgium, is the only country to not fully comply with the PCAOB inspection standards. What is the latest on that?

Mr. DUHNKE. With one caveat on Belgium: We are working constructively with them and anticipate an agreement.

On the China front, it remains status quo. My predecessor made a heroic effort to try to reach some accommodation with the Chinese, and we have been unable to do. So, we are at the same place we were a couple of years ago, and that is unable to inspect or enforce in China.

Mr. HILL. I know Congress thinks this is an important issue. We look forward to working with you in the coming days.

Thank you, Mr. Chairman.

Mr. DUHNKE. Thank you.

Chairman SHERMAN. I now recognize the gentleman from Illinois, Mr. Casten.

Mr. CASTEN. Thank you, Mr. New Chairman.

And thank you to our witnesses.

I want to pivot away from CECL. I have opinions on it, but I come at this as a new Member of Congress who spent 20 years in the energy industry. And having had to restate our entire books when FIN 46 came out and changed the variable interest accounting rules, where you could only really understand what our busi-



ness did from reading the footnotes, I am not wild about changing accounting standards, but you can manage it.

I also want to emphasize that, in an ideal world, accounting standards are value-neutral, and politically-isolated. But, again, from the experience I come from, I don't have any experience with non-politically-influenced accounting standards, because our tax books are politically-influenced, and if you are a regulated utility, whatever the utility books are for your rate-making capital is politically-influenced. So, there is no way that you don't have a set of accounting records that are subject to some political influence just because FASB is independent.

And, of course, there is significant discretion in, do you take a capital expense, do you take an operating expense, and how do you use that to smooth the earnings because we have our own political constituencies that we respond to as business leaders?

All of that is okay. But I think the question, if we can't get away from political influence, is, how do we deal with the reality that we have?

And so, with respect to CECL, the idea that banks have to book a reserve for some statistical likelihood of a future credit liability, and yet a business doesn't have to book a reserve for a whole host of other future, statistically possible liabilities, from customer loss to climate change and what have you, Chairman Golden, could you just explain to us very briefly what it is about CECL that leads FASB to conclude that that type of future risk should be booked but other types of future risks shouldn't?

Mr. GOLDEN. Sure.

CECL is designed to show investors what are the cash flows the company expects to receive from the financial instrument on the books. One is trying to forecast, based on historical information, current conditions, reasonable and supportable forecasts of economic conditions, what are the cash flows that one expects to collect.

If one expects to collect 100 percent of the cash flows, there is no loss. It is quite clear in the standard that if an entity held a U.S. Treasury bond, there would be no loss, because it is risk-free.

Mr. CASTEN. Is it solely because CECL derives from regulation that the loss is booked? Because I could sit there, and I could say, I own a property in Miami Beach that is going to have significant flooding, and any scientist could sit there and say, yes, you have a serious exposure there, but that wouldn't be a bookable loss in the way that a CECL would be.

Mr. GOLDEN. That is right, because the event that has caused your loss associated with the flooding has not occurred. The event that has caused the risk to the financial institution has occurred, because they have either purchased the security or they have originated the security.

Mr. CASTEN. Okay.

Let me then shift back to my utility world. In 2013, I think, or so, the EPA said that essentially all existing coal boilers under their Boiler MACT rule were going to have to put significant back-end controls on or shut down. It was a change in law, and it meaningfully affected their cash flows.

There wasn't a single utility or operator of a boiler that booked that loss on their books or booked that liability on their books. And this may be too far down in the weeds, but do you know what the difference was of why that didn't get booked as a loss?

Mr. GOLDEN. I am not familiar with that fact pattern. I would be happy to talk to you further to better understand why that was the case.

Mr. CASTEN. I am not trying to play "gotcha," but the difference was that all of the accounting groups said that was an obligation to invest in an asset as opposed to a liability. Same cash-flow future impact, but one of those never showed up on books, other than that people understood it. And so, again, it was a capital expenditures/operating expenses (CAPEX/OPEX) piece of distinguishing, so it sort of fell out of the accounting records, but we were sitting there saying, this business is materially affected, but you wouldn't know it from the financials.

So, with the time I have left, my question for you is, if you can't take away that there will be political influence over accounting standards—and I am not advocating either of these extremes. One extreme, we throw our hands up, and we say, "Do whatever you want." The other extreme, we say, "FASB should be a branch of government," right? I am not suggesting either of those extremes.

What could we do, as the Congress, when we pass these laws, whether they are environmental laws or tax laws or otherwise, to provide you with more clarity as to how to interpret, so that business owners aren't sitting there saying, I have to wait until all the FASB members complete the comment period so we can figure out how these will go through? Because, to my mind, that is the real risk. Is there something we can do in our legislation to provide you with greater clarity?

Mr. GOLDEN. I don't know. I would be happy to think about that. What comes to mind initially is strong and better enhanced communication between all parties.

Mr. CASTEN. Okay. I see I am out of time, so thank you. I yield back.

Chairman SHERMAN. Thank you. I have been informed that Mr. Steil from Wisconsin has his questions ready to go, so he is recognized for 5 minutes.

Mr. STEIL. Thank you very much, Mr. Chairman. Thank you for calling today's hearing.

Mr. Golden, a question for you. As you know, many insurance receivables are important for assets for most property and casualty insurers. And reinsurance programs vary, the National Association of Insurance Commissioners (NAIC's) standards reflect that, both from an accounting and regulatory capital perspective.

However, CECL treats all reinsurance receivables the same, and that seems to be causing friction between GAAP and the NAIC's statutory accounting principles. I have heard concerns from numerous folks that CECL is simply incompatible with the way that insurers are currently conducting their business model. The standard treatment of reinsurance receivables, I think, is one good example to kind of dive in to understand this with.

This isn't a purely academic issue. The way CECL affects the treatment of balance sheet items like reinsurance receivables, af-

fects the way that those insurance companies are doing business and thus ultimately impacts policyholders.

Can you give explain how FASB works with investors to determine whether insurance-specific changes would improve transparency?

Mr. GOLDEN. Sure. And you are correct, insurance receivables are within the scope of CECL.

We believe that the same accounting conclusion should be given to the same activity. And in essence, a reinsurance receivable is a receivable just like any other receivable. It is the same as a trade receivable.

We have a specific group that is designed to help the board understand implementation questions, to help the board narrow diversity, and to help the board become aware of when we need to provide additional educational material.

We specifically put a property casualty representative on that committee to help us understand if there are things that we need to do to provide additional education or narrow diversity for reinsurance receivable.

Mr. STEIL. Let me try to refocus the question a bit. How does that assist investors, in particular as it relates to transparency? Do you believe that this improves transparency to the benefit of investors?

Mr. GOLDEN. Yes, we do. What it does is it allows the investor to understand the real risk related to the reinsurance receivable.

Mr. STEIL. Okay. Let me follow up. As you know, CECL requires each financial institution to conduct its own modeling in order to determine their loss reserves. Because of that, it would appear that investors have to evaluate all of the different models that firms are using to determine the health of their loan portfolio, and this seems to be adding complexity and uncertainty rather than enhancing transparency for investors.

And, in fact, I have seen reports that investors are calling on companies to include both the current allowance for loan and lease losses and CECL loss reserves in their reporting.

Can you address some of this confusion as to how you are seeing this play out to enhance investors?

Mr. GOLDEN. We have had a lot of dialogue with investors to help them understand the additional information they are going to get from CECL.

One of the crucial things, we believe, for the success of CECL is that it is a very flexible approach. It is a principle-based approach.

We specifically did that so that management would have the flexibility to do their reasonable and supportable forecast based on their specific banking, but we didn't want to mandate one model, one way to do that.

As a result of that, there needs to be additional transparent disclosure as to how management has arrived at their estimate.

Mr. STEIL. I appreciate your feedback. I don't know that I agree with your conclusion.

I am going to yield the balance of my time to my colleague with reams of paper to my left, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Steil.

Just to follow up on the question here, you are talking about investors who—quite frankly, I can sit here, I have, as you said, piece of paper after piece of paper that says that—here is a headline: “Investors want new accounting standards, says FASB. Investors disagree.”

Here is one from former FDIC Chairman William Isaac, from an op-ed from this past year: “A January 2019 survey by Janney, the large investment house, found that 75 percent of bank investors oppose CECL.”

Here is one from the tax accounting vice president of the American Bankers Association: “Three-fourths of investors oppose.”

Here is an FIG Partners survey that says 85 percent of investors feel current accounting rules for U.S. bank reserves are sufficient and 83 percent believe it is procyclical.

Where in there is the urgency to have this change for the transparency of investors for thousands of individual entities that are affected for the benefit of the 400 banks that are publicly traded?

Mr. GOLDEN. We took on CECL because there is evidence that the incurred loss model delays loss recognition, created procyclicality, and caused complexity and confusion because of the need to—

Mr. LUETKEMEYER. Created procyclicality? It is going to exacerbate it, sir.

Mr. GOLDEN. I am just talking about the incurred loss model. During the financial crisis and subsequent to that, it was quite clear that investors were not using their incurred loss model. They were using an expected credit loss model.

We also, during that time, received feedback from investors, from preparers, and from banking regulators, both U.S. and global regulators, that we should make a change and focus on expected credit losses.

Mr. LUETKEMEYER. You don’t think mark-to-market had anything to do with this downturn?

Chairman SHERMAN. The gentleman’s time has expired.

Mr. LUETKEMEYER. I yield back.

Chairman SHERMAN. Thank you.

The Financial Services Committee has three House Committee Chairs on it, including the new Chair of the Committee on Oversight and Reform, Mrs. Maloney, who also happens to be the former Chair of this subcommittee. The gentlelady from New York, Mrs. Maloney, is recognized for 5 minutes.

Mrs. MALONEY. I thank the gentleman for his leadership, and for recognizing me, and I congratulate him on his new chairmanship of this critically important committee.

Before I get to questions, I just want to say that both of these entities, the Financial Accounting Standards Board and the Public Company Accounting Oversight Board, are very important, and I certainly strongly support their missions.

The PCAOB directly regulates auditors of public companies, so we should treat them the same that we treat other financial regulators. We give financial regulators significant independence, but in return, we require significant transparency.

But the PCAOB is not subject to the same transparency standards as other financial regulators. Specifically, they are not subject

to the Freedom of Information Act, even though other financial regulators are.

I just want to say that I would like to explore subjecting the PCAOB to the Freedom of Information Act in order to improve the transparency of this tremendously important regulator.

And with that, I would like to get to some questions for Chairman Duhnke.

In December of 2018, the SEC and the PCAOB issued a warning to investors about the challenges American regulators face when attempting to conduct oversight of U.S.-listed companies based in China and Hong Kong.

