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Insurance

Accounting and Financial Reporting Update

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Contents

Foreword

February 12, 2016

To our clients and colleagues in the insurance sector:

We are pleased to announce our eighth annual accounting and financial reporting update. The topics discussed in this publication were selected because they may be of particular interest to insurance entities.

Some of the notable standard-setting developments that occurred during 2015 were (1) the issuance of new guidance on short-duration insurance contract disclosures, (2) the FASB's work on long-duration insurance contracts, and (3) the SEC's continued focus on rulemaking, particularly in connection with its efforts to complete mandated actions under the Dodd-Frank Act.

This publication is divided into three sections: (1) "Updates to Guidance," which highlights changes to accounting and reporting standards that insurance entities need to start preparing for now; (2) "On the Horizon," which discusses standard-setting topics that will affect insurance entities as they plan for the future; and (3) "Other Topics" that may be of interest to entities in the insurance sector.

The annual accounting and financial reporting updates for the banking and securities, investment management, and real estate sectors are available on US GAAP Plus, Deloitte's Web site for accounting and financial reporting news.

In addition, be sure to check out the ninth edition of our *SEC Comment Letters — Including Industry Insights — What "Edgar" Told Us*, which discusses our perspective on topics that the SEC staff has focused on in comment letters issued to registrants over the past year, including an analysis of comment letter trends in each financial services sector.

As always, we encourage you to contact your local Deloitte office for additional information and assistance.

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Introduction

In many ways, the insurance industry is better positioned to grow than it has been for quite some time. The improving economy and steadily falling unemployment rate should be more conducive to the marketing of carriers' products and services. However, plenty of challenges — some new, some ongoing — are keeping industry executives on their toes. For example, whether they're dealing with the evolving threat of cybercrime, the effort to quantify and mitigate the impact of climate change, or how to most effectively manage capital at a time when funds from alternative investors entering the market are expanding capacity while undermining pricing leverage and profitability, insurance leaders will have their hands full. The larger industry players continue to face stricter government regulations than in the past, and accounting developments on the horizon may affect the financial statements of insurers. Entities in the sector will need to carefully assess the impact of these changes on their business.

Economic Growth

While low interest rates continued to propel overall growth in the insurance sector (along with reduced unemployment), they also resulted in continued lower investment income. Thus, several insurance entities considered compensating for their anemic organic growth by expanding their size, market reach, and capabilities through mergers and acquisitions (M&As[1]). Many carriers also continued the recent trend of allocating excess capital to boost shareholder value with stock buybacks or dividend payments rather than attempting potentially more problematic M&As.

Regulatory Reform

On the regulatory front, insurers will be called upon to implement a number of significant compliance changes for 2015. For one, they will file their first Own Risk and Solvency Assessment (ORSA) this year. ORSA reflects the new wave of insurance regulation, in which static examinations conducted every five years are replaced by an ongoing dialogue between regulators and the regulated.

The pace of regulatory evolution is unlikely to slacken soon, so it may be time for insurers to consider the process of compliance transformation. This may include enterprise-wide aggregation of core regulatory-change activities, the establishment of a coordinated response process for foreseeable regulations, and the use of scenario planning techniques for the unknown, along with the formation of rapid-response teams. Such transformation may help the ongoing process of planning for and responding to change. In addition, we expect the regulatory requirements to continue to increase in scope and number as state, federal, and international regulators battle for the supremacy of their standards and regimes. Even if certain companies are not technically subject to new regulations at first, they may eventually have to comply with them. Carriers should expect ongoing regulatory uncertainty as authorities jockey for position and debate whose set of rules the industry must ultimately follow.

Accounting Changes

In May 2015, the FASB issued a final ASU on disclosure requirements for short-duration insurance contracts. The Board is continuing to redeliberate targeted improvements for long-duration insurance contracts. Although timing is uncertain, redeliberations are expected to be completed in 2016.

[1] For a list of abbreviations and the full titles of Acts used in this publication, see Appendix B. For the full titles of standards and regulations used in this publication, see Appendix A.

The IASB's new insurance standard (expected to be issued in 2016) is likely to establish an accounting model and disclosure requirements that differ significantly from those under U.S. GAAP. Further, in December 2015, the IASB issued an ED to address IFRS 9 adoption for entities that are subject to the insurance standard.

For additional information about industry issues and trends, see Deloitte's 2015 Financial Services Industry Outlooks.

Updates to Guidance

Short-Duration Insurance Contracts

Background

In June 2013, the FASB released a proposed ASU for public comment as part of its joint project with the IASB on insurance contracts. Issuance of the proposal was preceded by two years of deliberations, during which the boards were unable to fully converge their proposals. In response to constituents' feedback on its proposal, the FASB decided in early 2014 to (1) refocus its efforts on making targeted improvements to insurance accounting under U.S. GAAP instead of pursuing an accounting model that would converge with IFRSs and (2) separately deliberate its targeted disclosure improvements for short-duration contracts and its targeted improvements for long-duration contracts. Notably, the FASB also decided to retain the existing scope of insurance accounting under U.S. GAAP instead of adopting the contract-based approach proposed by the IASB; accordingly, only insurance entities will be subject to the FASB's targeted improvements.

In May 2015, the FASB issued ASU 2015-09, which expands the breadth of disclosures entities must provide about short-duration insurance contracts issued by insurance entities.[1] The ASU focuses only on disclosures and does not change the existing U.S. GAAP accounting model for short-duration contracts.

Key Provisions

Under the ASU, insurance entities with short-duration insurance contracts must annually provide the following disclosures:

- "Incurred and paid claims [and allocated claim adjustment expenses (CAEs)] development information by accident year, on a net basis after risk mitigation through reinsurance, for the number of years for which claims incurred typically remain outstanding (that need not exceed 10 years, including the most recent reporting period presented in the statement of financial position). Each period presented in the disclosure about claims development that precedes the current reporting period is considered to be supplementary information." For the most recent reporting period presented, an insurer also must disclose, in the aggregate, the total net outstanding claims for all accident years not separately presented in the development tables.
- A reconciliation of the claims development disclosures "to the aggregate carrying amount of the liability for unpaid claims and [CAEs] for the most recent reporting period presented, with separate disclosure of reinsurance recoverable on unpaid claims."
- For each accident year presented in the incurred claims development table, information about (1) claim frequency (unless impracticable) and (2) the amounts of incurred-but-not-reported (IBNR) liabilities plus the expected development on reported claims.
- A description of the methods, and any significant changes to such methods, for determining (1) both IBNR and expected development on reported claims and (2) cumulative claim frequency.
- For all claims except health insurance claims, the historical average annual percentage payout of incurred claims by age, net of reinsurance, for those accident years presented in the claims development tables.
- Information about any significant changes in methods and assumptions used in the computation of the liability for unpaid claims and CAEs,[2] including reasons for the changes and the impact of the changes on the most recent reporting period in the financial statements.
- The carrying amounts of liabilities for unpaid claims and CAEs that are presented at present value and the effects of the discounting, including (1) the aggregate discount deducted from the liabilities, (2) the amount of interest accretion recognized during each period, and (3) the line item(s) in the statement of comprehensive income in which the interest accretion is classified.[3]

[1] The scope of the ASU is limited to insurance entities within the scope of ASC 944.

[2] Although this disclosure under the ASU is required only for annual periods, the ASU's Basis for Conclusions observes that ASC 270 requires disclosure in interim financial statements of the effects of a change in an accounting estimate.

[3] The ASU does not add any new requirement to discount short-duration insurance liabilities; however, the Board believes that financial statement users would find disclosure about discounted liabilities useful because existing U.S. GAAP and SEC staff guidance permit discounting of short-duration insurance contract liabilities under certain conditions.

- The disclosures should be aggregated or disaggregated to an extent "that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have significantly different characteristics."

In addition, insurance entities are required to disclose the following in both interim and annual periods:

- The rollforward of the liability for unpaid claims and CAEs.
- Total IBNR liabilities, plus expected development on reported claims, included in the liability for unpaid claims and CAEs for health insurance claims, either as a separate disclosure or as a component of the disclosure of the rollforward of the liability, at an appropriate level of disaggregation.

Effective Date and Transition

For public business entities, the ASU is effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. For all other entities, the guidance is effective for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017. Early adoption is permitted.

Upon adoption, the ASU must be applied retrospectively. However, certain of its requirements apply only to the current period. For example:

- Because the claims development and related tables depict cumulative experience, there is no need to provide comparative tables. In the year of adoption, an entity would provide the claims development tables, but those tables would not have to depict information about claims development for a particular category that occurred earlier than five years before the end of the year of adoption if it is impracticable to obtain the necessary information. For each subsequent year, the minimum number of years required in the claims development tables would increase by at least 1 year but need not exceed 10 years, including the most recent period presented in the statement of financial position.
- An entity would prospectively apply the requirement to disclose material changes in judgments made in calculating the liability for unpaid claims and CAEs.

Under the ASU, insurers are not required to provide certain of the transition disclosures specified in ASC 250-10.

Preparing for Implementation

Under existing U.S. GAAP and SEC requirements, some insurers may already be accustomed to accumulating and reporting information similar to that needed to comply with the ASU's requirements. However, they should be mindful of a number of considerations. Since the ASU may require insurers to disaggregate much of the information to a greater extent than before, they will need to have systems in place to capture the additional data. Insurers will typically include multiple years of claims development information for each disaggregated group of contracts in the tabular disclosure and will disclose comparative information (other than for those disclosures that pertain only to the current reporting period) for any prior periods that will be presented in the financial statements. Health insurers in particular should assess the data-gathering capability of their internal systems because they may not have had to previously accumulate and report such information under existing reporting requirements.

Furthermore, because most of the disclosures required by the ASU must be included in the audited footnotes to the financial statements (including information about claims development for the most recent reporting period), insurers must assess whether they have sufficient internal controls in place to ensure that the disclosures are complete and accurate.

Insurers that are SEC registrants should assess whether the proposed ASU's additional required disclosures will warrant modification to their MD&A discussion. As a best practice, they should also be able to explain differences between, or otherwise be able to reconcile, the disclosures provided under SEC Regulation S-X, Article 6, and their financial statement disclosures. Further, since the financial data reported under the new disclosures will be subject to interactive data (XBRL) reporting requirements, registrants should allow sufficient lead time (for either internal financial reporting personnel or third-party service providers) to prepare their interactive data files.

Multinational insurers should continue to monitor the IASB's insurance project as well as take note of the different requirements of IFRSs and U.S. GAAP in this area and, if necessary, assess whether they have systems and personnel capable of converting financial statements prepared under one set of standards to financial statements prepared in accordance with the other set of standards for internal or statutory reporting.

Finally, although private insurers will have an additional year to comply with the ASU's requirements, they should take full advantage of that extra time to ensure that their systems and controls are sufficient.

See Deloitte's May 2015 *Insurance Spotlight* for further discussion of ASU 2015-09.

Revenue Recognition

Background

In May 2014, the FASB and IASB issued their final standard on revenue recognition. The standard, issued as ASU 2014-09 by the FASB and as IFRS 15 by the IASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance (e.g., certain sections of ASC 360-20 and ASC 970-605). For additional information about ASU 2014-09 as issued, see Deloitte's May 28, 2014, *Heads Up* and July 2014 *Financial Services Spotlight*.

In response to concerns received by the FASB related to applying the new revenue recognition requirements, the Board issued the following three proposed ASUs in 2015 (currently in different stages of consideration), which would revise the new revenue recognition guidance in ASU 2014-09:[4]

- *Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)* — The proposal would address issues related to how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. Guidance would include (1) how to determine the unit of account, (2) whether the indicators in ASU 2014-09 are intended to help entities perform a single evaluation of control or represent an additional evaluation, and (3) how certain indicators are related to the general control principle. The proposal would also clarify that an entity should evaluate whether it is the principal or the agent for each good or service specified in a contract and thus whether an entity could be both the principal and agent for different performance obligations in the same contract. See Deloitte's September 1, 2015, *Heads Up* for more information.
- *Identifying Performance Obligations and Licensing* — The proposed amendments would clarify the guidance on an entity's identification of certain performance obligations. Proposed changes include guidance on immaterial promised goods and services and separately identifiable promises as well as (1) a policy election for shipping and handling fees incurred after control transfers and (2) clarifications related to licenses. The FASB directed its staff to draft a final ASU at its October 5, 2015, meeting. See Deloitte's May 13, 2015, *Heads Up* and October 8, 2015, journal entry for more information.
- *Narrow-Scope Improvements and Practical Expedients* — The proposed guidance would (1) clarify how to assess whether collectibility is probable in certain circumstances to support the existence of a contract, (2) add a practical expedient for the presentation of sales taxes on a net basis in revenue, (3) clarify how to account for noncash consideration at contract inception and throughout the contract period, and (4) establish a practical expedient to address contract modifications upon transition. See Deloitte's October 2, 2015, *Heads Up* for more information.

[4] The IASB's July 2015 ED also proposes similar changes to IFRS 15.

ASU 2014-09 notes that contracts within the scope of ASC 944 are excluded from the ASU's scope. However, certain products (or portions thereof) offered by insurance entities (e.g., administrative services only contracts or asset management services) may need to be accounted for under ASU 2014-09. This would occur if ASC 944 or other ASC topics do not contain separation or initial-measurement guidance. Accordingly, a key issue associated with an insurance entity's implementation of the new revenue standard is identifying whether a contract is partially or entirely within the scope of the new standard.