According to the SEC, there are 224 companies listed on U.S. exchanges with auditors located in countries that prohibit—prohibit—the PCAOB inspectors' inspections of financial details. They have a combined market cap of more than \$1.8 trillion.

Chinese law, in particular, restricts access to accounting information, citing national security and state secrecy. But buying shares in a company that can operate under completely opaque auditing standards or oversight is really more of a bet than a true investment.

I am very concerned that investors are not adequately protected. I can't help but think of the Enron scandal, which spurred the creation of the PCAOB.

How are these 224 companies able to list on U.S. exchanges in the first place? And are there any nations, other than China, that restrict access to accounting information? And besides directly negotiating with China to access accounting information, what can be done to best protect investors?

Mr. DUHNKE. A couple of things.

How are they listed? I will stay out of the SEC's jurisdiction, but to connect it to the PCAOB's jurisdiction, they require a PCAOB-registered auditor, which they have, and that allows them, through our process, to be listed on our exchanges.

And how do we protect people? The statement you refer to is one of the steps that Chairman Clayton and I took. We thought it was important to make sure the market knows exactly what the status is so that they know what they are getting and not getting out of the process.

We do a number of things at the PCAOB. We update and keep updated our website to make sure those who wish to find out what the status is can get it and understand what the current situation is.

Any time I have an opportunity to include this one, I will speak publicly about our lack of access on the inspections and the enforcement fronts. And at this point, it is a buyer-beware situation; people should know that whatever protection they glean from our activities, they do not have them in those instances.

Mrs. MALONEY. Thank you.

Independence is absolutely critical to the integrity of an audit, and under Sarbanes-Oxley, auditors are prohibited from providing services that, among other things, could create conflicts of interest or result in their acting as an employee of their clients. And in the last few years, the PCAOB inspections have found numerous violations by auditors of the independence rules.

Do you know what evidence the SEC is looking at to suggest that there needs to be a loosening of auditor independence rules?

Mr. DUHNKE. Once again, I would defer to the SEC on their particular process, but our interaction with them is through our rules and standards, and that is what we would address.

Mrs. MALONEY. Okay. And we don't have anyone here from the SEC.

I yield back.

Chairman SHERMAN. Thank you.

The gentleman from Ohio, Mr. Davidson, is recognized for 5 minutes.

Mr. DAVIDSON. Thank you all very much for coming today. I always enjoy talking to FASB, and I appreciate the chance to talk about the public company side of that as well. As a smaller business owner and investor, I have experienced some consternation with FASB, and I just want to better understand how FASB goes about assessing the impact of decisions.

Previous decisions that I think perhaps have been not accurate or effective or helpful for the market would be mark-to-market, as an example. The way that was implemented, there might be times where it would be rational to mark-to-market, but why change the entire depreciation schedule for an asset when there is no planned leverage and no planned disposal of the asset?

And another one is the distinction between operating in capital leases. Why obliterate that line that has been pretty well time-tested, and very well understood? And it all allows for misapplication in banks.

As the regulators apply them, it could be dynamic. Cynics might say that this is an opportunity to create deal flow for the investors that serve on some of the boards. Others might just say, maybe the companies here are bigger, and they are looking at it from a more academic perspective and they are not adequately understanding the impact.

What kind of testing does FASB perform before issuing standards? Does FASB engage in rigorous testing, engagement with industry, and cost-benefit analysis? Do you share that research?

Mr. GOLDEN. Sure. Let me address that with respect to the improvements we made with respect to lease accounting.

Before we take on any project, we can trace it back to some issue in the capital markets. With respect to leasing, as a result of the Enron and WorldCom events, there was a request by Congress that the SEC do an off-balance sheet study. They completed that off-balance sheet study, and the number one observation was operating lease accounting.

At that point, we took on a project to determine if putting leases on the balance sheets would be decision-useful information to investors. We went out to investors to look at, were they already putting operating leases on the balance sheet, and if so, would the board's measurement give them better information? And we think it did give them better information.

Since I have been chairman, we have created a Private Company Council that is specifically designed to give the FASB input on what private companies think about our proposals, and what are some differences that private companies should do to save costs.

One of the most significant achievements that we have had there is reducing the amount of disclosures for private company preparers, because we don't believe investors in private companies need the same amount of disclosures as public companies.

We also ask them, is there a more practical way in which to apply our standards? And with respect to leases, we did work with them to come up with a different discount rate philosophy.

Mr. DAVIDSON. Okay. How much influence does the SEC, which oversees FASB, and of course, they are overseen by Congress, how much does it have on FASB's work?

If you look at the influence of the SEC, I appreciate that you are creating this privately-held company. You don't necessarily want to create two entirely different standards, but perhaps you do if you are going to do things that really are relevant for the kinds of investors, institutional investors, and the kind of capitalization structures that are markedly different.

Mr. GOLDEN. Yes. We have had some successes with our Private Company Council to change quite substantially and have a different accounting for private companies. One is with respect to good will.

With respect to your question about the influence of the Securities and Exchange Commission, their staff have, we work closely with the Office of the Chief Accountant, we work closely with the chief auditor of the PCAOB, with the banking agencies, and with others that use our information.

We want to make sure the input we are seeking from the SEC is, are the standards enforceable, as well as, as they, through their Corp Fin review, see differences in opinion that are out there, we can narrow that diversity. If they have questions that can help them in their reviews or enforcement matters, we work with them to do that.

Mr. DAVIDSON. I appreciate that. I wish I had more time to go into a whole range of issues. I think CECL has been covered fairly adequately, but I think it is indicative of decisions where there is a lot of theory and not a lot of practice.

And I appreciate the effort with the Private Company Council to maybe look at it from different perspectives, as has been suggested, with the way that CECL came to be.

Thank you.

Chairman SHERMAN. Thank you.

Now, I am pleased to recognize the gentleman I have been sitting next to for over 20 years, on both of my committees, the gentleman from New York, Mr. Meeks, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

I am going to talk to Chairman Golden. I have been running around and talking to a number of folks, and I understand that switching to the CECL accounting method, from what they all tell me, will have significant real-world impacts on community banks, minority banks, and other providers of credit and banking services.

The fact of the matter is, many small financial institutions have struggled since the financial crisis, and they seem to think—and I may agree with them—that CECL is likely to be an additional blow

to the dwindling number of community banks and minority institutions.

Small community banks have been disappearing at an alarming rate since the financial crisis, specifically the number of minority depository institutions, which has fallen from 215 banks in 2008 to fewer than 150 today.

According to the FDIC, following the financial crisis, minority banks were 2½ times more likely to fail than all other banks. Today, MDIs represent only 2.8 percent of FDIC's insured banking charters and 1.3 percent of assets.

This matters because research confirms that MDIs play an active role in addressing persistent discrimination as they are far more likely to serve underbanked communities of color and low- and moderate-income communities than both large banks and non-minority-owned community banks.

I say all this because when I engage with these banks and I start talking to the MDIs about the challenges they face and their principal concerns going forward, CECL systematically is at the top or near the top of the list of their concerns. Just about every one that I spoke with.

Crucially, a negative impact on small- and mid-sized financial institutions will also reverberate to lower-income and middle-class Americans. If these financial institutions curb lending and restrict credit, low-income individuals could see their cost of borrowing rise or could lose access to credit altogether.

Moreover, if CECL causes more small lenders to close their doors, the already growing problem of banking deserts and unbanked individuals will be exacerbated.

Given these serious potential economic disruptions, let me ask you this. In response to questioning in this committee, banking regulators—and we have had them here—acknowledged that CECL will have a material impact on capital and may impact availability of loans to marginal communities. But all they can do is to seek to mitigate any such impact if FASB finalizes its rollout.

Can you say almost definitively, without a study or anything else, that CECL implementation will not increase costs or reduce access to credit for low-income communities and communities of color, which have already faced well-documented hurdles accessing credit?

Mr. GOLDEN. There will be a cost to transition to CECL, but we think the ongoing costs to apply CECL are similar to the costs today with respect to the incurred loss model.

With respect to the availability of credit, I think that is directly dependent upon the regulatory capital associated with the change.

Mr. MEEKS. My concern is that the ramifications are so crucial. And that is why I am so focused on making sure that there is a complete study beforehand, because once a bank—once you lose access to credit or an MDI closes, it is not going to come back. And so my concern with a major shift like this is, let's make sure to dot our i's and cross our t's.

If, in fact, CECL's implementation curtails access to credit or the cost of credit for low-income communities of color, is there any opportunity—I don't know, is it possible, or would you be open to re-peeling and reconsidering and trying to think of some alternative



ways to accomplish the intended accounting transparency rules without negatively impacting bank capital?

Mr. GOLDEN. We are always open to improving our standards. But most of the financial institutions, if not all of the financial institutions you are talking about, are not going to be required to implement CECL until 2023.

There will be a lot of information about the CECL rollout for the larger public companies, and I think we can all review and study before those financial institutions you are talking about are required to implement CECL.

Mr. MEEKS. I see that, unfortunately, I am out of time.

Chairman SHERMAN. I am sure the gentleman is gratified that the impact on low- and moderate-income families and families of color will be delayed to some degree until 2023, by which time I am sure we won't have any problem for low- and moderate-income families by then, we hope.

With that, I will recognize the gentleman from Indiana, Mr. Hollingsworth.

Mr. HOLLINGSWORTH. Chairman Golden, earlier, in your opening statement, you had said some percentage—I think it was in the 80s—of total banking assets that CECL is going to go into effect upon as of January 1st. What was that number?

Mr. GOLDEN. I think I said the vast majority.

Mr. HOLLINGSWORTH. Okay. So, we should be comforted by the fact that the vast majority of banking assets are already going to be subjected to this, and we will get the results of the vast majority of impacts and then we will make further determination afterwards?

I want to associate myself with the many comments on both sides of the aisle, the many letters that have gone back and forth, expressing deep and grave concerns over CECL going into effect.

You and I and others have had meetings about this where it has been explained to me that this is merely a temporal effect, we are taking those losses that are going to be incurred over time and we are just asking them to up-front characterize those, rather than over time characterize those, as though that is some small and minor effect.

I deeply, strongly, and vigorously, as we discussed before, believe that creates a lot of procyclicality, which will be problematic going forward.

We have read over and over again from economist after economist about some of the challenges the Fed may have in working through the next recession, given where interest rates are, given the quantitative easing that they have already undertaken in the past, and given subdued inflation. I am really concerned that we are setting ourselves up for an even larger problem going forward, caused by accounting.

I think that puts us in a very precarious position, and I would rather see us develop countercyclical ballast to this economy rather than more procyclical problems.

I will let others talk further about that, but rest assured, I feel as they do about the concerns on this.