Thinking It Through

Arrangements for which stakeholders have had questions related to scope include:

- *Contracts that contain both an insurance product and services* — An example of such a contract would be an agreement by a property and casualty insurance company to undertake activities that identify potential safety issues at a plant that the customer wishes to insure with the insurance company. Views are mixed regarding whether such activities represent a separate service to the customer that would be accounted for under ASC 606 or risk-mitigation activities that affect the insurance entity's underwriting process (and thus would not be separable from the insurance risk in the context of the contract and thus would be accounted for with the insurance risk under ASC 944).
- *Mortgage insurance contracts* — Because ASC 944 provides a revenue recognition scope exception for mortgage guaranty insurance entities, there is currently no specific guidance on mortgage insurance contracts in the Codification. This has led to the development of industry-specific practice. As a result, while ASC 606 specifically excludes insurance contacts from its scope, it is unclear whether the scope exception would result in a requirement for mortgage insurance contracts to be accounted for under ASC 606 and therefore nullify currently accepted accounting practices.

In addition, see the Revenue Recognition sections of Deloitte's 2015 *Banking and Securities — Accounting and Financial Reporting Update* and *Investment Management — Accounting and Financial Reporting Update* for considerations about arrangements — such as brokerage, asset management, and other third-party-provided services — that insurance entities may similarly enter into with their customers.

Effective Date and Transition

In August 2015, as a result of stakeholder concerns, the FASB issued ASU 2015-14,[5] which delays the effective date of ASU 2014-09. Accordingly, the ASU is effective for public business entities for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. Early adoption is permitted as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within those annual periods.

For nonpublic entities, the standard is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Nonpublic entities can also elect to early adopt the standard as of the following:

- Annual reporting periods beginning after December 15, 2016, including interim periods.
- Annual reporting periods beginning after December 15, 2016, and interim periods within annual reporting periods beginning one year after the annual reporting period of initial application of the new standard.

Implementation and Transition Activities

A number of groups are actively involved in implementation activities related to the new standard, including the TRG (see Deloitte's *TRG Snapshot*), the AICPA's revenue recognition task forces, various firms, the SEC,[6] and the PCAOB. Preparers should continue to monitor the activities of these groups before their adoption of the new guidance.

[5] The IASB amended IFRS 15 a month later to delay its effective date.

[6] The SEC has indicated that it plans to review and update the revenue recognition guidance in SAB Topic 13 in light of the ASU. The extent to which the ASU's guidance will affect a public entity will depend on whether the SEC removes or amends the guidance in SAB Topic 13 to be consistent with the new revenue standard.

Consolidation

Background

In February 2015, the FASB issued ASU 2015-02, which amends the consolidation requirements in ASC 810. The amendments could significantly change an insurance company's consolidation conclusion of whether it needs to consolidate a managed fund. Specifically, the amended guidance will affect an entity's evaluation of whether (1) the fees it receives from managing a fund should result in the consolidation of the entity, (2) limited partnerships and similar entities should be consolidated, and (3) variable interests held by the insurance company's related parties or de facto agents affect its consolidation conclusion. In addition, ASU 2015-02 eliminated the deferral of ASU 2009-17 (formerly Statement 167) for investments in certain investment funds. Therefore insurance companies, general partners, and investors in these funds will need to perform a drastically different consolidation evaluation.

Although the ASU focuses primarily on managed funds, insurance entities will need to reevaluate their previous consolidation conclusions for all entities they are involved with, including current VIEs, limited partnerships not previously considered VIEs, and entities previously subject to the deferral of ASU 2009-17.

See Deloitte's *Consolidation — A Roadmap to Identifying a Controlling Financial Interest* for additional information about ASU 2015-02.

Determining Whether Fees Paid to an Insurance Company Are Variable Interests

One of the first steps in assessing whether a reporting entity is required to consolidate a legal entity is to determine whether the reporting entity holds a variable interest in that legal entity. An insurance company's determination that its decision-making fee arrangement is not a variable interest would generally result in a conclusion that the insurance company is not required to consolidate the legal entity. In addition, it could affect whether the legal entity being evaluated is a VIE. While the ASU retains the current definition of a variable interest, it modifies the criteria for determining whether a decision maker's fee is a variable interest.

Before ASU 2015-02, six criteria must have been met before a reporting entity could conclude that a decision maker's or service provider's fee does not represent a variable interest. The ASU eliminates the criteria related to subordination of the fees (ASC 810-10-55-37(b)) and significance of the fees (ASC 810-10-55-37(e) and (f)). Accordingly, after adoption of ASU 2015-02, the evaluation of whether fees paid to a decision maker represent a variable interest focuses on whether (1) the fees are commensurate with the services provided, (2) the fee arrangement includes only customary terms and conditions (i.e., they are "at market"), and (3) the decision maker (including certain of its related parties) has any other variable interests that would absorb more than an insignificant amount of expected losses or returns. As a result, it is expected that fewer fee arrangements would be considered variable interests under the ASU.

Although the requirement to evaluate whether a fee arrangement is commensurate and at market existed before the ASU, different views have evolved regarding the evidence a reporting entity needs to support its conclusion that a fee arrangement is commensurate and market. At the 2015 AICPA Conference on Current SEC and PCAOB Developments (the "AICPA Conference"), an SEC staff member, Professional Accounting Fellow Chris Semesky, stated the following:

> I would also like to address the evaluation of whether a decision-maker's fee arrangement is customary and commensurate. [Footnote omitted] This evaluation is done at inception of a service arrangement or upon a reconsideration event, such as the modification of any germane terms, conditions or amounts in the arrangement.
>
> The determination of whether fees are commensurate with the level of service provided often may be determined through a qualitative evaluation of whether an arrangement was negotiated on an arm's length basis when there are no obligations beyond the services provided to direct the activities of the entity being evaluated for consolidation. This analysis requires a careful consideration of the services to be provided by the decision-maker in relation to the fees.

> The evaluation of whether terms, conditions and amounts included in an arrangement are customarily present in arrangements for similar services may be accomplished in ways such as benchmarking the key characteristics of the subject arrangement against other market participants' arrangements negotiated on an arm's length basis, or in some instances against other arm's length arrangements entered into by the decision-maker. There are no bright lines in evaluating whether an arrangement is customary, and reasonable judgment is required in such an evaluation. A decision-maker should carefully consider whether any terms, conditions, or amounts would substantively affect the decision-maker's role as an agent or service provider to the other variable interest holders in an entity.

Therefore, we believe that the evaluation should focus on whether the fee arrangements are negotiated at arm's length (i.e., between unrelated parties) or have been implicitly accepted by market participants. Most decision-maker or service-provider fee arrangements are negotiated at arm's length or have been implicitly accepted by market participants when a more than insignificant amount of the investor interests in the potential VIE are held by an unrelated party or parties (e.g., when an insurance company has marketed a fund to outside investors). In these situations, there is a presumption that the fees will be commensurate (even if the services are not provided by others in the marketplace). To support a conclusion that the arrangement is at market (i.e., customary) a reporting entity would, in addition to demonstrating that negotiations were at arm's length or there was implicit acceptance by market participants, compare its fee arrangement with other arrangements it negotiated with third parties. Therefore, in these situations, it would typically not be necessary for a reporting entity to compare its fee arrangement to others in the marketplace to support its conclusion that the fee arrangement is commensurate and at market unless the reporting entity has no other internal benchmarks.

Determining Whether a Limited Partnership or Similar Entity Is a VIE

The ASU amends the definition of a VIE for limited partnerships and similar entities. Under the ASU, a limited partnership is considered a VIE regardless of whether it has sufficient equity or meets the other requirements to qualify as a voting interest entity unless a single limited partner (LP) or a simple majority of all partners (excluding those interests held by the general partner (GP), entities under common control with the GP, and entities acting on behalf of the GP) has substantive kick-out rights (including liquidation rights) or the LPs have participating rights. As a result of the amendments to the definition of a VIE for limited partnerships and similar entities, partnerships historically not considered VIEs may need to be evaluated under the new VIE consolidation model. Conversely, partnership arrangements that include simple-majority kick-out or participating rights (rather than single-partner rights) may no longer be VIEs.

Although the ASU may not have caused an insurance company's consolidation conclusion to change, an updated analysis on the basis of the revised guidance would be required. In addition, even if a reporting entity determines that it does not need to consolidate a partnership that is a VIE, it would have to provide the existing extensive disclosures for any VIEs in which it holds a variable interest.

Determining Whether an Entity Other Than a Limited Partnership (or Similar Entity) Is a VIE

The ASU clarifies how a reporting entity should evaluate the condition in ASC 810-10-15-14(b)(1) (whether the equity holders (as a group) have power) for legal entities other than limited partnerships. Specifically, the ASU clarifies that in situations in which the equity holders have delegated the decision-making responsibility, and the decision maker's fee arrangement is a variable interest under ASC 810-10-55-37, the evaluation should focus on whether the equity holders have power over the legal entity's most significant activities through their equity interests. In making this assessment, the insurance company should consider whether the equity holders (investors in the fund) have the right to replace the insurance company as the decision maker. This is a significant change from the previous guidance, under which kick-out rights were only considered if they were held by a single party.

Example

Insurance company ABC enters into a management agreement with Fund X (a corporation). ABC manages the underlying investments and operations of the fund (i.e., directs the most significant activities of the fund) and earns a fee for its services that is commensurate and at market. As a result of ABC's other interest in X, its fee arrangement is considered a variable interest. However, the equity holders can constrain ABC's authority because they have the ability to (1) replace ABC as the fund manager, (2) approve ABC's compensation, and (3) determine X's overall investment strategy.

Under ASU 2015-02, the equity holders would have the power to direct the most significant activities of the fund, and if the fund does not meet any of the other conditions to be considered a VIE, it would be evaluated for consolidation under the voting interest entity model.

Which Party Should Consolidate?

In a manner consistent with the guidance in ASU 2009-17, the determination of whether an insurance company is required to consolidate a VIE under the ASU focuses on whether the insurance company has (1) the power to direct the activities that most significantly affect the economic performance of the VIE (power condition) and (2) a potentially significant interest in the VIE (economics condition). Although the ASU does not amend the existing threshold for evaluating whether an insurance company meets the economics condition, under the new consolidation requirements, if the fees paid to a VIE's decision maker are commensurate and at market, they should not be considered in the evaluation of the decision maker's economic exposure to the VIE, regardless of whether the reporting entity has other economic interests in the VIE. Under this new requirement, certain structures that were consolidated as a result of the significance of the fee arrangement would potentially need to be deconsolidated. This guidance applies to all entities that are VIEs, including limited partnerships and similar entities that are VIEs.

Thinking It Through

Under current guidance, an insurance company's assessment of whether it is the primary beneficiary of a VIE (and therefore must consolidate the VIE) that qualifies for the Statement 167 deferral focuses on whether the insurance company absorbs the majority of the VIE's variability as determined through quantitative analysis. Under the ASU, an insurance company would be required to consolidate a VIE if it meets both the power and economics conditions. Accordingly, an insurance company that has power over a VIE, but did not previously consolidate a VIE because it did not absorb a majority of the VIE's variability, may be required to consolidate the VIE if it holds an economic interest that could potentially be significant to the VIE (e.g., a 15 percent equity interest in the VIE).

The evaluation of which party controls a legal entity that is not considered a VIE focuses on the rights of the equity investors. Specifically, the analysis for limited partnerships would focus on whether any of the LPs have the substantive ability to unilaterally dissolve the limited partnership or otherwise remove the GP without cause and, if so, should consolidate the partnership. For all other entities, a party with a majority voting interest (i.e., greater than 50 percent) will generally be required to consolidate the entity.

Effects of Related Parties

The ASU significantly amends how variable interests held by a reporting entity's related parties or de facto agents affect its consolidation conclusion. Specifically, the ASU reduces the effects of interests held by an investment manager's related parties in the evaluation of (1) whether the investment manager's fee arrangement is a variable interest and (2) the investment manager's economic exposure to the VIE.

Effective Date and Transition

For public business entities, the ASU's guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. For entities other than public business entities, the ASU's guidance is effective for annual periods beginning after December 15, 2016, and interim periods beginning after December 15, 2017. The ASU would allow early adoption for all entities but would require entities to apply the guidance as of the beginning of the annual period containing the adoption date. Modified retrospective application (including a practicability exception) would be required, with an option for full retrospective application.

Classification and Measurement

Background

In January 2016, the FASB issued ASU 2016-01, which amends its guidance on the classification and measurement of financial instruments. During its deliberations, the FASB decided to abandon a converged approach with the IASB and instead chose to retain much of the existing requirements in U.S. GAAP. However, the amendments contain changes related to the following:

- Accounting for equity investments (apart from those that are accounted for under the equity method or those that are consolidated).
- Recognition of changes in fair value attributable to changes in instrument-specific credit risk for financial liabilities for which the fair value option has been elected.
- Determining the valuation allowance for deferred tax assets (DTAs) related to available-for-sale (AFS) debt securities.
- Disclosure requirements for financial assets and financial liabilities.

For more information about ASU 2016-01, see Deloitte's January 12, 2016, *Heads Up*.

Classification and Measurement of Equity Investments

The amendments will require entities to carry all investments in equity securities at fair value, with changes in fair value recorded through earnings (FVTNI), unless the equity investments are accounted for under the equity method or are consolidated. For equity investments that do not have a readily determinable fair value, the guidance will permit a practicability exception under which the equity investment would be measured at cost less impairment, if any, plus or minus observable price changes in orderly transactions. This practicability exception would not be available to reporting entities that are investment companies, broker-dealers in securities, or postretirement benefit plans.

An entity that has elected the practicability exception for equity investments that do not have a readily determinable fair value is required to assess whether the equity investment is impaired by qualitatively considering the following indicators (from ASC 321-10-35-3 in the ASU):

a. A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
b. A significant adverse change in the regulatory, economic, or technological environment of the investee
c. A significant adverse change in the general market condition of either the geographical area or the industry in which the investee operates
d. A bona fide offer to purchase, an offer by the investee to sell, or a completed auction process for the same or similar investment for an amount less than the carrying amount of that investment
e. Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.

If, on the basis of the qualitative assessment, the equity investment is impaired, the investee would be required to record an impairment equal to the amount by which the carrying value exceeds fair value. The investee would no longer be required to evaluate whether such impairment was other than temporary.