I wanted to address something else with you. In 2012, Congress passed the JOBS Act to expand the options for businesses to raise

capital through exempt offerings and attract more private market companies to public markets, which I think is a really laudable aim.

When you were discussing FASB reform efforts on liabilities and equity, you noted that this is an area where private companies and other smaller public companies might be disparately impacted by the complexity and confusion of the current standard. I wondered if you might talk a little bit about whether you take into consideration EGC on-ramp status or other things in thinking about some of these rules as they come on board for public companies that are smaller?

Mr. GOLDEN. Yes, absolutely. And I hope before my tenure as the FASB chairman is done, in the middle of June of this year, that we are able to complete a substantial improvement to simplify the distinguishing characteristics between liabilities and equity, which will allow us to decrease the number of restatements and reduce costs for those that are emerging companies.

With respect to the JOBS Act and emerging growth companies, we recognize that there is a benefit of deferring effective dates for smaller public companies, and we instituted a new philosophy that we worked on throughout 2019—

Mr. HOLLINGSWORTH. Can you explain to me what that benefit is that you recognize?

Mr. GOLDEN. That they are able to learn from public companies, that we were able to see an entire audit cycle, an entire Corp Fin review cycle, that the board can provide additional education material, narrow diversity, or make cost-effective changes before smaller public companies, private companies, are required to implement our standard.

Mr. HOLLINGSWORTH. Got it.

Mr. GOLDEN. In the past, we used to have a 1-year spread between public and private, and going forward, we will have a 2-year spread.

That said, on CECL, we are having a 3-year spread between when the public companies are required to go, and when the private companies, the not-for-profits, and the smaller public companies will be.

Mr. HOLLINGSWORTH. Okay. This continues to be an important aspect that this committee and, frankly, other people are talking about.

And with that, I am going to yield the balance of my time to the gentleman from Missouri.

Mr. LUETKEMEYER. I thank the gentleman.

Quick question for you, Mr. Golden. You talked about the need for this with regards to transparency for investors, and basically at this point it is only the publicly traded companies, which is basically 400 out of the 5,000 banks, and it doesn't really include the 6,000 credit card companies.

But if you go down the line and you talk about the GSEs, auto loans, insurance companies, even reinsurance companies, you are talking thousands and thousands and thousands of entities out here for the benefit of 400 entities.

Tell me how that works. Tell me how you can justify supporting 400 at the expense of thousands of other folks and driving some of

these folks out of business, when you look at the costs that they are going to incur, especially for credit unions and small banks.

Mr. GOLDEN. I believe by allowing a 3-year spread between public companies and smaller financial private institutions, we will be able to look at the use of CECL, the application of CECL, we will be able to narrow any diversity, we will be able to have additional cost savings before the community banks, before the credit unions are required to implement CECL.

Mr. LUETKEMEYER. I see my time has expired.

Mr. HOLLINGSWORTH. I will yield the time back.

Chairman SHERMAN. I now recognize the gentleman from Illinois, Mr. Foster.

Mr. FOSTER. Thank you, Mr. Chairman.

I was just musing over this, the business of procyclicality and countercyclicality. Speaking more generally, are there areas where we could introduce more countercyclicality into accounting generally? Just cast a wide net initially, and then I have some specifics.

Mr. GOLDEN. I don't have specifics of other standards. What we try to do at the FASB is we try to increase the decision-useful, neutral information to investors that gives them better information so that they can allocate capital, so they can decide where they want to lend, and so other users can make more informed decisions. We believe allowing investors to better allocate capital reduces the cost of capital, helps make our capital markets more—

Mr. FOSTER. Absolutely. And then, there is a bubble building about to collapse. That is the biggest misallocation of capital. The real estate bubble that we experienced a decade ago is probably the biggest misallocation of capital in human history.

And so, I was just fishing for accounting principles, sort of the general principles I was thinking of, was just to treat skeptically the value of recently appreciated assets. For example, don't use the mark-to-market price, but use some average over the last few years to get a better idea.

This thing is, this sort of principle, if applied throughout accounting, would really do a lot towards dampening bubbles and sort of automatically retracting the punch bowl as the party gets going, if you get my meaning.

I was wondering, are there other examples of options you had considered where the cyclicity could be used as the deciding factor in leaning the scales to stabilize the system?

Mr. GOLDEN. I cannot give you any specific examples at this point other than, like I said, our process is designed to ensure that investors are getting better, higher-quality, more decision-useful information.

Mr. FOSTER. Okay. Well, if things occur to you or if you come back with a more considered reply, either—

Mr. GOLDEN. We would be happy to.

Mr. FOSTER. Yes, I would appreciate that, because that is something that we can do to, as I say, stabilize the system.

And now, I will yield the remainder of my time to my colleague, Mr. Meeks.

Mr. MEEKS. Thank you.

The chairman just indicated, and I agree, that for the small community banks and MDIs, this does not take effect for them until 2023. And I think that is as a result of a lot of individuals who listened to the comments. There was a lot of noise. Because otherwise, if it wasn't for them, it might have moved forward, but you heard them.

The question then is, do you have the capacity to do the kind of research and investigations to determine where we are going with this? Would you agree to work with the Federal Reserve in trying to get something done in that regard? And then, what will you do with the information once you finish and do a complete study, particularly as it pertains to the community and small banks?

Mr. GOLDEN. We have sufficient resources at the FASB staff. Reviewing the information that comes from the capital markets of our change is not something new. We did it with respect to revenue recognition, we have done it with respect to lease changes, and we plan to do it with respect to CECL changes.

As I said in my opening remarks, we stand ready to help the study that is mandated by the U.S. Treasury in consultation with the banking agencies. We look forward to reading that study. If there are any recommendations that come out of the study, we will carefully implement those recommendations.

Mr. MEEKS. Because one of the things that I took out of the decision to have implementation for all of the largest financial institutions is that you then understood that CECL's impact had not been adequately studied in a quantitative manner.

And so, I hope that there is a quantitative study that is going to be done now, and once that quantitative study is completed and you see the standards, that it will have an effect on these banks as well as low- and moderate-income communities, that those findings then will be implemented and we don't continue, even—we are talking about 2023. Sometimes there is a delay, you do a study, there is no action as a result of the study, and then the same thing takes place and the same damages because of the cost.

I am out of time. I do give you credit for listening to people, though, the first time, and pushing it back to 2023.

Chairman SHERMAN. I thank the gentleman from New York, and I recognize the gentleman from Ohio, Mr. Stivers.

Mr. STIVERS. I want to thank you both for being here. And my first question is for Mr. Golden. The CECL change has been explained by some people as the biggest accounting change in 40 years. I am not going to ask you whether you agree that it is the biggest change in 40 years. Do you believe it is a major change or a minor change?

Mr. GOLDEN. I believe it is a major change for financial institutions.

Mr. STIVERS. I think so, too.

Can you tell me, did you engage in any field testing?

Mr. GOLDEN. We had 25 meetings over the course of the project where we went to the companies' sites and did field work.

Mr. STIVERS. And did you do comprehensive cost-benefit analysis?

Mr. GOLDEN. We think that our process was comprehensive. Again, the cost-benefit analysis was in connection with, was this going to give better decision-useful information to investors?

Mr. STIVERS. So you looked at it only under the lens of, does it give more information to investors, not a total cost-benefit analysis?

Mr. GOLDEN. We try to understand, is this going to give the investor better information about making more informed decisions, what are the costs that companies will incur to comply with the standard. That is how we have done our cost-benefit analysis, and that is what we did on this.

We also produced a document that describes in essence, in plain English, how we describe and consider the cost and benefits.

Mr. STIVERS. And did you look at any potential market instability created by CECL or procyclicality?

Mr. GOLDEN. I don't recall looking at anything related to market instability.

Mr. STIVERS. Great. I think you should look at all of those. Market instability is pretty important. And I will tell you my concern about CECL is, I think it is a rule for accountants, by accountants, which is 10 years too late, it is unnecessary, and it drives procyclical behavior and forces capital into artificially restricted buckets.

We need capital to protect insolvency and against future problems everywhere, not just restricted capital. Restricted capital might be available, or it might not be available, given what is going on and what the problem is, and that is my concern about CECL.

I have talked to the Federal Reserve about looking at CECL in accordance with their total capital standard and sort of adding it, giving credit for the CECL reserves as part of capital. But that still doesn't solve the problem, because it is restricted capital, and I am very concerned about that.

So I am going to be pursuing some legislation to require the Securities and Exchange Commission to put some controls around FASB because I am very concerned about no testing, no looking at what is going on with regard to market instability, and the impacts. Cost-benefit analysis needs to look at what happens and what the outcome of that will be, not just the cost in a myopic way of, do investors get more information?

And there is a whole bunch of private institutions that will have huge costs related to CECL, too. So, I am very concerned, and I am going to be looking at some serious legislation as a result of it. And that just is what it is.

I also want to ask Mr. Duhnke about our decline in initial public offerings that we have seen over the last 2 decades, frankly. And I know it came up in the JOBS Act question. They are sort of related. But we have had a decline because of the cost of compliance and the cost of going public in companies choosing to go public and take an IPO.

What is the PCAOB doing to look at regulatory costs that are reducing the number of companies that are going public? Because that means less investments available to mom-and-pop, Main Street investors. If you are a private company and not a public

company, it is not available to my Uncle Bill, but if you are a public company, it is.

What are you doing to try to look at that?

Mr. DUHNKE. I think what most directly relates to your question is, when our inspectors go in and do an inspection and they require documentation from audit firms, that request and that demand can extend to the company, which can make them incur additional costs. So, we are very focused on that, to make sure that we are not exceeding the requirements of our standards.

Mr. STIVERS. How do you streamline those regulations and processes to make sure that the process is not overly burdensome? And I want to make sure you get the information you need. But what are you doing to make sure you are not overly burdensome in those contexts?

Mr. DUHNKE. It is less a question of, how do we change a standard, as, how do we implement a standard?

Mr. STIVERS. Okay.

Mr. DUHNKE. We can do it through our inspections process.

Mr. STIVERS. Great.

Chairman Golden, as far as FASB goes, do you think there are any rules, accounting standards, that have come out of FASB that have resulted in precipitating the decline of IPOs over the last 20 years?

Mr. GOLDEN. No, I don't. I actually think the standards that we put forward have helped our capital markets.

As I talked to the gentleman earlier about the differences we made for private companies, we are careful to make sure that the differences do not impact entities' abilities to go public, and so far we have discovered that it does not.

Mr. STIVERS. I hope that is true, but I really worry that the burden you place on companies in a quest for more information for investors drives up the cost of companies going public, discourages companies from going public, and has precipitated the decline of initial public offerings, which means mom-and-pop investors get less access.

Chairman SHERMAN. Thank you.

Mr. STIVERS. Thank you. I yield back.

Chairman SHERMAN. It is now appropriate to recognize members of the Full Committee who are not members of the subcommittee, starting with the gentleman from Missouri, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Mr. Golden, you just indicated that you believed that CECL is a major rule. Do you think mark-to-market was a major rule?

Mr. GOLDEN. Yes, I do.

Mr. LUETKEMEYER. How did that work out?

Mr. GOLDEN. We have made a number of changes.

Mr. LUETKEMEYER. Not so hot. You had to rescind it, right?

Mr. GOLDEN. We did not rescind mark-to-market. We changed—the thing you are noting that occurred here had changes to where mark-to-market was—

Mr. LUETKEMEYER. But it exacerbated the downturn and you had to make some tremendous changes in that to make it actually stick around?

Mr. GOLDEN. You are correct.

Mr. LUETKEMEYER. And you did no study, you did no cost-benefit analysis on that before you implemented that one, correct? That is what you told me in private before. I assume that is still correct.

Mr. GOLDEN. I believe that is correct.

Mr. LUETKEMEYER. Okay. So, here we have another major rule that could have a similar dramatic effect and impact on our economy, and again we did not study, did not go to individuals, did not go to the private sector, which is going to have to implement this rule on a day-to-day basis and figure this out.

You had no concerns about this at all. Is that right?

Mr. GOLDEN. No. I recognize the concerns of this committee and the concerns of the various financial institutions. We take those concerns—

Mr. LUETKEMEYER. Yes, but not before you made it, not before you implemented it, apparently. Otherwise, you would have made some changes or not done it at all.

Mr. GOLDEN. I think CECL is an improvement to investors. I think it will help the public capital markets.

Mr. LUETKEMEYER. With all due respect, Mr. Golden, I think this is a solution in search of a problem. I think you structured this thing completely wrong. You have it to the benefit of 400 companies who don't want it, investors who don't want it, to be able to analyze those balance sheets, and at the expense of the other thousands and thousands of companies who are going to have to implement it and their costs and the effect on their customers.

In this committee, not too long ago, we had a gentleman from the National Association of Home Builders who indicated that for every thousand dollars' worth of increase in the cost of a home, 100,000 people got priced out of a home. They couldn't afford the home, to go for a mortgage anymore, and live the American Dream of having a home.

Did you ever consider the effect on the real people in the real world when you proposed this rule?

Mr. GOLDEN. Our thorough process was based on—that is consistent with our mission—whether or not—

Mr. LUETKEMEYER. So, you didn't talk to the real people in the real world who are going to have to deal with the effects of this, which means that when the banks and the credit unions have to implement this and be able to find enough resources to put into the reserves, they are going to have to raise the price of their products, especially for small banks and credit unions. Where are they going to get the income to be able to address these reserves?

And I can tell you, I have a study sitting right here with regards to the credit unions. One association gave me a study that says it is going to cost \$14 billion to \$15 billion. Where do you think that comes from? Are you concerned about that at all?

Mr. GOLDEN. Yes. And, again, that is one of the reasons why we gave an additional year for community banks and for credit unions so we can monitor the implementation for the public companies and stand ready to make—

Mr. LUETKEMEYER. Again, with all due respect, Mr. Golden, monitoring after the fact shows the negligence and incompetence, in my mind, when you have mark-to-market that you already had in

place in the past that didn't work, without a study or a cost-benefit analysis to show that it wouldn't work.

And now you have done the same thing, and you are sitting here trying to implement something again and monitor after the fact. To me, that is the definition of insanity, doing the same thing over and over again that doesn't work. It just blows my mind to see what you are doing.

There is no Federal agency that would be able to get away with what you just did. Do you realize that?

Mr. GOLDEN. We did a very rigorous cost-benefit analysis in connection with our mission.

Mr. LUETKEMEYER. No, you didn't. You told me you didn't. Either you fooled me before or you are fooling me now, because you told me in our private meeting that you didn't do a cost-benefit analysis and you didn't do a study on this. So, which one is it?

Mr. GOLDEN. We did a cost-benefit analysis in connection with our mission as it relates to—

Mr. LUETKEMEYER. Well, your mission, but that is not on the customers it is going to affect.

Mr. GOLDEN. Right.

Mr. LUETKEMEYER. How many people is it going to take?

Mr. GOLDEN. I'm sorry, what?

Mr. LUETKEMEYER. How many people is it going to take to get your attention, that this is going to affect real people in the real world, sir?

I deal with the real world. I am a business guy. I sit across the table from real people. I am a legislator. I sit across the table from my constituents. I go home every week and talk to them. These people are going to be hurt by your rule. A simple accounting standard is going to decimate the people in my district's ability to have home mortgages.

And it is a bipartisan effort. My friends on the other side of the aisle are as upset about this as I am. This has to stop. This can't continue. You should stop and look at the damage you are going to be doing to the citizens of this country.

And in essence, after that happens, it is going to devastate our economy. The ripple effect is going to be awful.

And without a study, you can't prove me wrong. I hope you can prove me wrong, because I don't want to see this happen to my constituents.

And the study, by the way, that the Treasury is going to do, that is my study I requested, and I hope you do work with them on that, and you do implement their changes, because hopefully, it will show that this has to be changed. This can't continue, sir.

With that, I yield back.

Chairman SHERMAN. Thank you.

We will now recognize the gentleman from Ohio, Mr. Gonzalez.

Mr. GONZALEZ OF OHIO. Thank you, Mr. Chairman.

I think the independence of FASB generally is a good thing, right? I think, generally speaking, it has been positive. And I think you don't want us making your rules for you. We don't have that expertise. Mr. Luetkemeyer does, but a lot of us do not.



Having said that, I can't help but echo the comments that others have made with how irresponsible the CECL decision feels from the outside.

You have testified multiple times that you have made CECL as consistent with your mission to provide useful information to investors, correct?

Mr. GOLDEN. Correct.

Mr. GONZALEZ OF OHIO. And you believe because there are exclusions for smaller banks, you will be able to know the effects ex-post and you may course-correct?

Mr. GOLDEN. Yes.

Mr. GONZALEZ OF OHIO. Okay. But you have also testified that you could care less about the real-world economic impacts of the decision to implement CECL, because you are solely focused on your mission—which is a noble mission, I grant you. But it is not clear to me that anything that you see going forward, unless it is that investors are complaining, would ever force you to course-correct.

And so, it is hard for me to square that. You either consider the economic real-world impacts, in which case you should have done it before CECL, or you don't, in which case anything that happens is going to be immaterial to your decision to change.

Mr. GOLDEN. One of the items we are looking forward to seeing the results of from the Treasury study is the impact on regulatory capital. And I think it is very important to understand how the impact on regulatory capital impacts the types of things that Mr. Luetkemeyer is talking about.

Mr. GONZALEZ OF OHIO. Okay. Again, I am going to give the gentleman from Missouri time in a second, but I want to switch to Chairman Duhnke.

I want to talk to you about China, specifically. It doesn't make any sense to me why Chinese firms should be able to avoid audits when American companies have to go through that process.

Do you need legislation from us to enact that change, or can you do this through the regulatory environment?

Mr. DUHNKE. The process that we follow is inspection. If there are violations, enforcement, resolution of the enforcement issue, and then whatever the sanction might be. The sanctions can be anywhere from something minor, to a fine, to deregistering of a firm.

Just to make sure we are clear here, we are not talking about Chinese companies. We are talking about auditing firms. That is whom our jurisdiction is over.

Then, once a decision for deregistering takes place, that implicates the SEC's world, and they have to look at listing standards and whether or not they would continue to qualify.

Mr. GONZALEZ OF OHIO. And how far along are we in terms of getting China up to those standards, in your estimation? Are we close? Are we far away? Where are we at?

Mr. DUHNKE. Again, let me be more specific than saying, "close" or "far away." We require sort of a three-pronged principle before we enter into negotiations with somebody for an inspections and enforcement agreement, and we have yet to reach agreement on those principles with the Chinese. Whereas, it is accepted by every other bilateral relationship we have, they have not accepted it, so

therefore we have not been able to enter any substantive conversations.

Mr. GONZALEZ OF OHIO. Okay. And we will follow up. I would like to hear more on how we can be assistive in that.

And with that, I will yield to Mr. Luetkemeyer.

Mr. LUETKEMEYER. I thank the gentleman from Ohio.

Mr. Golden, I think that this standard is going to have a dramatic effect on the capital and reserves. As I said a while ago, I have something in my folder here with regards to one group of credit unions associations is \$14 billion. I was talking to some FDIC folks yesterday, and they have a couple of banks. One of them is \$4 billion, another one is \$30 billion, and it is going to have to do some additional reserves.

How big an impact do you think this is going to have? Have you ballparked it at all? Mrs. Wagner talked a while ago about \$50 billion to \$100 billion. I think we are going to blow past \$100 billion. But do you have an idea? Is it concerning?

Mr. GOLDEN. I do agree that there is a significant increase in the allowance, which is a direct impact associated with capital. We do observe that the banking regulators have looked at that. They have given a transition, which will make it easier, and we look forward to seeing the Treasury report as to the totality of the impact on regulatory capital.

Mr. LUETKEMEYER. How big a number does it take before you do something?

Mr. GOLDEN. I'm sorry, I didn't—

Mr. LUETKEMEYER. I said, how big a number is it going to take to get your attention so that you make some changes or scrap this thing?

Mr. GOLDEN. You have our attention now. We don't set regulatory capital. So to the extent that this is required to impact and increase regulatory capital, that is not in the space of the FASB. We write standards that neutrally reflect the economics. We don't write standards to impact regulatory and bank capital—

Mr. LUETKEMEYER. But, sir, as my friend from Ohio put it very succinctly here, your lack of concern for the citizens of this country is breathtaking. Your inability to see the economic impact on our economy as a whole is breathtaking. That doesn't concern you?

Mr. GOLDEN. No, it absolutely does concern me. What I am saying is that we need to work with the banking regulators to better understand what types of capital changes they are going to do as a result of this.

Mr. LUETKEMEYER. Okay. My question then—I will restate it—is, what number gets your attention? A hundred million? Two hundred million? At what point do you sit down and say, “Whoa, this is too much, we have to scrap this thing and do something completely different?”

Mr. GOLDEN. I don't know the specific number, but this hearing, the results, you have my attention.

Mr. LUETKEMEYER. How big a number do you think it takes? Can I get a ballpark?

Mr. GOLDEN. I don't know.

Mr. LUETKEMEYER. Sir, I appreciate the additional time from the chairman, but this really concerns me.