Thinking It Through

Under current U.S. GAAP, marketable equity securities other than equity method investments or those that result in consolidation of the investee are classified as either (1) held for trading, with changes in fair value recognized in earnings, or (2) AFS, with changes in fair value recognized in other comprehensive income (OCI). Further, nonmarketable equity securities for which the fair value cannot be readily determined generally would be measured at cost (less impairment) unless the fair value option is elected. However, for insurance-specific entities, such investments are also measured at fair value through OCI in accordance with the industry-specific guidance (ASC 944). For AFS and nonmarketable investments held by insurance entities, changes in fair value are accumulated in OCI and not recognized in earnings until the investments are sold or an other-than-temporary impairment is identified.

Under the new guidance, since equity securities can no longer be accounted for as AFS or, in accordance with the insurance-specific guidance, through OCI and will instead be recorded at FVTNI (unless the practical expedient is elected for nonmarketable securities), entities holding such investments could see more volatility in earnings.

Changes in Fair Value of a Liability Attributed to Changes in Instrument-Specific Credit Risk

For financial liabilities (excluding derivative instruments) for which the fair value option has been elected, the amendments will require an entity to separately recognize in OCI any changes in fair value associated with instrument-specific credit risk. The guidance indicates that the portion of the total change in fair value that exceeds the amount resulting from a change in a base market risk (such as a risk-free interest rate) may be attributable to instrument-specific credit risk, but also acknowledges that there may be other methods an entity may use to determine instrument-specific credit risk.

Valuation Allowance on a Deferred Tax Asset Related to an AFS Debt Security

The new guidance eliminates the diversity in practice related to the evaluation of the need for a valuation allowance for DTAs related to debt securities that are classified as AFS. Under current U.S. GAAP, entities may perform this evaluation either separately from their other DTAs or in combination with them. The new guidance clarifies that an entity should "evaluate the need for a valuation allowance on a [DTA] related to [AFS] securities in combination with the entity's other [DTAs]."

Changes to Disclosure Requirements

For nonpublic business entities, the amendments eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost. In addition, for such financial instruments, public business entities would not be required to disclose (1) the information related to the methods and significant assumptions used to estimate fair value or (2) a description of the changes in the methods and significant assumptions used to estimate fair value. The guidance also clarifies U.S. GAAP by eliminating the provisions in ASC 825 that had been interpreted to permit an "entry" price notion for estimating the fair value of loans for disclosure purposes. The amendments require a public business entity to disclose the fair value in accordance with the exit price notion in ASC 820. In addition, all entities are required to disclose in the notes to the financial statement all financial assets and financial liabilities grouped by (1) measurement category (i.e., amortized cost or fair value — net income or OCI) and (2) form of financial asset (i.e., securities and loans/receivables).

Effective Date and Transition

For public business entities, the ASU's guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. For entities other than public business entities, the ASU's guidance is effective for annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019. Early adoption of certain of the standard's provisions is permitted for all entities. Nonpublic business entities are permitted to adopt the standard in accordance with the effective date for public business entities.

Upon adoption, entities will be required to make a cumulative-effect adjustment to beginning retained earnings as of the beginning of the fiscal year in which the guidance is effective, with the exception of the following:

- Guidance (including disclosure requirements) on equity securities without readily determinable fair values will be applied prospectively to all equity investments that exist as of the date of adoption.
- Guidance consistent with ASC 820 on using the exit price notion to measure the fair value of financial instruments for disclosure purposes will be applied prospectively. If information is no longer comparable as a result of adopting the guidance, entities will be required to disclose that fact.

FASB's Simplification Initiative

Debt Issuance Costs

Background

In April 2015, the FASB issued ASU 2015-03, which changes the presentation of debt issuance costs in financial statements. The ASU specifies that "debt issuance costs related to a note shall be reported in the balance sheet as a direct deduction from the face amount of that note" and that "[a]mortization of debt issuance costs also shall be reported as interest expense." Under previous guidance, an entity reported debt issuance costs in the balance sheet as deferred charges (i.e., as an asset).

The amendments do not affect the current guidance on the recognition and measurement of debt issuance costs. For example, the costs of issuing convertible debt would not change the calculation of the intrinsic value of an embedded conversion option that represents a beneficial conversion feature under ASC 470-20-30-13. Thus, entities may still need to track debt issuance costs separately from a debt discount.

Thinking It Through

Requiring presentation of debt issuance costs as a direct reduction of the related debt liability (rather than as an asset) is consistent with the presentation of debt discounts under U.S. GAAP. In addition, it converges the guidance in U.S. GAAP with that in IFRSs, under which transaction costs that are directly attributable to the issuance of a financial liability are treated as an adjustment to the initial carrying amount of the liability. It also reflects the SEC staff's views regarding the treatment of equity issuance costs as a reduction of the gross proceeds of an equity offering. Further, it conforms U.S. GAAP to FASB Concepts Statement No. 6, which states, "Debt issue cost is not an asset for the same reason that debt discount is not — it provides no future economic benefit. Debt issue cost in effect reduces the proceeds of borrowing and increases the effective interest rate and thus may be accounted for the same as debt discount."

Since the ASU's issuance, practitioners have inquired about the appropriate balance sheet presentation of costs incurred in connection with revolving-debt arrangements. At the June 2015 EITF meeting, the SEC staff announced that it would "not object to an entity deferring and presenting [such] costs as an asset and subsequently amortizing the . . . costs ratably over the term of the line-of-credit arrangement." While the SEC staff's announcement, which was codified in August 2015 by the issuance of ASU 2015-15, clarifies that revolving-debt arrangements are outside the scope of ASU 2015-03, it does not address whether the ASU's presentation approach is an acceptable accounting policy for such arrangements and, if so, how an entity should implement such an approach. Under the ASU, an entity would deduct debt issuance costs from the related debt liability. However, it is unclear how the entity would present any remaining unamortized debt issuance costs if it repaid the amounts outstanding under the revolving-debt arrangement and still had an option to make new borrowings under the same arrangement. In this case, there would no longer be a liability with which to associate the costs. It is also unclear how the entity would present any remaining unamortized costs if the costs exceeded the amount currently outstanding under the revolving-debt arrangement.

Given the implementation questions associated with application of the ASU's presentation approach to revolving-debt arrangements, as well as questions about the acceptability of such application, we expect that many, if not most, entities will elect to apply the accounting policy outlined by the SEC staff at the June 2015 EITF meeting. Under that policy, an entity presents remaining unamortized debt issuance costs associated with a revolving-debt arrangement as an asset even if the entity currently has a recognized debt liability for amounts outstanding under the arrangement. Further, such costs are amortized over the life of the arrangement even if the entity repays previously drawn amounts.

Thinking It Through

Before adopting ASU 2015-03, an entity may have remeasured debt issuance costs into its functional currency by using historical exchange rates because (1) it presented debt issuance costs in the balance sheet as deferred charges under ASC 835-30 and (2) ASC 830-10-45-18(i) requires that deferred charges be treated as a nonmonetary balance sheet item that is remeasured by using historical rates.

Upon adopting ASU 2015-03, however, an entity presents debt issuance costs (other than costs related to line-of-credit or revolving-debt arrangements) in the balance sheet as a direct deduction from the related debt liability (in accordance with ASC 835-30-45-1A, as amended by ASU 2015-03) rather than as a deferred charge. The remeasurement of the carrying amount of the debt liability into the entity's functional currency, therefore, reflects any deduction related to debt issuance costs. Under ASC 830-10-45-17, monetary liabilities (including the carrying amount of a monetary debt liability that has been adjusted for debt issuance costs) are remeasured into the entity's functional currency by using current exchange rates.

Notwithstanding the Board's stated intention of not changing the recognition and measurement guidance on debt issuance costs, an entity that presented debt issuance costs (other than issuance costs associated with line-of-credit or revolving debt arrangements) as deferred charges and treated such costs as a nonmonetary item under ASC 830-10 before adopting ASU 2015-03 would need to (1) retrospectively adjust, upon transition to ASU 2015-03, its accounting for debt issuance costs under ASC 830-10 in accordance with ASC 835-30-65-1(c) and (2) perform remeasurement as of each subsequent reporting period by using current exchange rates.

Effective Date and Transition

For public business entities, the guidance in ASU 2015-03 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. For entities other than public business entities, the guidance is effective for fiscal years beginning after December 15, 2015, and interim periods beginning after December 15, 2016. Early adoption is allowed for all entities for financial statements that have not been previously issued. Entities should apply the new guidance retrospectively to all prior periods (i.e., the balance sheet for each period is adjusted).

The ASU requires an entity to "disclose in the first fiscal year after the entity's adoption date, and in the interim periods within the first fiscal year, the following:

1. The nature of and reason for the change in accounting principle
2. The transition method
3. A description of the prior-period information that has been retrospectively adjusted
4. The effect of the change on the financial statement line item (that is, the debt issuance cost asset and the debt liability)."

Measurement-Period Adjustments

Background

In September 2015, the FASB issued ASU 2015-16, which amended the guidance in ASC 805 on the accounting for measurement-period adjustments. The ASU was issued as part of the FASB's simplification initiative in response to stakeholder feedback that restating prior periods to reflect adjustments made to provisional amounts recognized in a business combination adds cost and complexity to financial reporting but does not significantly improve the usefulness of the information provided to users.

Key Provisions of the ASU

Under previous guidance, when an acquirer identified an adjustment to provisional amounts during the measurement period, the acquirer was required to revise comparative information for prior periods, including making any change in depreciation, amortization, or other income effects recognized in completing the initial accounting, as if the accounting for the business combination had been completed as of the acquisition date.

The ASU requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The effect on earnings of changes in depreciation or amortization, or other income effects (if any) as a result of the change to the provisional amounts, calculated as if the accounting had been completed as of the acquisition date, must be recorded in the reporting period in which the adjustment amounts are determined rather than retrospectively.

Thinking It Through

Although the ASU changes the accounting for measurement-period adjustments, it does not change the definition of a measurement-period adjustment, which is an adjustment to the amounts provisionally recognized for the consideration transferred, the assets acquired, and the liabilities assumed as a result of "new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date." Errors, information received after the measurement period ends, or information received about events or circumstances that did not exist as of the acquisition date are not measurement-period adjustments.

Disclosure Requirements

The ASU also requires that the acquirer present separately on the face of the income statement, or disclose in the notes, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.

Effective Date and Transition

For public business entities, the ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The ASU must be applied prospectively to adjustments to provisional amounts that occur after the effective date. Early application is permitted for financial statements that have not been issued.

The only disclosures required at transition will be the nature of and reason for the change in accounting principle. An entity should disclose that information in the first annual period of adoption and in the interim periods within the first annual period if there is a measurement-period adjustment during the first annual period in which the changes are effective. For more information about the ASU, see Deloitte's September 30, 2015, *Heads Up*.

Accounting Alternatives for Private Companies

Background

The following guidance (developed in 2014 by the Private Company Council (PCC)) is effective in 2015:

- *Goodwill* — In January 2014, the FASB issued ASU 2014-02, which allows private companies to use a simplified approach to account for goodwill after an acquisition. Under such approach, an entity would (1) amortize goodwill on a straight-line basis, generally over 10 years; (2) test goodwill for impairment only when a triggering event occurs; and (3) make an accounting policy election to test for impairment at either the entity level or the reporting-unit level. The ASU also eliminates "step 2" of the goodwill impairment test; as a result, an entity would measure goodwill impairment as the excess of the entity's (or reporting unit's) carrying amount over its fair value. An entity that elects the simplified approach should adopt the ASU's guidance prospectively and apply it to all goodwill that exists (and any goodwill arising from future acquisitions) as of the beginning of the period of adoption. The ASU is effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. See Deloitte's January 27, 2014, *Heads Up* for more information.
- *Hedge accounting* — In January 2014, the FASB issued ASU 2014-03, which gives private companies a simplified method of accounting for certain receive-variable, pay-fixed interest rate swaps used to hedge variable-rate debt. An entity that elects to apply the simplified hedge accounting to a qualifying hedging relationship would continue to account for the interest rate swap and the variable-rate debt separately on the face of the balance sheet. However, the entity would be able to assume no ineffectiveness in the hedging relationship, thereby essentially achieving the same income statement profile as with a fixed-rate borrowing expense. In addition, the entity is allowed more time to complete its initial hedge documentation. An entity that applies the simplified approach also may elect to measure the related swap at its settlement value rather than at fair value. Financial institutions (including banks, savings and loan associations, savings banks, credit unions, finance companies, and insurance entities) are specifically ineligible to elect this accounting alternative. The ASU is effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Entities that elect the simplified approach should adopt the ASU under either a full retrospective or a modified retrospective method. See Deloitte's January 27, 2014, *Heads Up* for more information.
- *Identified intangible assets* — In December 2014, the FASB issued ASU 2014-18, which gives private companies an exemption from having to recognize certain intangible assets for (1) assets acquired in a business combination or (2) investments accounted for under the equity method or upon the adoption of fresh-start accounting. Specifically, an entity would not be required to separately recognize intangible assets for noncompete agreements and certain customer-related intangible assets that arise within the scope of the ASU. Because the amounts associated with these items would be subsumed into goodwill, an entity that elects this accounting alternative would also be required to adopt ASU 2014-02 (see discussion above), resulting in the amortization of goodwill. Entities that elect the alternative should adopt the ASU prospectively to the first eligible transaction within the scope of the ASU that occurs in the annual period beginning after December 15, 2015 (with early adoption permitted), and all transactions thereafter. See Deloitte's December 30, 2014, *Heads Up* for more information.

Proposed Changes to Effective Date and Transition Guidance in Certain Private-Company ASUs

In September 2015, the FASB issued for public comment a proposed ASU that would give private companies a one-time unconditional option to forgo a preferability assessment the first time they elect a PCC accounting alternative within the proposal's scope. It would also eliminate the effective dates of PCC accounting alternatives that are within the proposal's scope as well as extend the transition guidance in ASU 2014-02 and ASU 2014-03. The proposal's amendments could affect all private companies within the scope of ASUs 2014-02 and 2014-03 as well as ASU 2014-07 and ASU 2014-18. See Deloitte's October 6, 2015, *Heads Up* for more information.