Chairman SHERMAN. Thank you.

Mr. LUETKEMEYER. I yield back.

Chairman SHERMAN. One announcement about future hearings. I would very much want to hear not only from the ranking member but everyone else about their ideas on what should be the topics of future hearings.

So far, I have seen a need for us to hold a future hearing on LIBOR and legacy LIBOR, to hold a future hearing on bond rating agencies, also known as credit rating agencies. And after this hearing, it is very clear to me that we need to bring in some accounting professors, and then hear again from the FASB.

With that, pursuant to a prior understanding, I will recognize the ranking member for a 1-minute closing statement, and then I will finish with a 1-minute closing statement.

Mr. HUIZENGA. Thanks, Mr. Chairman.

Chairman Duhnke, thank you for showing up at our CECL hearing, CECL overview today.

I do want to follow through on some of my concerns that I had expressed about some of the redundancies, the overlap, the efficiencies, this is a time when many are concerned about deficits and spending, that we look the American taxpayer in the eye and tell them we are giving them the best value that they can possibly get out of their hard-earned dollars.

Mr. Golden, I appreciate you being here. I know it is clear to you that there is broad bipartisan concern about the direction, and the timing, as I had indicated in my opening statement, with the Treasury report that is being worked on. And I know the efforts of my friend and colleague from Missouri to get that study done and put into the FSGG appropriations. It is something that many of us believe should, and certainly must, in my opinion, have valuable information, not only for us, but for you, with what is transpiring here.

My time is up. I appreciate this. And I look forward to future hearings.

Chairman SHERMAN. The FASB has a bigger impact on Americans' lives than any other entity I can name, that they can't name and do not know about. It exercises governmental power and needs oversight.

As to CECL, all of the supposed benefits could be obtained by simply providing supplemental disclosures in footnotes. That provides all the transparency. That gives the analysts all of the information they could possibly want. And if they want more, we could give them another footnote.

The decision to instead affect the basic financial statements poses a grave danger to our whole concept of accounting, since it moves us down the road of saying, we must predict and pre-recognize all imaginable or future bad events. That isn't historic, that isn't reporting verifiable history. That is doing the analysts' jobs for them and predicting the future.

And finally, research and development. It is obviously bad accounting. It cannot be defended. It wasn't used for a hundred years. And it hurts our competitiveness around the world and is responsible for us not getting a lot of the research results we need.

Before we adjourn, I want to thank our witnesses for their testimony today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereupon, at 3:59 p.m., the hearing was adjourned.]

# **A P P E N D I X**

January 15, 2020

**Testimony of William D. Duhnke III  
Chairman, Public Company Accounting Oversight Board**

**Hearing on “Overseeing the Standard Setters: An Examination of the Financial Accounting Standards Board and the Public Company Accounting Oversight Board”**

**Before the U.S. House of Representatives Committee on Financial Services  
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets**

**Washington, D.C.  
January 15, 2020**

Chairman Sherman, Ranking Member Huizenga, and distinguished members of the subcommittee, thank you for the opportunity to appear before you today to discuss the important work of the Public Company Accounting Oversight Board (PCAOB).<sup>1</sup>

I joined our five-member board in early 2018, along with four other new board members. Not since the PCAOB was first founded in 2003 have five new Board members joined the organization at roughly the same time. With such a significant change in the Board’s composition, came a significant opportunity. We had the chance to reflect on lessons learned over the prior 15 years, to innovate, and to improve how we approach audit oversight.

In 2018, we used the opportunity to perform a comprehensive assessment of the PCAOB. To help our assessment, we engaged in significant public outreach. We sought input from our core stakeholders on what we were doing well, what we needed to improve, and how we could best improve audit quality. We heard from the SEC, investors, audit committees, financial statement preparers, audit firms, academics, and others. The message we received back was loud and clear: The PCAOB was ripe for change. The PCAOB had, in many respects, lost the public’s trust. The organization was out of touch with market developments and stakeholders’ needs. It had not matured significantly since opening its doors in 2003. During that time, it developed a culture that lacked internal accountability. And, its integrity had been compromised in 2017 by employees leaking confidential inspections information to those we are charged to regulate.

---

<sup>1</sup> The views I express here today are my own and do not necessarily represent the views of the board, or any individual board member.

With that as our starting point, we set the PCAOB back on the path envisioned by Congress when it passed the Sarbanes-Oxley Act. We published a new five-year strategic plan in November 2018. That plan emphasizes the need for us to transform the PCAOB into a trusted leader that promotes high quality auditing through forward-looking, responsive, and innovative oversight. It articulates five specific goals and identifies the core values we expect our people to demonstrate as they work towards those goals: integrity, excellence, effectiveness, collaboration, and accountability.

In 2019, we began the work necessary to implement our vision and execute on our strategic goals. Doing so has required substantial change. That change has permeated the entire organization and has touched nearly every aspect of our work. Change is never easy, but the Board collectively believes the changes we are pursuing are necessary to fulfill our mandate. We are grateful to those at the PCAOB who have embraced our current path. Because of their efforts, we've made substantial progress.

Let me highlight a few examples. First, we have focused on improving the effectiveness of our oversight. That oversight involves inspections of audit firms, enforcement of auditing standards and related securities laws, and standard-setting for the audit profession.

With respect to our inspections, we have begun a multi-year transformation of how we plan for, conduct, and report on inspections. We have significantly increased our emphasis on audit firms' systems of quality control. We also have developed—and will soon roll out publicly—a revised inspection report. Our revised report will reflect incremental progress towards providing stakeholders with more timely and relevant information related to our inspections. Further, we have begun to report not only audit deficiencies, but also successful practices we have observed.

In enforcement, where we share concurrent jurisdiction with the SEC, we have placed a renewed emphasis on investigating significant audit failures. We also have issued settled orders and decisions in numerous significant matters, covering violations related to substantive auditing standards, auditor independence rules, audit documentation alterations, and non-cooperation with our inspections. Our investigative pipeline remains consistent with recent years.

With regard to standard-setting, we have been active in improving existing auditing standards. In late 2018, we adopted significant changes to the standards related to auditing accounting estimates, which are at the core of many public companies' reported financial results. We also adopted important changes to the standards governing auditors' use of the work of specialists. In 2019, we began the process of modernizing our standards that govern audit firm quality controls. Strong

systems of quality control provide the foundation for audit firms to execute consistent, high-quality audits. Last month, we issued a concept release seeking public input on how to best update our current quality control standards.

Second, we have placed an increased focus on innovation and technology. We have met with numerous groups to explore technologies affecting both auditing and financial reporting. We must ensure that our work does not inhibit those innovations that support audit quality.

Third, we have greatly expanded our engagement and outreach to stakeholders. We hosted numerous roundtables with investors and audit committees. And, for the first time in the PCAOB's history, we invited every audit committee chair for the U.S. audits we inspected in 2019 to speak with us.

Finally, we have launched significant process and cultural changes within the PCAOB. We recently stood up our Office of Enterprise Risk Management, and hired our first-ever Chief Risk Officer, Chief Information Security Officer, Chief Compliance Officer, and Chief Data Officer. We reorganized our research and analysis function. We also drafted our first-ever human capital strategic plan.

These are just a few of the changes we have pursued recently. As we continue to push forward with our core strategic priorities throughout 2020, we welcome feedback from the subcommittee, as well as investors, audit committees, preparers, and others on our oversight efforts.

Thank you. I'd be pleased to answer any questions you may have.



**Testimony of Russell G. Golden**

**Hearing on Overseeing the Standard Setters: An Examination of the Financial Accounting Standards Board and the Public Company Accounting Oversight Board**

**Before the U.S. House of Representatives Committee on Financial Services  
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets**

**Washington, D.C.  
January 15, 2020**

Chairman Sherman, Ranking Member Huizenga, and Members of the Subcommittee:

My name is Russell Golden, and I am the Chairman of the Financial Accounting Standards Board ("FASB" or "Board"). I would like to thank you for this opportunity to participate in today's important hearing.

In furtherance of the Subcommittee's oversight of financial reporting matters, I would like to:

- Provide a brief overview of the FASB including a description of our robust and transparent standard-setting process and how the FASB remains accountable to our stakeholders;
- Highlight some of our standard-setting activities, including our implementation support activities; and
- Provide an overview of our agenda and future activities.

**The FASB**

Established in 1973, the FASB operates with oversight by the Financial Accounting Foundation ("FAF"), a private-sector, not-for-profit organization based in Norwalk, Connecticut. Through authority granted to it by the Congress, the U.S. Securities and Exchange Commission ("SEC"), has recognized the FASB as the designated accounting standard-setter for public companies for more than 45 years. The FASB also establishes financial accounting and reporting standards for private companies and not-for-profit organizations that follow U.S. generally accepted accounting principles ("U.S. GAAP").

Additionally, many organizations, including state Boards of Accountancy and the American Institute of Certified Public Accountants ("AICPA"), recognize FASB standards as authoritative.

U.S. GAAP is essential to the efficient functioning of the U.S. economy because investors, creditors, donors, and other users ("investors and other users") of financial reports rely heavily on credible, concise, and understandable financial information. Many people who make decisions on capital allocation cannot require reporting entities to provide them directly with the information they need and must rely on general purpose financial reports. Because the FASB's goal is to improve the utility of financial information in making capital allocation decisions,

meeting the needs of those investors and other users is a primary consideration in developing accounting standards. While not all users analyze information in the same manner, they all share a desire for financial reports that are comparable and that provide information that faithfully represents the results of an organization's activities.

The FASB recognizes, however, that information contained in financial reports is produced by a financial reporting system with multiple participants, including entities that prepare financial statements, auditors, regulators, and other stakeholders. Therefore, the FASB gives careful consideration to all stakeholders' views on all aspects of an accounting standard proposal, including the benefits to investors and other users of financial information and the compliance costs of the standard, as the standard is developed. In today's dynamic financial markets, the need for integrity, transparency, and objectivity in financial reporting has become even more critical to ensuring the continued strength of U.S. capital markets and to the broader prosperity of our economy as a whole.

We at the FASB take our role in promoting the integrity of our capital markets very seriously, as has the Congress. In the Sarbanes-Oxley Act of 2002 ("SOX"), the Congress recognized the importance of protecting the integrity of the FASB's accounting standard-setting process from undue influence by providing the FASB with an independent, stable source of funding from annual accounting support fees collected from issuers of securities, as those issuers are defined in SOX.