Other Private-Company Matters

Throughout 2015, the PCC has discussed aspects of financial reporting that are complex and costly for private companies, including stock-based compensation, the application of VIE guidance to nonleasing common-control arrangements, and the balance sheet classification of debt.

At a recent meeting, the PCC agreed that it would continue to deliberate stock-based compensation and consider feedback received in connection with the FASB's proposed ASU on employee share-based payment accounting improvements. See Deloitte's June 12, 2015, *Heads Up* for more information.

The PCC also asked the FASB staff to research (1) examples that would clarify the application of VIE guidance to nonleasing common-control arrangements and (2) potential modifications to existing business scope exceptions to address application issues.

In addition, the PCC decided in February 2015 that it would not "amend the existing definitions of a nonpublic entity at this time. The existing definitions will remain in the FASB Codification until potentially amended at a later date by the FASB. The definition of a public business entity, [as amended by ASU 2013-12] should continue to be used for future accounting and reporting guidance."[7]

Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share or Its Equivalent

Background

In May 2015, the FASB issued ASU 2015-07, which is based on the final consensus reached by the EITF on Issue 14-B. The ASU removes the disclosure requirement to categorize investments[8] for which the practical expedient[9] is used to measure fair value at net asset value (NAV) within the fair value hierarchy. The ASU also amends or removes other disclosure requirements for eligible investments measured at NAV and contains consequential amendments to ASC 230-10 related to the statement of cash flows and to ASC 715-20 regarding sponsors of defined benefit plans.

Key Provisions

Rather than categorizing within the fair value hierarchy[10] eligible investments that are measured by using the NAV practical expedient, the ASU requires an entity to disclose the NAV of those investments to reconcile the fair value of the investments within the fair value hierarchy to the line item(s) presented in the statement of financial position. In addition, eligible investments that apply the NAV practical expedient no longer need to disclose the other information required by ASC 820-10-50-2, such as transfers between fair value levels, a level-three rollforward schedule, or the description of the valuation techniques for certain assets and liabilities.

Thinking It Through

Entities must still comply with the requirements in ASC 820-10-50-6A, which include disclosing the investment's NAV and the nature, risk, and redeemability of eligible investments that apply the NAV practical expedient in measuring fair value.

Also, in instances in which the practical expedient is used to measure fair value at NAV for all of an entity's investments, the information required by ASC 820-10-50-6A may be disclosed in a manner that complies with the ASU's requirement to reconcile the fair value of the investments in the disclosure to the line item(s) presented in the statement of financial position. Accordingly, an entity would not present a blank fair value hierarchy leveling tabular disclosure to meet the ASU's reconciliation requirement.

[7] See the PCC's overview of decisions reached on PCC Issue No. 14-01.

[8] ASC 820-10-15-4 and 15-5 provide the requirements for an investment's eligibility to apply the NAV per share (or its equivalent) practical expedient in measuring fair value.

[9] The NAV practical expedient is discussed in ASC 820-10-35-59 through 35-62.

[10] Under ASU 2015-07, sponsors of defined benefit plans within the scope of ASC 715-20 that elect the NAV practical expedient to measure plan investments at fair value will no longer be able to categorize such investments within the levels of the fair value hierarchy in the plan investment footnote.

In addition, the ASU amends the scope of the disclosure requirements in ASC 820-10-50-6A to include only investments that (1) are eligible for the practical expedient and (2) have elected to apply the practical expedient in measuring fair value at NAV. The ASU also removes the guidance in ASC 820-10-50-6A(g), under which certain disclosures were required when it was probable that an investment would be sold for an amount different from the NAV.

Thinking It Through

ASU 2015-07 simplifies the reporting requirements by limiting the disclosures required by ASC 820-10-50-6A to those investments measured under the NAV practical expedient (rather than all eligible investments that may apply the practical expedient).

Effective Date and Transition

For public business entities, the ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The effective date is deferred by one year for entities other than public business entities. Early adoption is permitted. The ASU should be applied retrospectively to all periods presented.

Determining Whether the Host Contract in a Hybrid Financial Instrument Is More Akin to Debt or to Equity

In November 2014, the FASB issued ASU 2014-16 to reduce the diversity in practice related to how entities determine the nature of the host contract of a hybrid instrument issued in the form of a share (e.g., convertible preferred stock) as part of the analysis for determining whether the hybrid instrument contains any embedded derivatives that must be bifurcated under ASC 815-15.

Currently, reporting entities use one of two acceptable methods (and must apply it consistently) for determining the nature of a host contract: the chameleon approach[11] and the whole-instrument approach.[12]

There is little to no diversity in the application of the chameleon approach. However, in practice, there is diversity in the application of the whole-instrument approach to a convertible preferred share with noncontingent, fixed-price redemption features. That is, entities place varying degrees of weight on the various embedded features.

For example, some place significant weight on the fixed-price redemption feature and conclude that the host is debt-like. These entities are of the opinion that the existence of a noncontingent, fixed-price redemption feature is a presumptive factor in the conclusion that the host contract is debt-like because it does not expose the holder to any residual risk. As a result, the embedded conversion feature could be bifurcated under this approach.

Others are of the opinion that all relevant terms and features must be taken into account and that an entity should also consider equity-like features (including the conversion option) in evaluating the nature of the host contract under the whole-instrument approach. This would result in a conclusion that (1) the host contract is equity-like (as a result of placing more emphasis on the contract's equity-like features, including the conversion feature), (2) the conversion option is clearly and closely related to that host contract, and (3) accordingly, the embedded conversion feature should not be bifurcated.

[11] Under the chameleon approach, an entity determines the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid instrument, except for the particular embedded feature being analyzed for bifurcation. When the chameleon approach is used to analyze a hybrid instrument with multiple embedded features, the nature of the host contract may change as each embedded feature is analyzed separately.

[12] Under the whole-instrument approach, an entity determines the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid instrument, including the embedded feature being analyzed for bifurcation. When the whole-instrument approach is used to analyze a hybrid instrument with multiple embedded features, the nature of the host contract should not change as each embedded feature is analyzed separately.

Under the ASU, entities whose instruments are within the scope of the guidance are required to apply the whole-instrument approach when determining the nature of the host contract in a hybrid financial instrument issued in the form of a share. That is, the chameleon approach is no longer permitted.

The ASU also contains implementation guidance to help reporting entities apply the whole-instrument approach. Under the implementation guidance, a reporting entity would (1) identify all stated and implied substantive terms and features of the instrument and whether those terms and features are debt-like or equity-like, (2) analyze the substance and relative weight of each characteristic, and (3) on the basis of all terms and features, and considering the substance and relative weight of each, determine the nature of the host contract. The ASU does not require any new disclosures.

For public business entities, the ASU's guidance is effective for annual periods (and interim periods therein) beginning after December 15, 2015. For all other entities, the guidance is effective for annual periods beginning after December 15, 2015, and interim periods thereafter. Early adoption is permitted.

A reporting entity may adopt the guidance by using either a modified or full retrospective approach. Under either approach, the reporting entity would be required to determine the nature of a host contract by taking into account the facts and circumstances that existed on the date it issued or acquired the instrument.

Thinking It Through

Application of the whole-instrument approach in lieu of the chameleon approach may increase the likelihood that an entity would conclude that an embedded feature is clearly and closely related to the host because that feature is viewed as an attribute of the host contract. However, under the ASU, an entity must carefully evaluate the substance of all relevant terms and features — and assess their relative strength — in reaching a conclusion about the nature of the host. For example, the ASU states that "an entity shall not presume that the presence of a fixed-price, noncontingent redemption option held by the investor in a convertible preferred stock contract, in and of itself, determines whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument." Thus, in determining the nature of the host, an entity must conduct a robust analysis of all terms and features of the hybrid instrument.

On the Horizon

Insurance Long-Duration Contracts

Deliberations to Date

In August 2014, the FASB began its discussions of targeted improvements to the accounting for long-duration insurance contracts. As of November 19, 2015, the Board had tentatively decided that insurance entities should:

- Update all assumptions used to calculate the liability for future policy benefits related to traditional long-duration contracts, limited-payment contracts, participating life insurance contracts, and nontraditional contracts.
- Update the assumptions used to determine the liability for future policy benefits as follows: (1) cash flow assumptions would be updated annually at the same time (chosen by management) every year or more frequently if actual experience or other evidence indicates a need to revise previous assumptions, (2) discount rate assumptions would be updated quarterly, and (3) market risk benefits measured at fair value would be updated quarterly.
- Expand the assumptions used to measure the liability for future policy benefits related to participating life insurance contracts to include factors such as investment yields, expected mortality, termination (lapse), expense, and dividend payments (e.g., expected future cash flows).
- For traditional long-duration and limited-payment contracts, calculate the effect of assumption updates by using a retrospective approach under which an insurer would (1) immediately recognize in earnings the effects of changes in cash flow assumptions and (2) initially record in OCI the effects of changes in the discount rate.
- Not include a provision for adverse deviation in their calculation of the liability.
- Not be required to perform a premium-deficiency test.
- Use a discount rate based on a portfolio of high-quality, fixed-income investments to discount those long-duration contracts that, under existing GAAP, are discounted using an expected investment yield.
- Continue to use the effective interest method to amortize deferred acquisition costs (DAC) relating to certain investment contracts.
- Amortize DAC related to other types of long-duration contracts over "the expected life of a book of contracts in proportion to the amount of insurance in force" unless the amount of insurance in force is variable and cannot be reliably predicted, in which case a straight-line method may be applicable.
- Measure market risk benefits at FVTNI for contracts and benefits that meet certain criteria, and present the component of such changes attributable to the insurer's own credit risk in OCI.

Thinking It Through

Under the tentative model for traditional long-duration contracts, an insurer that updates its assumptions for the applicable contracts would calculate a revised net premium ratio (computed as the present value of future policy benefits, divided by the present value of future net premiums) by using its actual historical experience and its updated cash flow projections based on the revised assumptions, excluding the impact of changes in the discount rate. It would then (1) recognize a cumulative catch-up adjustment in earnings for the current period to adjust its liability for future policy benefits to the amount that would have been recorded had the revised net premium ratio been applied since contract inception and (2) accrue the liability for future policy benefits in future periods on the basis of the revised net premium ratio. The changes in the liability attributable to changes in the discount rate would be (1) recognized immediately in OCI and (2) reclassified to earnings over the life of the liability. Further, the net premium ratio would not exceed 100 percent.

Next Steps

All tentative decisions are subject to change. At future meetings, the FASB is expected to discuss (1) presentation and disclosure requirements in connection with the tentative decisions, (2) whether an impairment model for DAC is necessary and whether the conclusions about DAC also apply to the valuation of business acquired (which currently applies DAC accounting), and (3) transition considerations.

Leases

Background

The FASB has been working with the IASB for almost a decade to address concerns related to the off-balance-sheet treatment of certain lease arrangements by lessees. The boards' proposed model would require lessees to adopt a right-of-use (ROU) asset approach that would bring substantially all leases, with the exception of short-term leases (i.e., those with a lease term of less than 12 months), on the balance sheet. Under this approach, a lessee would record an ROU asset representing its right to use the underlying asset during the lease term and a corresponding lease liability (similar to the current approach for capital leases).

Thinking It Through

A lessee would include in the calculation of the ROU asset any initial direct costs related to a lease. A lessor would continue to account for initial direct costs in a manner consistent with the current requirements. However, the boards decided to amend the definition of initial direct costs. In May 2014, the boards tentatively decided that the definition of initial direct costs for both lessees and lessors should include only those costs that are incremental to the arrangement and that the entity would not have incurred if the lease had not been obtained. This definition would be consistent with the definition of incremental cost in the recently issued revenue recognition standard. Under this definition, costs such as commissions and payments made to existing tenants to obtain the lease would be considered initial direct costs. In contrast, costs such as allocated internal costs and costs to negotiate and arrange the lease agreement (e.g., professional fees such as those paid for legal and tax advice) would be excluded from this definition.

Lessee and Nonlease Components

Lessees and lessors would be required to separate lease components and nonlease components (e.g., any services provided) in an arrangement and allocate the total transaction price to the individual components. Lessors would perform the allocation in accordance with the guidance in the new revenue recognition standard, and lessees would do so on a relative stand-alone price basis (by using observable stand-alone prices or, if the prices are not observable, estimated stand-alone prices). However, the boards have noted that lessees would be permitted "to elect, as an accounting policy by class of underlying asset, to not separate lease components from nonlease components, and instead account for the entire contract . . . as a single lease component."[1]

Thinking It Through

The boards agreed that an activity should be considered a separate nonlease component when the activity transfers a separate good or service to the lessee. For example, maintenance services (including common area maintenance services) and utilities paid for by the lessor but consumed by the lessee would be separate nonlease components because the lessee would have been required to otherwise contract for these services separately. However, the boards have not addressed whether payments for property taxes or insurance would be considered a nonlease component.

[1] Quoted text is from the boards' May 2014 agenda paper.

Lessee Accounting

While the boards agree that a lessee should record an ROU asset and a corresponding lease liability when the lease commences, the FASB and the IASB support different approaches for the lessee's subsequent accounting. The FASB decided on a dual-model approach under which a lessee would classify a lease by using criteria that are similar to the lease classification criteria currently in IAS 17. Under IAS 17, there are no "bright lines" such as those under current U.S. GAAP (e.g., the 90 percent fair value test in ASC 840). For leases that are considered finance leases (many current capital leases are expected to qualify as finance leases), the lessee would account for the lease in a manner similar to a financed purchase arrangement. That is, the lessee would recognize interest expense and amortization of the ROU asset, which typically would result in a greater expense during the early years of the lease. For leases that are considered operating leases (many current operating leases are expected to continue to qualify as operating leases), the lessee would recognize a straight-line total lease expense. For both types of leases, the lessee would recognize an ROU asset for its interest in the underlying asset and a corresponding lease liability.