It is important to note that although the FASB has the responsibility to set accounting standards, it does not have authority to enforce them. Officers and directors of a company are responsible for preparing financial reports in accordance with the accounting standards that the FASB issues, but auditors then provide an opinion as to whether those financial statements have been prepared in accordance with those accounting standards. The Public Company Accounting Oversight Board ("PCAOB") is charged with overseeing auditors of public companies, which includes an auditor's analysis of whether a public company has complied with appropriate accounting standards. The SEC has the ultimate authority to analyze whether public companies have complied with accounting standards.

#### *The FASB's Mission*

As I have noted, the FASB recognizes the critical role that high-quality accounting standards play in financial reporting and in supporting the efficient functioning of our capital markets. Robust and transparent financial reporting increases investor confidence, which leads to better capital allocation decisions and economic growth.

The objective of financial reporting is to depict the economics of a transaction neutrally and thus provide financial information about the reporting organization that is useful to existing and potential investors, lenders, and other creditors in making resource allocation decisions.

These decisions typically involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit.

The FASB's mission is twofold: to establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports and to educate stakeholders on how to most effectively understand and implement those standards. Accounting standards are not intended to drive behavior in a particular way; rather, they seek to present financial information so that users can make informed decisions about how to best deploy their capital. The FASB remains committed to ensuring that our nation's financial accounting and reporting standards provide investors with the information they need to confidently invest in the U.S. markets.

As it works to develop accounting standards for financial reporting, the FASB is committed to employing a transparent, inclusive, and orderly process. Our comprehensive procedures permit timely, thorough, and open study of financial accounting and reporting issues and because we understand that the FASB's actions affect so many stakeholders, the procedures also encourage broad public participation throughout the standard-setting process.

The FASB accomplishes its mission through a process that:

1. Improves the usefulness of financial reporting by focusing on the primary characteristics of relevance and faithful representation of financial information, as well as other enhancing characteristics of useful information including comparability, verifiability, timeliness, and understandability;
2. Guides and educates the public, including users of financial statements, the individuals that prepare financial statements, auditors, and others. Through outreach to stakeholders, the form of standards themselves, and related implementation activities, the FASB improves the common understanding of the nature and purposes of information contained in financial reports;
3. Keeps standards current to reflect changes in methods of doing business and changes in the economic environment;
4. Considers promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process; and
5. Promotes the convergence of accounting standards internationally when that helps to improve the quality of financial reporting where such convergence is deemed to be appropriate in the public interest and for the protection of investors.

#### ***Oversight of the FASB***

The FASB operates in an open, collaborative, and accountable manner. First, the FAF Board of Trustees exercises its authority over the FASB by overseeing its administration and finances, as well as that of the FASB's sister organization the GASB and their advisory councils, the Financial Accounting Standards Advisory Council ("FASAC"), the Governmental Accounting Standards Advisory Council ("GASAC"), and the Private Company Council ("PCC"). The Board of Trustees comprises 14-18 independent members from varied backgrounds and perspectives, including users, preparers, and auditors of financial statements; state and local government officials; academics; and regulators.

Through their oversight, the Trustees ensure the effective, efficient, and appropriate stewardship of the FASB's resources as it carries out its standard-setting mission. The Trustees also appoint members to the FASB and its advisory councils and promote and protect the integrity of the FASB's standard-setting processes. To further enhance this oversight function, the Trustees established a post-implementation review process that evaluates the FASB's standard-setting processes to ensure they are as robust, transparent, and inclusive as possible.

Second, the FASB also is subject to SEC oversight with respect to standard-setting for public companies. The SEC has the statutory authority to establish financial accounting and reporting standards for publicly held companies and they are authorized to delegate this authority. For more than 45 years, the SEC has looked to the FASB to set accounting standards. In 2003, the SEC issued a Policy Statement, Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, which reaffirms this longstanding relationship with the FASB.

And last, but certainly, not least, the FASB is accountable to its stakeholders, including the Congress, for establishing standards that are consistent with our guiding principles and our comprehensive processes.

#### *The Standard-Setting Process*

An independent standard-setting process is foundational to producing high-quality accounting standards. The FASB sets accounting standards through a public process that actively seeks input from all stakeholders. I note that the FASB's Rules of Procedure, established under the FAF's bylaws, require this level of openness and stakeholder involvement in the standard-setting process.

#### *Stakeholder Feedback*

The FASB's standard-setting process involves a range of activities intended to solicit and incorporate stakeholder feedback, including, as appropriate, public meetings, public roundtables, field visits or field tests, liaison meetings and presentations to interested parties, and the exposure of our proposed standards for public comment. Videocasts of FASB Board meetings and education sessions are available on its website to make it easier for stakeholders to observe and participate in our standard-setting process. The FASB also creates podcasts and webcasts to provide short, targeted summaries of our proposals and new standards so that stakeholders can quickly assess whether they have an interest and want to comment.

We also proactively request meetings with stakeholders, including a wide range of investors, auditors, and reporting entities, to discuss our proposals or to identify implementation issues with existing standards, which helps us to assess whether the proposals or existing standards will lead to better information as well as to assess the related implementation and ongoing costs. The FASB supplements its direct public outreach by meeting regularly with numerous advisory groups that assist the FASB in its work. The members of these advisory groups are drawn from a broad cross-section of the profession. The FASB's standard-setting

process and the resulting standards necessarily benefit from advisory group members sharing their views and experience with us on matters related to projects on the agenda, possible new agenda items, practice and implementation of new standards, and strategic and other matters.

In addition to the FASB's advisory groups, the FAF established the PCC in 2012, which advises the FASB on private company matters while the Emerging Issues Task Force ("EITF" or "Task Force") assists the FASB in improving financial reporting through the timely identification, discussion, and resolution of financial accounting issues relating to U.S. GAAP.

The PCC has an integral role in the process of establishing and improving standards of accounting and reporting as they apply to private companies. The PCC advises the FASB on whether modifications or exceptions to existing U.S. GAAP should be afforded to address the needs of private company financial statements. Any proposed changes to existing U.S. GAAP require endorsement by the FASB and are subject to the same standard-setting process as all other standards.

The EITF assists the FASB in addressing implementation, application, or other emerging issues that can be analyzed within existing U.S. GAAP. The EITF was designed to develop implementation guidance for accounting standards to reduce differences in accounting practice on a timely basis. Task Force members are drawn from a cross section of the FASB's stakeholders, including auditors, preparers, and users of financial statements. The chief accountant or the deputy chief accountant of the SEC attends Task Force meetings regularly as an observer. The structure of the EITF is designed to include persons in a position to be aware of emerging issues before they become widespread and before divergent practices become entrenched. The FASB also meets regularly with SEC and PCAOB staff.

Because banking regulators have a keen interest in U.S. GAAP financial statements as a starting point in assessing the safety and soundness of financial institutions, our staff is in frequent contact with them. Additionally, FASB members and members of our senior staff meet with them on a quarterly basis and otherwise, as appropriate. We also understand the Congress's interest as a stakeholder in the FASB's work, so we provide briefings for Members and their staffs on accounting developments. In short, the FASB actively seeks input from all of its stakeholders on proposals and processes and we are listening to them. Broad consultation provides us with the opportunity for the FASB to hear and consider all stakeholder views, to identify unintended consequences, and, ultimately, to encourage acceptance and understanding of the standards that are adopted.

#### FASB Guiding Principles

The FASB is keenly aware of the need to balance compliance costs of standards with the benefits investors and other users of financial reports gain. The FASB's broad and inclusive consultation process helps it to assess these factors and strike appropriate balances. The FASB exercises its judgment after considering relevant research, analyzing stakeholder views, and carefully deliberating issues. The FASB is guided by the following principles:

1. To be objective in its decision making and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully as possible without purposely influencing behavior in any particular direction.
2. To actively solicit and carefully weigh the views of stakeholders in developing standards and concepts. The ultimate determinant of standards and concepts, however, must be the FASB's judgment, based on research, public input, and careful deliberation, about the usefulness of the resulting information.
3. To issue standards only when the expected benefits justify the expected costs. The FASB strives to determine that proposed standards fill a significant need and that the expected costs they impose, compared with possible alternatives, are justified in relation to the overall expected benefits.
4. To issue high-quality standards, which are grounded in a consistently applied conceptual framework, set forth objectives and principles stated in clear and unambiguous language, and foster consistent application by providing structure and necessary detail derived from the principles.
5. To manage the process of improving standards in ways that balance the desire to minimize disruption of accounting and financial reporting processes with the need to improve the decision-usefulness of information in financial reports. The FASB establishes reasonable effective dates and transition provisions when new standards are introduced. The FASB also must balance the desire for comprehensive improvements in standards with the need for incremental changes that produce timely reporting improvements in areas important to users.
6. To provide clear and timely communications, endeavoring at all times to keep the public informed of important developments about the FASB's operations and activities.
7. To review the effects of past decisions and interpret, amend, or replace standards in a timely fashion if such action is indicated.

#### **FASB Activities**

Accounting standards that work provide relevant information to investors, lenders, and other financial statement users, helping them make better-informed decisions—decisions about whether to provide capital or where to lend or donate money. For an accounting standard to work, people must be able to consistently understand it and correctly apply it.

Standards that work encompass the entire standard-setting process from the research phase, through initial deliberations, and re-deliberations, to finalization of the standard and implementation efforts post-issuance.

Throughout that entire process, the FASB consistently listens and responds to stakeholders; performs quality research; and engages in quality communication. We welcome accountability to all our stakeholders.

#### ***Implementation Activities***

Our work does not end when a final standard is issued. In some ways, it is just beginning. Quality standards need quality implementation. You cannot have one without the

other. With that goal in mind, we undertake a variety of initiatives focused on educating our stakeholders, helping preparers and practitioners interpret the standards, and listening to our stakeholders to understand if we need to make clarifications to the standards to address unintended consequences, if any. For example, the Board recently revised its effective date philosophy and, as a result, deferred the effective date for leases, credit losses, hedging and insurance for certain entities on the basis of feedback from stakeholder outreach and from monitoring implementation. This revised effective date philosophy acknowledges that implementation is often far more challenging for private companies, smaller public companies, and not-for-profit organizations. The nature and extent of the initiatives vary depending on the scope and degree of changes in the new standard. For example, Transition Resource Groups (“TRGs”) are most useful for comprehensive standards that have significant and broad changes. Accordingly, the FASB created TRGs with the issuance of our Revenue Recognition and our Credit Losses standards.

The FASB also has an implementation web portal, which is an easy-to-navigate source of information that preparers need when implementing our major new standards. Portal visitors can even link directly to our staff specialists through the FASB Technical Inquiry Service. This longstanding resource allows stakeholders to submit technical questions about any of our standards. More specifically, I will highlight some of the implementation initiatives associated with three major Accounting Standards Updates (“Updates”) since I became Chairman.