Thinking It Through

The proposed leasing guidance could significantly affect insurance entities that currently account for their real estate leases as operating leases. Under the proposal, they would be required to record these arrangements in their statement of financial position. In addition, as a result of the proposal's requirement to classify real estate leases by using an approach with criteria that are similar to those in IAS 17, insurance entities would potentially recognize a different expense profile in their income statement. In addition, under the proposed IAS 17 approach, a lessee would be required to separately assess the classification of land and other elements of a property lease unless the land element is clearly immaterial. This change may result in the bifurcation of more real estate leases into separate land and building elements. The land and building elements would be separately evaluated for lease classification purposes.

Lessor Accounting

In 2014, the boards discussed constituent feedback on the ED and decided not to make significant changes to the existing lessor accounting model. Rather, they agreed to adopt an approach similar to the existing capital/finance lease and operating lease models in ASC 840 and IAS 17. However, the FASB decided to align the U.S. GAAP classification requirements with the criteria in IAS 17. In addition, the FASB decided that for leases that are similar to current sales-type leases, the lessor would only be permitted to recognize the profit on the transaction if the arrangement would have qualified as a sale under the new revenue recognition guidance (ASC 606). The FASB also reaffirmed its previous decision to eliminate leveraged-lease accounting but tentatively decided to allow entities to continue to apply the current leveraged-lease guidance to leveraged-lease arrangements that exist as of the final standard's effective date.

Thinking It Through

Insurance companies may invest in leveraged-lease arrangements to generate investment returns. As a result of the FASB's decisions related to leveraged-lease arrangements, insurance companies would no longer be permitted to apply the specialized accounting for new arrangements after the adoption of the final guidance. Rather, they would be required to account for a leveraged lease as two separate arrangements.

Next Steps

The FASB has completed its redeliberations on leases and is expected to issue a final standard in the first quarter of 2016. The new guidance will be effective for public business entities for fiscal years beginning after December 15, 2018 (i.e., calendar periods beginning on January 1, 2019), including interim periods therein. For all other entities, the standard will be effective for annual periods beginning after December 15, 2019 (i.e., calendar periods beginning on January 1, 2020), and interim periods thereafter. Early adoption will be permitted. Further, the IASB issued its final standard on leases (IFRS 16) in January 2016.

Definition of a Business

In November 2015, the FASB issued a proposed ASU on the first phase of its project on the definition of a business. The proposal is in response to concerns that as a result of the current broad definition of a business, many transactions are accounted for as business combinations when they are more akin to asset acquisitions. Comments on the proposed guidance were due January 22, 2016.

Under the proposal:

- A set of assets and activities ("set") must include an input and a substantive process that together contribute to the ability to create outputs in order to be a business.
- If substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or group of similar identifiable assets, the set would not be a business.
- The definition of outputs is narrowed to be consistent with ASC 606.

Thinking It Through

The proposed ASU could affect the insurance industry as a result of the different accounting for business combinations and asset acquisitions. For example, acquisition costs are expensed in a business combination and capitalized in an asset acquisition. Thus, a more narrow definition of a business will result in more asset acquisitions and, therefore, more capitalized costs.

In addition, it is not yet clear whether or, if so, how the proposed ASU would affect the treatment of block reinsurance transactions.

Single Asset Concentration

An entity can now first determine whether substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or group of similar identifiable assets and, if so, then conclude that the set is not a business. If this threshold is not met, the entity can apply the proposed ASU's framework for evaluating whether an input and a substantive process are both present and together contribute to the ability to produce outputs.

This assessment incorporates the concept of "integral equipment" into current accounting whereby a tangible nonfinancial asset that is attached to and cannot be physically separated from another tangible nonfinancial asset without incurring significant costs or diminution in value to either asset would be viewed as a single identifiable asset.

The proposed guidance also indicates that tangible assets and intangible assets cannot be combined into a single asset and would not be viewed as similar assets under this threshold test.

Input and Process Requirement

The proposal provides a framework for determining whether a set has an input and a substantive process that collectively contribute to the ability to create outputs ("input and process requirement").

In situations in which a set does not have outputs, the set would meet the input and process requirement if it includes an organized workforce that has the necessary skills, knowledge, or experience to perform an acquired process that, when applied to another acquired input(s), is critical to the ability to develop or convert that acquired input(s) into outputs.

In situations in which a set has outputs, the set would meet the input and process requirement if any of the following are present:

- An "organized workforce that has the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that when applied to an acquired input or inputs, is critical to the ability to continue producing outputs."
- The "acquired process (or group of processes), when applied to an acquired input or inputs, contributes to the ability to continue producing outputs and cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs."
- The "acquired process (or group of processes), when applied to an acquired input or inputs, contributes to the ability to continue producing outputs and is considered unique or scarce."

In addition, if a set has outputs, a continuation of revenues does not result in the conclusion that a substantive process has been acquired. In fact, any contracts with continued revenue streams, such as in-place leases or customer contracts, are excluded from the analysis of the input and process requirement, and only those factors listed above would be evidence that this requirement has been met.

Definition of Outputs

Under current guidance, outputs are defined as "the result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants." The proposal would change this definition to the "result of inputs and processes applied to those inputs that provide goods or services to customers, other revenues, or investment income, such as dividends or interest." The revised definition of outputs aligns with how outputs are considered in the new revenue guidance in ASC 606 and narrows the definition to not include just any form of return as an output.

Transition and Effective Date

The amendments in the proposal would be applied prospectively to any transaction that occurs on or after the effective date. No disclosures would be required at transition. The FASB will determine the effective date and whether the proposed amendments may be applied before the effective date after it considers stakeholder feedback on the proposed amendments.

For additional information, see Deloitte's December 4, 2015, *Heads Up*.

Financial Instrument Impairment

Background

The FASB spent much of 2015 drafting amendments to its impairment guidance. The amendments will introduce the current expected credit loss (CECL) model, which is a new impairment model[2] for certain financial instruments that is based on expected losses rather than incurred losses. Under the CECL model, an entity would recognize as an allowance its estimate of the contractual cash flows not *expected* to be collected. The FASB believes that the CECL model will result in more timely recognition of credit losses and will reduce the complexity of U.S. GAAP by decreasing the number of credit impairment models used to account for debt instruments.[3]

Under the existing impairment models (often referred to as incurred loss models), an impairment allowance is recognized only after a loss event (e.g., default) has occurred or its occurrence is probable. In assessing whether to recognize an impairment allowance, an entity may only consider current conditions and past events; it may not consider forward-looking information.

The CECL Model

Scope

The CECL model will apply to most[4] debt instruments (other than those measured at FVTNI), trade receivables, lease receivables, reinsurance receivable and recoverable amounts that result from insurance transactions, financial guarantee contracts,[5] and loan commitments. However, AFS debt securities will be excluded from the model's scope and will continue to be assessed for impairment under ASC 320 (the FASB has proposed limited changes to the impairment model for AFS debt securities, as discussed below).

Recognition of Expected Credit Losses

Unlike the incurred loss models in existing U.S. GAAP, the CECL model does not specify a threshold for the recognition of an impairment allowance. Rather, an entity will recognize an impairment allowance equal to the current estimate of expected credit losses (i.e., all contractual cash flows that the entity does not expect to collect) for financial assets as of the end of the reporting period. Credit impairment will be recognized as an allowance — or contra-asset — rather than as a direct write-down of the amortized cost basis of a financial asset.

Thinking It Through

Because the CECL model does not have a minimum threshold for recognition of impairment losses, entities will need to measure expected credit losses on assets that have a low risk of loss (e.g., investment-grade held-to-maturity debt securities). However, an "entity would not be required to recognize a loss on a financial asset in which the risk of nonpayment is greater than zero [but] the amount of loss would be zero." Although the Board decided not to specify the exact types of assets for which it would allow an entity to recognize zero credit losses, we believe that U.S. Treasury securities and certain highly rated debt securities may have been contemplated by the FASB.

[2] Although impairment began as a joint FASB and IASB project, constituent feedback on the boards' "dual-measurement" approach led the FASB to develop its own impairment model. The IASB, however, continued to develop the dual-measurement approach and issued final impairment guidance based on it as part of the July 2014 amendments to IFRS 9. For more information about the IASB's impairment model, see Deloitte's August 8, 2014, *Heads Up*.

[3] Note that the proposed CECL model would replace or amend several existing U.S. GAAP impairment models. See Appendix B of Deloitte's March 13, 2015, *Heads Up* for a tabular summary of those models.

[4] The CECL model would not apply to the following debt instruments:
- Loans made to participants by defined contribution employee benefit plans.
- Policy loan receivables of an insurance entity.
- Pledge receivables (promises to give) of a not-for-profit entity.
- Loans and receivables between entities under common control.

[5] The CECL model would not apply to financial guarantee contracts that are accounted for as insurance or measured at FVTNI.

Measurement of Expected Credit Losses

Under the amendments, an entity's estimate of expected credit losses represents all contractual cash flows that the entity does not expect to collect over the contractual life of the financial asset. When determining the contractual life of a financial asset, the entity would consider expected prepayments but would not be allowed to consider expected extensions unless it "reasonably expects that it will execute a troubled debt restructuring with a borrower."[6]

The entity would consider all available relevant information in making the estimate, including information about past events, current conditions, and reasonable and supportable forecasts and their implications for expected credit losses. That is, while the entity would be able to use historical charge-off rates as a starting point in determining expected credit losses, it would have to evaluate how conditions that existed during the historical charge-off period differ from its current expectations and accordingly revise its estimate of expected credit losses. However, the entity would not be required to forecast conditions over the contractual life of the asset. Rather, for the period beyond the period for which the entity can make reasonable and supportable forecasts, the entity would revert to an unadjusted historical credit loss experience.

Thinking It Through

Measuring expected credit losses will most likely be a significant challenge. Entities may also incur one-time or recurring costs associated with implementing the CECL model, such as those related to system changes, data collection, and using forward-looking information to estimate expected credit losses over the contractual life of an asset.

AFS Debt Securities

The impairment of AFS debt securities will continue to be accounted for under ASC 320. However, the amendments revise that guidance by:

- Limiting the credit losses recognized to the difference between the security's amortized cost and its fair value.
- Requiring an entity to use an allowance approach (vs. permanently writing down the security's cost basis).
- Removing the requirement that an entity must consider the length of time fair value has been less than amortized cost when assessing whether a security is other-than-temporarily impaired.
- Removing the requirement that an entity must consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists.

Thinking It Through

The Board did not revise (1) step 1 of the existing other-than-temporary impairment model (i.e., an "investment is impaired if the fair value of the investment is less than its cost") or (2) the requirement under ASC 320 that entities recognize the impairment amount only related to credit in net income and the noncredit impairment amount in OCI. However, entities would use an allowance approach when recognizing credit losses (as opposed to a permanent write-down of the AFS security's cost basis). As a result, in both of the following instances, an entity would reverse credit losses through current-period earnings on an AFS debt security:

- If the fair value of the debt security exceeds its amortized cost in a period after a credit loss had been recognized through earnings (because fair value was less than amortized cost), the entity would reverse the *entire* credit loss previously recognized and recognize a corresponding adjustment to its allowance for credit losses.

[6] Quoted text is from the FASB's summary of tentative Board decisions reached as of December 22, 2015.

- If the fair value of the debt security does not exceed its amortized cost in a period after a credit loss had been recognized through earnings (because fair value was less than amortized cost) but the credit quality of the debt security improves in the current period, the entity would reverse the credit loss previously recognized only in an amount that would reflect the improved credit quality of the debt security.

These revisions to the impairment model in ASC 320 could result in earlier recognition of impairment.

Transition

For most debt instruments, the amendments will require entities to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is effective (modified retrospective approach). However, instrument-specific transition provisions are provided for other-than-temporarily impaired debt securities, purchased credit-deteriorated (PCD) financial assets, and certain beneficial interests within the scope of ASC 325-40.

Other Significant Decisions

The new guidance will also reflect the FASB's tentative decisions related to the following:

- Practical expedients when measuring expected credit losses.
- Write-offs.
- Modifications.
- PCD assets.
- Certain beneficial interests within the scope of ASC 325-40.
- Loan commitments.
- Disclosures.

Effective Date and Early Adoption

The Board tentatively decided the following:

- For public business entities that meet the definition under U.S. GAAP of an SEC filer, the final standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.
- For public business entities that do not meet the definition of an SEC filer, the final standard will be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.
- For all other entities, the final standard will be effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years beginning after December 15, 2020.

The Board also tentatively decided that public business entities that meet the definition under U.S. GAAP of an SEC filer will not be permitted to early adopt the final standard. All other entities will be permitted to early adopt the final standard, but not before an SEC filer would adopt the standard.

Next Steps

The FASB expects to issue a final standard in the second quarter of 2016. For a comprehensive summary of the impairment project to date, see the project update page on the FASB's Web site.

Hedging

Background

As part of its project on targeted improvements to hedge accounting, the FASB held several educational sessions during 2015. Those sessions have thus far culminated in three decision-making meetings at which the FASB made a number of tentative decisions that, if ultimately adopted, would significantly modify certain aspects of the existing hedge accounting model. The Board expects to issue a proposed ASU reflecting these tentative conclusions in the second quarter of 2016.

Overall Hedging Model

The FASB tentatively decided to retain, for both fair value and cash flow hedges, (1) the highly effective threshold used to qualify for hedge accounting under current U.S. GAAP and (2) the current guidance allowing an entity to voluntarily dedesignate a hedging relationship. Further, under the proposal, an entity would still need specified documentation in place at hedge inception, including a description of its method for quantitatively assessing hedge effectiveness (unless the criteria for using the shortcut or critical-terms-match methods are met, obviating the need for quantitative assessments). However, an entity would not have to actually complete that initial quantitative assessment of hedge effectiveness until the end of the reporting period in which it designated the hedge (i.e., an entity could have up to three months to complete the initial quantitative assessment of effectiveness). Also under the proposal, after hedge inception, an entity would need to perform quantitative assessments of hedge effectiveness only when facts and circumstances change.

The Board also tentatively decided to eliminate the traditional concept of hedge ineffectiveness:

- For highly effective cash flow hedging relationships, the entire change in the fair value of the hedging instrument included in an entity's hedge effectiveness assessment would initially be recorded in OCI. When the hedged item affects earnings, the amount in accumulated OCI would be reclassified to the same income statement line as the earnings effect of the hedged item. Any portion of the change in the fair value of the hedging instrument that is excluded from an entity's hedge effectiveness assessment would be recognized immediately in earnings (but presented on the same income statement line as the earnings effect of the hedged item).
- For highly effective fair value hedging relationships, the entire change in the fair value of the hedging instrument would be recorded in earnings immediately in the same income statement line as the hedged item.
- For highly effective net investment hedging relationships, the entire change in the fair value of the hedging instrument included in an entity's hedge effectiveness assessment would initially be recorded as part of the cumulative-translation adjustment in OCI. When the hedged item affects earnings, the amount in accumulated OCI would be reclassified to the same income statement line as the earnings effect of the hedged item. Any portion of the change in the fair value of the hedging instrument that is excluded from an entity's hedge effectiveness assessment would be recognized immediately in earnings.

In addition, the FASB tentatively decided to require additional disclosure about (1) cumulative-basis adjustments for fair value hedges and (2) the effect of hedging on individual income statement line items. It also tentatively decided to require expanded qualitative disclosures about the quantitative goals, if any, that an entity set to achieve its hedging objectives.

Nonfinancial Hedging Relationships

For hedges of nonfinancial items, the Board tentatively decided to change existing U.S. GAAP to permit an entity to designate as a hedged item a contractually specified component or ingredient that is linked to a contractually stated rate or index. Any cap, floor, or negative basis that is related to the pricing of a contractually specified component of a nonfinancial item would not preclude designation of that component as a hedged item — an entity would just need to consider such pricing features in its assessment of hedge effectiveness.

Financial Hedging Relationships

For hedges of financial items, the FASB tentatively decided to (1) allow the contractually specified index rate in a variable-rate hedged item to be the designated interest rate risk (thereby relieving entities of the need to designate a benchmark interest rate for cash flow hedges of variable-rate instruments); (2) retain the existing benchmark interest rate definition for hedges of fixed-rate instruments, with minor modifications to eliminate inconsistencies; and (3) designate the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap index as a permitted benchmark interest rate.

In addition, the tentative decisions would allow an entity, for fair value hedges of interest rate risk, to:

- Consider only the effects of the designated hedged risk (e.g., interest rate risk) on a prepayment option when determining the change in the value of the debt for hedges of callable debt.
- Designate as the hedged risk only a portion of the hedged item's term (i.e., compute the change in the hedged item's fair value by using the same term as that of the hedging instrument).
- Calculate the change in the fair value of the hedged item attributable to changes in the benchmark interest rate by using either (1) total coupon cash flows or (2) only those cash flows related to the benchmark interest rate. However, an entity would be required to use total coupon cash flows when the effective interest rate of the hedged item is less than the benchmark interest rate on the date of hedge designation.

Shortcut Method

The FASB tentatively decided to retain the shortcut method in current U.S. GAAP. However, the Board also tentatively decided to allow an entity to document at hedge inception the long-haul method it would use to measure hedge ineffectiveness if the shortcut method could not be applied. That is, if the entity later determines that continued use of the shortcut method is inappropriate, it can continue the hedging relationship by using the long-haul method designated at inception as long as the hedging relationship has been highly effective since inception.

Next Steps

The FASB staff will (1) continue to develop a staff draft of the proposed ASU reflecting the Board's decisions; (2) analyze the costs, benefits, and potential complexity of the tentative decisions; and (3) identify any issues that need to be brought back to the Board for a vote. In addition, the FASB will need to address transition and the comment period of the proposed ASU.

Thinking It Through

When the proposal is issued, companies should carefully analyze it to assess its possible ramifications on their hedging strategies, systems, and internal controls, and they are encouraged to provide feedback on the proposed amendments to the FASB. Multinational companies should note that the FASB's proposed hedging model is likely to differ significantly from the IASB's IFRS 9 hedging model.

To follow the status of the FASB's hedging project, see the project page on Deloitte's US GAAP Plus Web site.

FASB's Simplification Initiative

Goodwill and Identifiable Intangible Assets for Public Business Entities and Not-for-Profit Entities

Background

As discussed above, in November 2013, the FASB endorsed a decision by the PCC to allow nonpublic business entities to amortize goodwill and perform a simplified goodwill impairment test. In addition, in 2014 the FASB endorsed the PCC's alternative that gives private companies an exemption from having to recognize certain intangible assets for (1) assets acquired in a business combination or (2) investments accounted for under the equity method or upon the adoption of fresh-start accounting. The Board received feedback on the PCC's decision indicating that many public business entities and not-for-profit entities had similar concerns about the cost and complexity of applying these requirements. In response, the Board added a project on goodwill and a separate project on intangible assets to its agenda in 2014.

Current Status and Next Steps

The goodwill project is currently in the initial deliberations phase. At its meeting on October 28, 2015, the FASB tentatively decided to split the project into two phases. The first phase would focus on simplifying the goodwill impairment test. In the second phase, the Board would work with the IASB to address stakeholder concerns related to the subsequent accounting for goodwill.

At the October meeting, the Board discussed how to simplify the goodwill impairment test and tentatively decided to remove step 2, thus eliminating the requirement to complete a hypothetical purchase-price allocation. The FASB also tentatively decided not to give entities the option to perform step 2 and to instead require them to adopt the simplified impairment test prospectively. An ED related to the first phase of the project is expected to be released in the first half of 2016. The comment period would be 60 days.

The identifiable intangible assets project is currently in the initial deliberations phase. The FASB will continue its research related to this project in conjunction with the IASB.

Employee Share-Based Payments

In June 2015, the FASB issued a proposed ASU on share-based payments as part of its simplification initiative and expects to issue the final standard during the first quarter of 2016. The proposed ASU would affect several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, minimum statutory withholding requirements, classification in the statement of cash flows, and classification of awards with repurchase features. In addition, the proposed ASU contains two practical expedients for nonpublic entities under which such entities can use the simplified method to estimate the expected term of an award and make a one-time election to switch from fair value measurement to intrinsic value measurement for liability-classified awards.

The FASB received over 60 comment letters on the proposal (which were due by August 14, 2015) from various respondents, including preparers, professional and trade organizations, and accounting firms. While respondents were generally supportive of the proposed changes, a number of them were concerned with a key provision related to accounting for excess tax benefits and deficiencies. Specifically, the ASU proposes to eliminate the APIC pool and require entities to record all excess tax benefits and deficiencies to the income statement. While respondents generally agreed with the Board's proposal to eliminate the APIC pool, many would prefer to record all excess tax benefits and deficiencies directly to equity.

For additional information about the proposed ASU, see Deloitte's June 12, 2015, *Heads Up*, and see the project page on Deloitte's US GAAP Plus Web site

Balance Sheet Classification of Debt

Background

As part of its simplification initiative, the FASB has tentatively decided to replace its current, fact-specific debt classification guidance with a cohesive principle that would be applied in the determination of whether debt liabilities should be classified as current or noncurrent in a classified statement of financial position. All debt arrangements (i.e., those that "provide a lender a contractual right to receive money and a borrower a contractual obligation to pay money on demand or on fixed or determinable dates"[7]) would be within the scope of the tentative decisions.

> **Thinking It Through**
>
> The scope of this project also includes convertible debt instruments, even though they may be settled in shares upon conversion, and mandatorily redeemable financial instruments that are classified as liabilities, even if they were issued in the form of an entity's equity shares.

Tentative Decisions

Debt Classification Principle

The Board has tentatively decided that "an entity should classify a debt as noncurrent if one or both of the following criteria are met as of the balance sheet date:

1. The liability is contractually due to be settled more than 12 months (or operating cycle, if longer) after the balance sheet date
2. The entity has a contractual right to defer settlement of the liability for at least 12 months (or operating cycle, if longer) after the balance sheet date."[8]

> **Thinking It Through**
>
> Under existing U.S. GAAP, an entity in some cases considers transactions entered into after the balance sheet date, but before the financial statements are issued, in classifying debt as current or noncurrent. For example, an entity may exclude short-term obligations from current liabilities in certain circumstances if it has issued long-term obligations or equity securities to refinance a short-term obligation on a long-term basis after the balance sheet date but before the financial statements are issued. Under the Board's tentative decision, the classification would instead be made on the basis of the entity's rights and obligations as of the balance sheet date. The proposed classification principles would more closely align U.S. GAAP with IFRSs (i.e., paragraph 69 of IAS 1).

Although the classification of debt generally would be based on the facts and circumstances as of the balance sheet date, the Board tentatively decided to make an exception in certain circumstances when the entity receives a waiver of a debt covenant violation. When an entity violates a debt covenant on or before the balance sheet date, and the long-term debt becomes a short-term obligation, the entity would not automatically be required to classify the debt as current. If the lender grants the entity a waiver of the covenant before the entity's financial statements are issued, the entity would classify the debt as noncurrent and present the debt separately on the face of the balance sheet. The purpose of such presentation would be to notify financial statement users that this debt is classified as noncurrent even though the entity violated one or more covenants as of the balance sheet date. The exception would not apply to waivers that involve a debt modification or extinguishment under ASC 470-50.

[7] Quoted text is from the FASB's July 29, 2015, meeting handout.
[8] Quoted text is from the FASB's summary of tentative Board decisions reached at its January 28, 2015, meeting.

For an entity's application of the waiver exception, the Board tentatively decided to retain existing U.S. GAAP guidance[9] under which (1) the waiver of the current violation must be greater than 12 months from the balance sheet date and (2) it is *not* probable that the borrower will be unable to comply with the covenant by the covenant compliance dates within the next 12 months.

Subjective Acceleration Clauses

Subjective acceleration clauses are clauses under which the lender may accelerate the maturity date of the debt as a result of conditions that are not objectively determinable (e.g., if the debtor fails to maintain *satisfactory* operations or if a *material adverse change* occurs). The FASB tentatively decided that subjective acceleration clauses should affect the classification of debt only when such clauses are triggered.

Thinking It Through

Under current U.S. GAAP, long-term obligations subject to a subjective acceleration clause in certain circumstances (e.g., if the borrower is experiencing recurring losses or liquidity problems) are classified as current even if the lender has not invoked the clause. On the basis of the Board's tentative decision, however, it appears that a subjective acceleration clause would only affect the classification of debt when the entity's debt payment has been accelerated.

Disclosures and Transition

The FASB has tentatively decided to (1) incorporate into U.S. GAAP the disclosure requirements related to debt covenant violations that currently exist in SEC guidance[10] and (2) require the disclosures for both public and nonpublic business entities. The Board has also decided to require entities to disclose the nature and existence of significant subjective acceleration clauses and debt covenants.

The guidance would apply on a prospective basis to all debt that exists as of the effective date. On transition, an entity would be required to disclose:

- The nature of and reason for the change in accounting principle.
- The effect of the change on affected financial statement line items in the current period.

The effective date will be determined after stakeholder feedback is received.

Next Steps

The FASB expects to issue a proposed ASU with a 60-day comment period in the second quarter of 2016.

Equity Method Simplification

In June 2015, the FASB issued a proposed ASU on equity method accounting as part of its simplification initiative. The proposal is intended to eliminate the requirements for an investor to (1) account for basis differences related to its equity method investees and (2) retroactively account for an investment that becomes newly qualified for use of the equity method because of an increase in ownership interest or degree of influence.

On the basis of the feedback received on its proposed ASU, the FASB directed the staff to perform additional research on whether to eliminate the requirement to account for the basis differences. However, the FASB decided to further clarify and finalize its proposed guidance related to eliminating the retroactive accounting for an investment that becomes newly qualified for use of the equity method of accounting upon an increase in ownership interest or degree of influence. The FASB clarified that unrealized holding gains or losses in accumulated OCI related to an AFS security that becomes eligible for the equity method should be recognized in earnings as of the date on which the investment qualifies for the equity method.

[9] See ASC 470-10-45-1(b).

[10] See SEC Regulation S-X, Rule 4-08 (ASC 235-10-S99-1(c)).

The FASB directed the staff to draft a final standard for issuance, which is expected in the first quarter of 2016. The guidance in the ASU will be applied prospectively to increases in the level of ownership interest or degree of influence occurring after the final ASU's effective date. No transition disclosures will be required. For all entities, the final standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. In addition, all entities will be permitted to early adopt the guidance upon issuance of the final standard.

Liabilities and Equity — Targeted Improvements

Background

In November 2014, the FASB added to its agenda a project to "simplify the accounting guidance related to financial instruments with characteristics of liabilities and equity."[11] The project focuses on the following:

1. Application of the indexation guidance in ASC 815-40 to "equity-linked financial instruments containing 'down round' features."
2. The indefinite deferral of the liability classification guidance in ASC 480-10 on certain "mandatorily redeemable financial instruments for certain nonpublic entities and certain mandatorily redeemable noncontrolling interests."
3. Potential improvements to the accounting guidance in ASC 815-40 on "[f]reestanding contracts indexed to, and potentially settled in, an entity's own stock."
4. "Improving the navigation within the Codification."

Deliberations on the first phase of this project began at the FASB's September 6, 2015, meeting, during which the Board discussed items (1) and (2) above. The FASB expects to issue the proposed ASU during the first quarter of 2016.