#### Revenue Recognition

For revenue, we established a TRG made up of a cross-section of our stakeholders. The Revenue Recognition TRG addresses potential issues arising from the implementation of the revenue recognition guidance. Based on input from the TRG and other outreach performed, the FASB issued five technical improvements to address narrow aspects (to improve operability, reduce implementation cost, and mitigate the potential for broad noncomparability in application) of the guidance that do not impact the core principle of the guidance, namely that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the FASB has answered over 200 technical inquiries, issued 60 educational papers, and held 3 dedicated continuing professional education (“CPE”) webinars.

#### Leases

More recently for leases, the FASB has held 12 implementation Board meetings and issued 5 targeted improvements to the standard. In addition, we have responded to more than 250 technical inquiries, created 4 educational videos and held a dedicated CPE webcast.

We continue to work on leases today. We are currently in the process of performing outreach with public companies, audit firms, regulators and our advisory groups to understand difficulties that may have been experienced during implementation so that we can apply the lessons learned and determine if there are further improvements that can be made to the standard.

## Credit Losses

The Credit Losses TRG met twice before the standard was issued and the discussions helped to educate the Board on concerns that Credit Losses TRG members had about the standard so that the FASB could address them before the standard was finalized. The Credit Losses TRG has also met three times since the standard was issued to discuss specific implementation issues from stakeholders. The discussions have helped to educate stakeholders broadly about the new standard, and the FASB stands ready to hold additional Credit Losses TRG meetings as needed to facilitate a discussion with the Board about aspects of the standard that may require further clarification.

We continue to make improvements to the Credit Losses standard to provide clarity that improves the operability and reduces unnecessary costs without compromising the quality of information provided to investors. Since the issuance of the standard, we have issued three technical improvements and two staff questions-and-answer documents in response to stakeholders who asked us to clarify certain aspects of the current expected credit losses (“CECL”) guidance. In August, the FASB staff initiated a series of workshops around the country to help community banks and credit unions of all sizes understand the CECL standard. At these sessions, the staff dives deeper into the important concepts of the standard and provides insight into what the Board was thinking during the standard’s development. The staff also answers specific questions about implementing the guidance. In 2020, the FASB will collaborate with the Conference of State Bank Supervisors to hold workshops in participating states based on each state’s training needs.

**Recently Completed Activities**

The FASB has recently completed a number of amendments to U.S. GAAP through the issuance of Updates. These Updates include simplifications and clarifications of existing accounting standards, accommodations to improve the process for implementing new Updates, and changes to how companies recognize and present certain transactions in their financial statements and footnote disclosures. The Chairman’s Report detailing all our standard-setting activities by quarter is available on our website under the Reference Library menu<sup>1</sup>. Some of the more significant Updates are summarized below:

1. **Revised philosophy for setting the effective dates of major Updates.** In November we issued Update 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*. This Update represents a change in philosophy for setting the effective dates of major Updates. Under the new philosophy, a major Update is first effective for public companies that are Securities and Exchange Commission (SEC) filers, excluding those entities eligible to be smaller reporting companies (SRCs) under the SEC’s definition. For all other companies,

<sup>1</sup> The following URL links directly to the Chairman’s Report:  
<https://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176157097727>



it is anticipated that the FASB would consider for comprehensive amendments, requiring an effective date staggered at least two years after the initial effective date.

The FASB has issued several major Updates since 2014. On the basis of feedback obtained from outreach with stakeholders and monitoring of implementation, the Board has gained a greater understanding about the implementation challenges encountered by all types of entities when adopting a major Update. The challenges are often magnified for private companies, smaller public companies, and not-for-profit organizations. Many factors affect the severity of the challenges encountered by those entities including the availability of internal and external resources to manage the change and the timing of education about major Updates. The FASB decided to defer the effective dates of several recently issued major Updates for certain entities in light of its enhanced understanding about the implementation challenges they face. The following Updates' effective dates were partially revised by Update 2019-10:

- Update 2016-02, *Leases (Topic 842)* was already effective for certain entities including public companies, therefore the Board retained the effective date for those companies, including SRCs. The Update will be effective beginning in 2021 for all other companies.
- Update 2016-13, *Financial Instruments—Credit Losses (Topic 326)* will be effective beginning in 2020 for calendar-year-end public companies that meet the definition of an SEC filer, excluding SRCs, and beginning in 2023 for all other companies.
- Update 2017-12, *Derivatives and Hedging (Topic 815)* was already effective for public companies, therefore the Board retained the effective date for those companies, including SRCs. The Update will be effective beginning in 2021 for all other companies.

2. **Improved accounting and reporting for long-duration insurance contracts.** The FASB completed its project on the accounting for long-duration contracts issued by insurance entities with the release of Update 2018-12, *Financial Services—Insurance (Topic 944)* in August 2018. This guidance improves financial reporting by insurance entities that issue long-duration insurance contracts such as life insurance, disability income insurance, long-term-care insurance, and annuities.

The Update makes the following targeted improvements to the existing insurance standard:

- *Requires updated assumptions for liability measurement.* Assumptions used to measure the liability for insurance contracts will be reviewed—and, if there is a change, updated—at least annually, with the effect recorded in net income.
- *Standardizes liability discount rate.* The liability discount rate will be a standardized, market-observable discount rate (upper-medium grade fixed-income

instrument yield), with the effect of rate changes recorded in other comprehensive income.

- *Improves measurement of market risk benefits.* The two previous measurement models will be reduced to one measurement model (fair value), resulting in greater uniformity across similar market-based benefits and better alignment with the fair value measurement of derivatives used to hedge capital market risk.
- *Simplifies amortization of deferred acquisition costs on a more level basis.* Deferred acquisition costs will be amortized on a constant-level basis over the expected life of the contract.
- *Requires enhanced disclosures.* Several new disclosures will be required, including liability rollforwards and information about significant inputs, judgments, assumptions, and methods used in measurement.

The FASB issued Update 2019-09, *Financial Services—Insurance (Topic 944)* in conjunction with the revision of its philosophy for setting the effective dates of major Updates. Update 2019-09 deferred the effective date of the improvements to the insurance standard. Under the new guidance, the standard should be applied beginning in 2022 for calendar-year-end public companies that meet the definition of an SEC filer, excluding SRCs, and beginning in 2024 for all other companies.

3. **Improved effectiveness of disclosures in the financial statements.** The FASB's Disclosure Framework project included the development of a framework in the form of a Concepts Statement for the FASB to use as a tool when setting disclosure requirements. In August 2018, the FASB completed that portion of its Disclosure Framework project by issuing a chapter of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, related to notes to financial statements. That chapter encompasses the Board's decision process component of the Disclosure Framework project. The Board's decision process helps the Board identify relevant information and establish limits on information that should be included in the notes to financial statements.

The Disclosure Framework project also included a review of existing disclosures on specific topics using the newly developed framework. The FASB has used the framework to improve disclosure requirements in fair value measurement and defined benefit plans through the issuance of the following two Updates in August 2018:

- Update 2018-13, *Fair Value Measurement (Topic 820)*
- Update 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20)*

The FASB continues its work on this aspect of the Disclosure Framework through application of the framework to existing disclosures on other topics including inventory, income taxes, and interim reporting.

4. **Aligned definition of materiality.** The FASB issued an update to an existing chapter of the Conceptual Framework that aligns the FASB's definition of materiality with other definitions in the financial reporting system. The materiality concepts will now be consistent with the definition of materiality used by the SEC, the auditing standards of the PCAOB and the AICPA, and the United States judicial system.
5. **Simplified rules around hedge accounting.** Financial statement preparers expressed concerns over the difficulties associated with applying hedge accounting and its limitations for hedging both nonfinancial and financial risks. Users of financial statements also expressed concerns over the way hedging activities are reported in the financial statements. In August 2017, the FASB issued Update 2017-12, *Derivatives and Hedging (Topic 815)*, which permits more flexibility in hedging interest rate risk for both variable rate and fixed rate financial instruments and introduces the ability to hedge risk components for nonfinancial hedges. The guidance also will enhance the presentation of hedge results in the financial statements and make targeted improvements to simplify a company's assessment of hedge effectiveness. The guidance was effective beginning in 2019 for calendar-year-end public companies and will be effective beginning in 2021 for all other companies. Those effective dates reflect the FASB's new philosophy on setting effective dates. Companies and investors alike have been extremely supportive of this Update, and many companies have decided to early adopt it.
6. **Simplified accounting for non-employee share-based compensation.** Companies sometimes grant share-based awards to nonemployees such as external legal counsel and suppliers. The FASB heard through several channels, including its ongoing dialogue with the PCC, that the accounting for share-based awards granted to nonemployees could be simplified. Some of the areas for simplification apply specifically to nonpublic entities. In June 2018, the FASB issued Update 2018-07, *Compensation—Stock Compensation (Topic 718)* to reduce cost and complexity and improve financial reporting for share-based awards granted to nonemployees. The Update substantially aligned the accounting for share-based payments to nonemployees and employees by expanding the scope of Topic 718, *Compensation—Stock Compensation*, which previously only included share-based awards granted to employees, to also include share-based awards granted to nonemployees in exchange for goods and services to be used in a grantor's own operations. The guidance was effective beginning in 2019 for calendar-year-end public companies and beginning in 2020 for all other companies.
7. **Improvements to the new lease accounting standard.** The new leases standard requires organizations that lease assets—referred to as "lessees"—to recognize assets and liabilities for the rights and obligations created by leases with a lease term of more than 12 months. The FASB has been proactively addressing implementation issues about the new leases standard since its issuance in 2016. We have issued several Updates to reduce unnecessary costs without compromising the ultimate quality of information provided to

investors. For example, we issued Update 2018-11, *Leases (Topic 842)* in July 2018 in response to feedback from our lessor stakeholders. That Update simplified transition requirements for lessors and provided a practical expedient for the separation of nonlease components from lease components. We also issued Update 2018-01, *Leases (Topic 842)* that reduces a lessee's cost to transition historical land easements to the new standard by providing an optional transition practical expedient to not evaluate existing or expired land easements under the new leases standard if they were not previously accounted for as leases under the previous leases standard. Those Updates have the same effective date as the new leases standard.

8. **Accounting for the Tax Cuts and Jobs Act.** Stakeholders in the banking and insurance industries submitted unsolicited comment letters to the FASB about a narrow-scope financial reporting issue that arose as a consequence of the Tax Cuts and Jobs Act. In response, we issued Update 2018-02, *Income Statement—Reporting Comprehensive Income (Topic 220)* in February 2018. That Update helped companies address certain stranded income tax effects in accumulated other comprehensive income (AOCI) resulting from the Tax Cuts and Jobs Act by providing companies with an option to reclassify stranded tax effects within AOCI to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. Consequently, the guidance eliminates the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. The Update was effective beginning in 2019 for calendar-year-end companies. We also issued five staff Q&A documents to address various financial accounting and reporting implementation issues related to the Tax Cuts and Jobs Act including aspects of the accounting related to the Base Erosion Anti-Abuse Tax and global intangible low-taxed income.