Down-Round Features

At its September meeting, the Board tentatively decided to create a new accounting model that would replace the existing guidance on such features in ASC 815-40.

Thinking It Through

A down-round feature is a provision in an equity-linked financial instrument (e.g., a freestanding warrant contract or an equity conversion feature embedded within a host debt or equity contract) that triggers a downward adjustment to the instrument's strike price (or conversion price) if the entity issues equity shares at a lower price (or equity-linked financial instruments with a lower strike price) than the instrument's strike price. The purpose of the feature is to protect the instrument's counterparty from future issuances of equity shares at a more favorable price. For example, a warrant may specify that the strike price is the lower of $5 per share or the common stock offering price in any future initial public offering of the shares. Under current U.S. GAAP, a contract that contains a down-round feature does not qualify as equity because it precludes a conclusion that the contract is indexed to the entity's own stock under ASC 815-40-15 (as illustrated in ASC 815-40-55-33 and 55-34).

Unlike current U.S. GAAP, the Board's tentative approach related to down-round features would not preclude an entity from concluding that an instrument is indexed to the entity's own stock. For example, when an entity evaluates whether it is required to classify a freestanding warrant to acquire the entity's common stock as a liability under ASC 815-40, the existence of the down-round feature would not affect the analysis. Similarly, a down-round feature would be excluded from the analysis of whether (1) an embedded conversion feature in a debt host contract must be bifurcated as an embedded derivative under ASC 815-15 or (2) it qualifies for the derivative accounting scope exception in ASC 815-10-15-74 for contracts indexed to an entity's own stock and classified in stockholders' equity.

[11] Quoted text is from the project update page on the FASB's Web site.

Under the tentative approach, if a down-round feature is triggered, the accounting for it would be aligned with the classification of the related instrument. For an equity-classified instrument, the transfer of value from the entity to the holder at the time the down-round feature is triggered would result in the recognition of a dividend to the investor. If the instrument is classified as a liability, the transfer of value resulting from the down-round feature when triggered would be recognized through a charge to earnings. If the entire instrument is classified as a liability with changes in fair value charged to earnings each reporting period, no separate adjustment would be required since the value of the down-round when triggered would inherently be captured in the periodic adjustment.

The FASB believes that existing U.S. GAAP requirements sufficiently address disclosures related to instruments with down-round features. However, the Board supported the addition of a narrow requirement for entities to disclose, in the period the down-round feature is triggered, the impact of recognizing the feature.

Thinking It Through

Under current U.S. GAAP, the existence of a down-round feature automatically precludes the instrument being evaluated (whether freestanding or embedded) from meeting the derivative accounting scope exception in ASC 815-40-15-74. As a result of the tentative approach, there would be (1) more freestanding contracts on own equity (e.g., warrants) that meet this scope exception (and thus more contracts being included within equity rather than accounted for as derivative liabilities) and (2) fewer embedded features (e.g., equity conversation features) that meet all the criteria in ASC 815-15 for bifurcation as embedded derivatives. This will reduce earnings volatility in the issuer's financial statements since derivatives liabilities, unlike equity-classified contracts, are adjusted to their fair value each reporting period.

Indefinite Deferrals Under ASC 480-10

The transition guidance in ASC 480-10 indefinitely defers the application of some of its requirements to certain instruments and entities (i.e., certain mandatorily redeemable financial instruments of nonpublic entities that are not SEC registrants and certain mandatorily redeemable noncontrolling interests). Accordingly, such instruments may qualify as equity under U.S. GAAP even though ASC 480-10-25 suggests that they should be classified as liabilities. The Board tentatively agreed to replace the indefinite deferrals in ASC 480-10 with scope exceptions that have the same applicability. This is not intended to have any impact on accounting treatment but rather to improve navigation within the Codification.

Presentation of Net Periodic Benefit Cost

In January 2016, the FASB issued a proposed ASU on the presentation of net periodic benefit costs as part of its simplification initiative. Under the proposed guidance, entities would be required to (1) disaggregate the current service cost component from the other components of net benefit cost and present it with other current compensation costs for the related employees in the income statement and (2) present the remaining components of net benefit cost elsewhere in the income statement and outside of income from operations, if such a subtotal is presented.

Further, the proposed ASU would require retrospective application for the change in the presentation of the service cost component and the other components of net benefit cost in the income statement. An entity would disclose the nature of and reason for the change in accounting principle in the first interim and annual reporting periods in which it adopts the ASU.

Comments on the proposed ASU are due by April 25, 2016. For additional information about the proposed ASU, see Deloitte's January 28, 2016, *Heads Up*.

Other Topics

Disclosure Framework

Background

In July 2012, the FASB issued a discussion paper as part of its project to develop a framework to make financial statement disclosures "more effective, coordinated, and less redundant." The paper identifies aspects of the notes to the financial statements that need improvement and explores possible ways to improve them. The FASB subsequently decided to distinguish between the "Board's decision process" and the "entity's decision process" for evaluating disclosure requirements.

FASB's Decision Process

In March 2014, the FASB released for public comment a proposed concepts statement that would add a new chapter to the Board's conceptual framework for financial reporting. The proposal outlines a decision process to be used by the Board and its staff for determining what disclosures should be required in notes to financial statements. The FASB's objective in issuing the proposal is to improve the effectiveness of such disclosures by ensuring that reporting entities clearly communicate the information that is most important to users of financial statements. See Deloitte's March 6, 2014, *Heads Up* for additional information.

Entity's Decision Process

In September 2015, the FASB issued a proposed ASU that would amend the Codification to indicate that the omission of disclosures about immaterial information is not an accounting error. The proposal, which is part of the FASB's disclosure effectiveness initiative, notes that materiality is a legal concept applied to assess quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements taken as a whole. See Deloitte's September 28, 2015, *Heads Up* for additional information.

Comments on the proposed ASU were due by December 8, 2015.

Topic-Specific Disclosure Reviews

In addition to proposing amendments to guidance, the FASB staff is analyzing ways to "further promote [entities'] appropriate use of discretion" in determining proper financial statement disclosures. The Board is applying the concepts in both the entity's and the Board's decision process in considering "section-specific modifications." In the second half of 2015, the FASB reached tentative decisions about disclosure requirements in the following Codification topics:

- ASC 820 (fair value measurement).
- ASC 740 (income taxes).
- ASC 715-20 (defined benefit plans).
- ASC 330 (inventory).

Proposed changes to the disclosure requirements for fair value measurement and income taxes are discussed below.

Fair Value Measurement

Objective for Disclosures

In December 2015, the FASB issued for public comment a proposed ASU that would amend the requirements in ASC 820 for disclosing fair value measurements. The proposed ASU would add the following objective to ASC 820 to encourage preparers to use discretion in complying with the disclosure requirements:

> The objective of the disclosure requirements in this Subtopic is to provide users of financial statements with information about all of the following:
>
> a. The valuation techniques and inputs that a reporting entity uses to arrive at its measures of fair value, including judgments and assumptions that the entity makes
>
> b. The effects of changes in fair value on the amounts reported in financial statements
>
> c. The uncertainty in the fair value measurement of Level 3 assets and liabilities as of the reporting date
>
> d. How fair value measurements change from period to period.

In addition to establishing a disclosure objective, the Board has tentatively decided to make changes (i.e., eliminations, modifications, and additions) to the specific fair value disclosure requirements of ASC 820.

Eliminated and Modified Disclosure Requirements

Policy on Timing of Transfers Between Levels and Transfers Between Levels 1 and 2

The proposed ASU would remove the requirement in ASC 820-10-50-2C for an entity to disclose its policy on the timing of transfers between levels of the fair value hierarchy. An entity would still be required to have a consistent policy on timing of such transfers. The requirement to separately disclose the amounts transferred between Level 1 and Level 2 and the corresponding reason for doing so would also be removed.

Level 3 Fair Value Measurements

The Board made the following tentative decisions that affect disclosures about Level 3 fair value measurements:

- *Valuation process* — Remove requirements in ASC 820-10-50-2(f) (and related implementation guidance in ASC 820-10-55-105) for an entity to disclose its valuation processes for Level 3 fair value measurements.

Thinking It Through

Removing the disclosure requirement in ASC 820-10-50-2(f) will result in divergence between U.S. GAAP and IFRSs. The requirement was added to the FASB's and IASB's jointly issued standard on the basis of a recommendation by the IASB's expert panel. The panel explained that the disclosure would help users understand the quality of the entity's fair value estimates and give investors more confidence in management's estimate. The FASB tentatively decided to remove the requirement because it would conflict with the Board's proposed concepts statement. The Board indicated that disclosure of internal control procedures is outside the purpose of the notes to the financial statements and is not required under other topics in U.S. GAAP.

Removing this requirement does not change management's responsibility for internal controls over the valuation process and related auditor testing. Further, it should not affect investor confidence in the quality of the fair value estimate given the regulatory environment in the United States (e.g., SEC and PCAOB) as well as the intense scrutiny in this area. The Board also noted that investors are typically familiar with the overall valuation process.

- *Measurement uncertainty* — Retain the requirement in ASC 820-10-50-2(g) to provide a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs. However, the Board plans to clarify that this disclosure is intended to communicate information about the uncertainty in measurement as of the reporting date and not to provide information about sensitivity to future changes in fair value.

- *Quantitative information about unobservable inputs* — Require disclosure of the range and weighted average of the unobservable inputs to comply with the requirement in ASC 820-10-50-2(bbb) (as shown by example in the implementation guidance in ASC 820-10-55-103). Disclosing the period used to develop significant unobservable inputs based on historical data would also be required.
- *Level 3 rollforward* — Retain the Level 3 rollforward requirement for public business entities. For entities that are not public business entities, the Board tentatively decided to modify the Level 3 rollforward guidance and remove the requirement to disclose the change in unrealized appreciation or deprecation related to investments held as of the balance sheet date under ASC 820-10-50-2(d). Instead, disclosures would be required about transfers into and out of Level 3 and purchases of Level 3 investments. The Board indicated that entities are already required to disclose the ending balance in the fair value hierarchy table, and they could disclose transfers into (and out of) and purchases of Level 3 investments in a sentence rather than in a full rollforward as required today. A defined benefit plan sponsor would also remove the reconciliation of beginning and ending balances for plan investments categorized as Level 3 within the fair value hierarchy (i.e., the Level 3 rollforward) and would only be required to disclose transfers into and out of Level 3 and purchases of Level 3 assets in its defined benefit plan footnote (for more information about the FASB's proposed ASU on reviewing defined benefit plan disclosures, see Deloitte's January 28, 2016, *Heads Up*).

Thinking It Through

The Board discussed the results of user outreach on the Level 3 rollforward and noted that some financial statement users believe that the rollforward is useful because it helps them understand management's decisions, especially for different economic cycles. The full rollforward was generally deemed less useful for users of private-company financial statements. Transfers into and out of Level 3 were generally considered to be the most useful aspect of the rollforward.

NAV Disclosures of Estimates of Timing of Future Events

The following disclosures currently required under ASC 820-10-50-6A(b) and ASC 820-10-50-6A(e) would apply only when they have been communicated to the reporting entity by the investee or are otherwise made publicly available (even if not specifically communicated to the investor):

- "For each class of investment that includes investments that can never be redeemed with the investees, but the reporting entity receives distributions through the liquidation of the underlying assets of the investees, the reporting entity's estimate of the period of time over which the underlying assets are expected to be liquidated by the investees."
- "[W]hen the restriction from redemption might lapse."

Thinking It Through

The objective of this change is to prevent an investor from having to make its own estimate when it does not have knowledge of the timing from the investee or other public source. In addition, ASU 2015-07 removed the requirement for entities to categorize within the levels of the fair value hierarchy all investments they have measured under the NAV practical expedient.

New Disclosure Requirements — Unrealized Gains and Losses

Public business entities would disclose fair value changes for assets and liabilities held as of the balance sheet date disaggregated by fair value hierarchy level (i.e., Levels 1, 2, and 3) for (1) net income before taxes and (2) comprehensive income. This is currently only required for the Level 3 amounts within net income under ASC 820-10-50-2(c) and (d). This requirement would not apply to entities that are not public business entities in accordance with the private-company decision-making framework.

Transition and Next Steps

The proposed ASU requires that the modifications to disclosures about changes in unrealized gains and losses and the changes in the quantitative information about unobservable inputs (see discussion above) would be applied prospectively beginning in the period of adoption. Entities would apply all other changes in disclosures retrospectively to all periods presented.

The FASB did not propose an effective date. Rather, the Board indicated that it plans to determine such date after considering stakeholders' feedback on the proposed ASU. Comments on the proposed ASU are due by February 29, 2016. See Deloitte's December 8, 2015, *Heads Up* for additional information.

Income Taxes

At its meeting on January 7, 2015, the FASB staff outlined potential revisions to the disclosure requirements in ASC 740 that would enhance a financial statement user's understanding of foreign taxes. The Board's efforts are largely driven by findings in the post-implementation review of Statement 109 that users want more information that will allow them to analyze (1) "the cash effects associated with income taxes, particularly current period taxes paid by jurisdiction (e.g., U.S. and foreign), and estimate future tax payments" and (2) "earnings determined to be indefinitely reinvested in foreign subsidiaries."

At its October 21, 2015, meeting, the FASB discussed income tax disclosure requirements related to income taxes paid, deferred income taxes, valuation allowances, and rate reconciliation and reached the following tentative decisions, which would apply to both public and nonpublic entities:

- *Income taxes paid* — The Board would add requirements for a reporting entity to disclose (1) when a change in tax law has been enacted and it is probable that the change will affect the reporting entity in a future period and (2) the disaggregation of the income taxes paid between foreign and domestic jurisdictions.
- *Deferred income taxes* — An entity would be required to disclose the balance sheet line item(s) in which deferred taxes are presented (i.e., a mapping of total deferred taxes to the balance sheet line items in which they are reported).
- *Valuation allowances* — An entity would need to explain the "nature and amounts of the valuation allowance recorded and released during the reporting period."[1]
- *Rate reconciliation* — The Board tentatively decided that:
    - Nonpublic entities would be required to present a rate reconciliation in the notes to the financial statements, as ASC 740-10-50-12 currently requires for public entities.
    - A disaggregation of a component of the rate reconciliation would be required if the individual component is greater than or equal to 5 percent of the tax at the statutory rate in a manner consistent with SEC Regulation S-X.
    - An entity would be required to disclose a qualitative description of the items that have caused a significant year-over-year change to the effective tax rate.