#### **XBRL**

In 2010, the FASB assumed ongoing development and maintenance responsibilities for the US GAAP Financial Reporting Taxonomy ("Taxonomy"), which was originally developed by XBRL US, Inc. under contract to the SEC. In 2009, the SEC issued rules requiring public companies and foreign private issuers that prepare their financial statements in accordance with U.S. GAAP to phase in use of the Taxonomy. Under these rules, companies will tag and submit their financial statements and related notes to the SEC using the Taxonomy.

The Taxonomy is a list of machine-readable tags in XBRL that allows companies to label precisely the thousands of pieces of financial data that are included in typical long-form financial statements and related footnote disclosures. XBRL is a standard for tagging business and financial reports to increase the transparency and accessibility of business information by using a uniform format. Once tagged with the Taxonomy, financial reports can be analyzed rapidly and cost effectively by investors, analysts, journalists, and the SEC staff. The FASB updates the Taxonomy each year to reflect new accounting and financial reporting guidance.

### Ongoing Standard-Setting Activities

The Technical Agenda Overview provides information about current FASB projects at a glance, including status updates and expected issuance timelines for due process documents and final standards. Some of our more significant projects are highlighted below. The most current Technical Agenda Overview is available on our website under the Projects menu<sup>2</sup>.

#### LIBOR Reform

In 2018, we added a project to our agenda to broadly consider how the market wide transition from existing reference rates such as the London Interbank Offer Rate or LIBOR to more transaction based rates such as the Secured Overnight Financing Rate or SOFR would broadly affect the accounting for contracts undergoing this transition. In November, the FASB voted to approve temporary, optional, guidance to ease the potential accounting burden and facilitate this market driven initiative. The guidance will make it easier to report interest rate changes for contracts that meet certain criteria. Companies also will be permitted to preserve their hedge accounting when reference rate reform takes effect. A final Update is expected to be issued in early 2020, in time for companies to begin modifying their LIBOR based contracts and adjusting their interest rate hedges to reflect replacement reference rates.

#### Liabilities and Equity

Our stakeholders highlighted that the guidance on accounting for financial instruments with characteristics of both liabilities and equity was overly complex, internally inconsistent, and the source of frequent restatements. In July, we issued a proposed Update that would reduce the number of accounting models for convertible debt instruments and convertible preferred stock. It also would revise certain exceptions to the scope of derivative accounting guidance and improve and amend the related disclosure and earnings-per-share guidance. The FASB is continuing its redeliberations on this project and the final Update will seek to reduce complexity and provide investors with more useful information in this area.

#### Goodwill and Intangible Assets

A 2013 review of the Business Combinations standard identified stakeholder concerns about the cost to assess goodwill for impairment. Since then, the FASB has issued guidance to resolve those concerns. Some of this guidance provided relief to specific types of entities such as private companies and not-for-profit entities and based on that work we decided to revisit the subsequent accounting for goodwill and intangible assets for all companies. In 2019, the FASB issued an Invitation to Comment to gather input from a broad base of stakeholders on potential changes to the existing accounting models. We received more than 100 comment letters and invited 30 comment letter respondents to share their views on the topic at public roundtable meetings held in November. We heard diverse views during the roundtable meetings, and the

<sup>2</sup> The following URL links directly to the most current Technical Agenda Overview:  
[https://www.fasb.org/cs/ContentServer?c=Document\\_C&cid=1176164187985&d=&pagename=FASB%2FDocument\\_C%2FDocumentPage](https://www.fasb.org/cs/ContentServer?c=Document_C&cid=1176164187985&d=&pagename=FASB%2FDocument_C%2FDocumentPage)

FASB will continue discussion about intangible assets and the subsequent accounting for goodwill early this year.

#### Segment Reporting

The FASB continues its work on the Segment Reporting project, the objective of which is to improve the segment aggregation criteria and disclosures to provide users with more decision-useful information about the reportable segments of a public entity. The FASB recently completed a disclosure study and will use the information obtained from that study to perform outreach with investors on potential segment disclosure improvements. We also are analyzing ways to clarify existing segment disclosure requirements on the amount of total assets by reportable segment.

#### Conclusion

The FASB is committed to producing high-quality accounting standards. To achieve that goal, we are committed to a comprehensive and transparent process that encourages broad participation and objectively considers all stakeholder views. In doing so, we will continue to guide and educate the public, including users, the individuals who prepare financial statements, auditors, and others. Through its open and robust process, which includes extensive outreach to stakeholders, the FASB improves the resulting standards and related implementation activities. Furthermore, the FASB's efforts also improve the common understanding of the nature and purposes of information contained in financial reports. I appreciate the opportunity to appear before you. We look forward to working with you on these and related issues.

## Voices CECL standard expected to make a major impact

By Jonathan Jacobs

November 12, 2019, 2:18 p.m. EST



---

Substantial losses suffered by both financial and nonfinancial entities during the financial crisis prompted the Financial Accounting Standards Board to consider changes to its guidance on accounting for credit losses. Regulators and other market participants perceived that loan loss reserves recognized under then current GAAP were "too little, too late."

In response, in June 2016 the FASB issued Accounting Standard Update (ASU) 2016-13, Measurement of Credit Losses on Financial Instruments (Topic 326), which requires a new method for recognizing credit losses that is referred to as the current expected credit loss (CECL) method. CECL represents a significant change from prior GAAP, which is still used by most entities. Under prior GAAP, loss reserves are recognized when it is probable a loss has already been incurred. The CECL method requires the recognition of all losses expected over the life of a financial instrument upon origination or purchase of the instrument, unless the company elects to recognize such instruments at fair value with changes in profit and loss (the fair value option).

Given the nature and characteristics of the financial instruments involved within this ASU, the accounting impact is estimated to affect more than 5,000 commercial banks and other financial entities that provide credit in the U.S., as well as non-financial institutions. According to current public disclosures made by various institutions, the estimated increases to allowance of loan and

1/16/2020

CECL standard expected to make a major impact | Accounting Today

lease loss reserves could range from \$50 billion to \$100 billion (30 to 50 percent) for about \$10 trillion of applicable loans, for the financial services industry alone. Certain implementation questions are still being addressed and further guidance will continue to be provided in the future.

---

#### Article 6 new powerful QuickBooks Online Advanced features

Advanced helps accountants serve fast-growing, complex clients with its signature features.

PARTNER INSIGHTS  
SPONSOR CONTENT FROM  **quickbooks.**

The updated guidance is anticipated to significantly impact institutions, both financial institutions, as well as non-financial institutions, through both the changes in loss reserve methodology itself as well as the associated technological, operational and reporting advances that will be needed for proper implementation.

The broad range of financial instruments covered by CECL include financial instruments carried at amortized cost (such as loans held for investments, held to maturity debt securities, trade receivables, receivables that relate to repurchase agreements and securities lending agreements, and reinsurance receivables), finance leases and off balance sheet credit exposures that are not accounted for as insurance contracts or derivatives (such as loan commitments, standby letters of credit and financial guarantees.)

Given the recent changes, CECL will be required to be implemented by public companies that are not included as smaller reporting companies in fiscal years beginning after Dec. 15, 2019, including interim periods within those fiscal years. Other entities are permitted to wait until their first fiscal year beginning after Dec. 15, 2022.

The accounting methodology prior to the adoption of CECL requires the use of an incurred loss model, which recognizes reserves only for losses that are probable of having already been incurred. This methodology does not require (or permit) the incorporation of forward-looking economic forecasts, consideration of industry cycles or the impact and potential adjustments



related to the creditworthiness of borrowers. As such, the incurred loss approach can result in reserves that do not reflect expected future developments.

Under ASU 2016-13, the incurred loss model is replaced with the CECL model, which requires entities to estimate and immediately recognize credit losses expected to occur over the contractual life of the financial asset. Measurement under the new methodology is based on, but not limited to, current market conditions, reasonable supportable forecasts over the lifetime of the financial instruments, availability and quality of data, and segmentation and granularity of financial instruments that share similar risk characteristics.

Examples of shared risk characteristics include payment status, internal or external credit score, risk rating or classification, financial asset type, collateral type, size, effective interest rate, term, geographic location, industry of borrower and vintage, among others.

There is no one method or model that is prescribed by the FASB within the ASU; however there are various models and methodologies that should be contemplated depending on the availability and quality of data and the segmentation of the financial instruments. For example, these models and methodologies would include loss rate, discounted cash flows, vintage analyses, probability of defaults/loss given defaults, provision matrices and regression analyses.

To adhere to the financial reporting requirements of CECL, an institution's CECL solution must address and document the following: (i) the historic information gathered and analysis performed on such data, as well as considering the impact of the current environment and prospective economic forecasts over the horizon period, (ii) the rationale for the appropriate segmentation or pooling of financial instruments by category, (iii) the selection of the appropriate models and methodologies, (iv) the identification and assessment of any potential qualitative factors, (v) how the institution interprets and understands the results and impacts from the models and methodologies applied for the CECL reserves, and (vi) the calculation of management's current estimation of lifetime losses, as well as back testing for reasonability of results through normal and stressed economic environments.

1/16/2020

CECL standard expected to make a major impact | Accounting Today

Other aspects that an institution must consider prior to making their CECL election include (i) the implementation and process requirements, or alternatively through the fair value option election, (ii) the necessary documentation and governance requirements across audit, risk and compliance, and (iii) the impact of the decision and assessment on its total allowance for credit losses when an institution acquires another company.

Companies, auditors and regulators are expected to observe CECL's impacts and disclosures during the 2020 financial reporting year. To ensure CECL is meaningful to all preparers, auditors, investors, analysts and other users and reviewers of financial statements, during this time, refinements will be made by each institution, with potential recommendations and guidance to follow.

*Jonathan Jacobs is the global financial services industry leader at Duff & Phelps, with more than 30 years of experience in financial consulting. Jennifer Press is a managing director in the Alternative Asset Advisory practice at Duff & Phelps and is responsible for service capabilities in structured credit and whole loans, bringing over 17 years of fixed-income and capital markets experience. John Schrader is a managing director in the Alternative Asset Advisory practice at Duff & Phelps, with over 20 years of fixed-income, capital markets and investment banking experience.*

**Jonathan Jacobs** Global financial services industry leader, Duff & Phelps



 **REPRINT**

---

For reprint and licensing requests for this article, [click here](#).

---

**CECL      Accounting standards      FASB**