In addition, the Board tentatively decided to require disclosures about the (1) gross amounts and expiration dates of carryforwards recorded on a tax return, (2) tax-effected amounts and expiration dates of carryforwards that give rise to a deferred tax asset, and (3) total amount of unrecognized tax benefits that offset deferred tax assets related to carryforwards.

The Board directed its staff to begin drafting a proposed ASU for public comment that would take into account all the tentative decisions reached to date regarding income tax disclosure requirements. Such decisions include the Board's previous tentative decisions made about disclosure requirements related to indefinitely reinvested foreign earnings and unrecognized tax benefits.

[1] Quoted text is from the FASB's summary of tentative Board decisions reached at its October 21, 2015, meeting.

Undistributed Foreign Earnings

At its February 11, 2015, meeting, the FASB tentatively decided that entities should:

- Disclose information separately about the domestic and foreign components of income before income taxes. Further, entities should separately disclose income before income taxes of individual countries that are significant relative to total income before income taxes.[2]
- Disclose the domestic tax expense recognized in the period related to foreign earnings.
- Disclose unremitted foreign earnings that, during the current period, are no longer asserted to be indefinitely reinvested and an explanation of the circumstances that caused the entity to no longer assert that the earnings are indefinitely reinvested. These disclosures should be provided in the aggregate and for each country for which the amount no longer asserted to be indefinitely reinvested is significant in relation to the aggregate amount.
- Separately disclose the accumulated amount of indefinitely reinvested foreign earnings for any country that is at least 10 percent of the aggregate amount.

Unrecognized Tax Benefits

At its meeting on August 26, 2015, the FASB tentatively decided to:

- Add a disclosure requirement in the tabular reconciliation to disaggregate settlements between cash and noncash (e.g., settlement by using existing net operating loss or tax credit carryforwards).
- Add a disclosure requirement to provide a breakdown of the amount of total unrecognized tax benefits shown in the tabular reconciliation by the respective balance-sheet lines on which such unrecognized tax benefits are recorded.
- Eliminate the requirement in ASC 740-10-50-15(d) for entities to provide details of positions for which it is reasonably possible that the total amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months.

Since the two new proposed disclosure requirements for unrecognized tax benefits are related to the tabular reconciliation, they will only apply to public entities.

The Board directed its staff to prepare examples of the proposed additional disclosures.

Interim Reporting

To date, the FASB has discussed five interim reporting concepts under its proposed concepts statement. The Board generally agreed that interim financial statements should describe "differences in recognition, measurement, and presentation of line items" and should explain "how the interim period relates to the entire year."[3] Two of the interim reporting concepts pertained to disclosing changes from the latest annual financial statements, and two pertained to disclosing items that are not peripheral or are "especially important."

To determine the meaning of "especially important," the Board will assess the interim disclosure requirements being proposed in the Board's project on reviewing fair value measurement disclosures as well as the interim disclosure requirements related to revenue in ASC 270-10-50-1A. On the basis of this process, the FASB can assess whether entities should disclose an item or amount that has not changed but is especially important.

[2] In ASC 740, income before income taxes is also referred to as pretax financial income.

[3] Quoted text is from a handout for the Board's January 7, 2015, meeting.

Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (EITF Issue 15-F)

In April 2015, to reduce diversity in the application of ASC 230, the FASB added Issue 15-F to the EITF's agenda. Issue 15-F addressed nine separate issues related to cash flow classification. In January 2016, the FASB issued a proposed ASU based on consensuses reached by the EITF on all of the issues except for one, which the EITF will address separately. Comments on the proposed ASU are due by March 29, 2016. The table below summarizes each issue and its status.

Cash Flow Classification Issue and Proposed Treatment	Status
Debt Prepayment or Extinguishment Costs Cash payments for debt prepayment or extinguishment costs would be classified as cash outflows for financing activities.	Included in proposed ASU
Settlement of Zero-Coupon Bonds At settlement, the cash outflows of a zero-coupon bond would be classified in operating and financing activities. The cash payment of the accreted interest would be classified in operating activities, while the cash payment attributable to the original proceeds (i.e., the principal) would be classified in financing activities.	Included in proposed ASU
Contingent Consideration Payments Made After a Business Combination Contingent consideration payments that were not made soon after a business combination would be separated and classified in operating and financing activities. Cash payments up to the amount of the contingent consideration liability that are recognized as of the acquisition date, including any measurement-period adjustments, would be classified in financing activities, while any excess cash payments would be classified in operating activities.	Included in proposed ASU
Proceeds From the Settlement of Insurance Claims Cash proceeds from the settlement of insurance claims would be based on the nature of the insurance coverage (i.e., nature of the loss). For insurance proceeds received in a lump-sum settlement, an entity would determine the classification on the basis of the nature of each loss included in the settlement.	Included in proposed ASU
Proceeds From the Settlement of Corporate-Owned Life Insurance (COLI) Policies and Bank-Owned Life Insurance (BOLI) Policies Cash proceeds from the settlement of COLI and BOLI polices would be classified in investing activities. However, an entity would be permitted, but not required, to align the classification of premium payments on COLI and BOLI policies with the classification of COLI and BOLI proceeds (i.e., payments for premiums may be classified as investing, operating, or a combination thereof).	Included in proposed ASU
Distributions Received From Equity Method Investees An entity would classify distributions received from an equity method investee in operating or investing activities (or both) by applying a cumulative-earnings approach. The proposed ASU does not address equity method investments measured under the fair value option.	Included in proposed ASU
Beneficial Interests in Securitization Transactions A transferor's beneficial interests received as proceeds from the securitization of an entity's financial assets would be disclosed as a noncash activity. Subsequent cash receipts of beneficial interests from the securitization of an entity's trade receivables would be classified as cash inflows from investing activities.	Included in proposed ASU
Application of the Predominance Principle The guidance would clarify when an entity would (1) separate cash flows of a single item into more than one class of cash flows or (2) aggregate multiple cash flows into one class of cash flows on the basis of predominance.	Included in proposed ASU
Restricted Cash Changes in restricted cash that affect an entity's cash and cash equivalent balance would be classified as investing activities (i.e., on the basis of the nature of the cash flow). The remaining restricted cash-related issues will be discussed at a future meeting.	Initial EITF deliberations

Under the proposed ASU, this guidance would be applied retrospectively to all periods presented unless doing so would be impracticable, in which case an entity would apply the guidance prospectively as of the earliest date practicable. The FASB will discuss an effective date and whether to permit early adoption after considering stakeholder feedback on the proposed ASU.

Views of Task Force members differed during the EITF's initial discussion about the guidance on restricted cash; accordingly, the EITF chose to exclude that issue from the proposed ASU and directed the FASB staff to perform further research. The Task Force is expected to continue its discussions of restricted cash at its March 3, 2016, meeting.

For more information on the proposed ASU, see Deloitte's February 4, 2016, *Heads Up*. For summaries of the decisions reached by the EITF on the issues, see Deloitte's June 2015, September 2015, and November 2015 *EITF Snapshot* newsletters.

Accounting for Interest Income Associated With the Purchase of Callable Debt Securities

Background

In March 2015, the FASB added to its agenda a project to improve interest income disclosures for purchased debt securities and loans. The objective of this project is to enhance the transparency and usefulness of the information provided in the notes to the financial statements about interest income on purchased debt securities and loans. Possible enhancements include requiring disclosure of:

- The separate components of the effective yield on purchased debt securities and loans, specifically (1) the contractual interest and (2) the accreting premium or discount.
- The outstanding amounts of principal and premiums or discounts on purchased debt securities and loans, with separate disclosure of those amounts subject to call options.

At its September 2015 meeting, the Board continued deliberating disclosures about interest income on purchased debt securities and loans and also decided to expand the scope of the project to include the amortization period used for callable debt securities. The Board tentatively decided that for purchased callable debt securities, (1) premiums would be amortized to the first call date and (2) discounts would be amortized to the maturity date. This would be a change from current practice, which requires premiums and discounts to be amortized to the maturity date in absence of the entity holding a large number of similar securities for which it has elected as an accounting policy to amortize prepayments and discounts over the expected life of the securities.

Next Steps

The Board directed the staff to research (1) current disclosure requirements for callable debt securities and loans and (2) whether the scope of the financial instruments included in the project should be amended. At a future meeting, the staff will provide the Board with its research and proposed disclosure requirements related to interest income for purchased debt securities and loans.

Thinking It Through

This project aims to improve the disclosures about interest income reported in the financial statements so users of the financial statements can determine how much of reported interest income is attributable to the cash paid by borrowers and how much is attributable to the amortization of premiums or discounts. In addition, in response to specific feedback, the Board plans to alter the current interest income accounting model for callable debt securities purchased at a premium because the current accounting model may result in (1) the recognition of too much interest income before prepayment of the debt instrument by the borrower and (2) the possibility of a delayed recognition of a loss for the unamortized premium.

Statutory Developments (NAIC)

Adoption of Actuarial Guideline XLVIII (AG 48)

In December 2014, the NAIC adopted AG 48, which is the NAIC's short-term solution to regulate the use of XXX/AXXX reserve financing arrangements until the requirements of principles-based reserving (PBR) take effect. AG 48 does not prohibit captive reserve transactions but instead provides a uniform standard for such arrangements. For a ceding entity to comply with the new standard, a portion of its statutory reserve (generally the amount of reserve required by PBR) must be secured by high-quality assets. The portion of the statutory reserve that exceeds the PBR level may be backed by other forms of security as approved by the ceding entity's domiciliary regulator. This guideline applies to covered policies valued under Sections 6 and 7 of Model 830 ceded January 1, 2015, and later. It does not apply to policies issued and ceded as of December 31, 2014. As a result, policies subject to a captive arrangement as of December 31, 2014, are grandfathered.

AG 48 is considered to be an interim step in the regulation of XXX/AXXX captive reinsurance transactions. The NAIC is continuing work on updating related reserve requirements and reinsurance regulations.

Other Developments

In December 2014, the NAIC revised the guidance in SSAP 40R on accounting for investments in real estate. The revision expanded the standard's scope to include wholly owned limited liability companies (LLCs) that hold only one real estate investment and allows entities to account for the investment in the LLC as a direct investment of real estate if specific conditions are met. The revision became effective January 1, 2015.

Also in December 2014, the NAIC issued SSAP 107, which provides accounting guidance on three programs under the Affordable Care Act known as risk adjustment, reinsurance, and risk corridors. The guidance became effective December 15, 2014.

In March 2015, the NAIC revised SSAP 69 to clarify that the cash flow statement is limited to transactions involving "cash" as defined in the statement. The revision also expanded the disclosure requirements to include noncash operating items. This clarification is effective December 31, 2015.

In November 2015, the NAIC issued INT 15-01, which became effective immediately. The interpretation clarifies and provides guidance on recognition and measurement of risk corridor receivables. Under the interpretation, 2014 risk corridor receivables in excess of the 12.6 percent proration amount provided by the U.S. Department of Health and Human Services must be non-admitted. In addition, 2015 and 2016 receivables must be non-admitted until the preceding period's benefit amounts are paid in full.

SEC Update

AICPA Conference on Current SEC and PCAOB Developments

At the 2015 AICPA Conference, numerous speakers and discussion panels shared their insights into current accounting, reporting, and auditing practice issues. Key topics addressed at this year's event included the following:

- *Disclosure effectiveness* — Speakers focused on improving disclosure requirements, with the goal of enhancing the information provided to investors and promoting efficiency, competition, and capital formation. The SEC reiterated its continued focus on disclosure effectiveness, including its outreach to the investor community, its ongoing collaboration with the FASB, its recent release requesting public comment on certain disclosure requirements of Regulation S-X, an expected release seeking feedback on certain aspects of Regulation S-K, and other near-term initiatives.
- *ICFR* — ICFR continues to be a key focus for regulators, preparers, and auditors. SEC Chief Accountant James Schnurr stated that "[m]anagement's ability to fulfill its financial reporting responsibilities depends, in large part, on the design and effectiveness of internal control over financial reporting." Several speakers commented that the frequency of ICFR-related findings in PCAOB inspections highlights the need for management, auditors, and audit committees to work together to address potential underlying issues with controls and assessments.
- *IFRSs* — The SEC's consideration of the potential incorporation of IFRSs into the U.S. financial reporting system has long been a topic at the AICPA Conference, and this year was no exception. At the 2014 AICPA Conference, Mr. Schnurr introduced a potential fourth alternative regarding the use of IFRSs in the United States that would allow U.S.-based filers to voluntarily provide supplemental IFRS-based information without reconciliation to U.S. GAAP. In his remarks before the 2015 AICPA Conference, Mr. Schnurr indicated that the OCA is likely to recommend that the SEC consider and commence rulemaking that is consistent with this fourth alternative.
- *Audit committees* — Speakers observed that the roles and responsibilities now frequently imposed on audit committees in addition to their core SEC-required duties may interfere with their primary responsibility of overseeing the company's financial reporting. Mr. Schnurr recapped the SEC staff's efforts over the past year to address "(a) whether investors are interested in hearing from audit committees on how (not just if) they have fulfilled their responsibilities; and (b) whether the Commission's rules support such reporting." As part of these efforts, the Commission issued a concept release in July 2015 to seek feedback on the proposed changes to the reporting requirements as well as on additional disclosures investors may want.
- *Non-GAAP measures* — While no new rules on non-GAAP measures have been issued and none are expected at this time, such measures were still a key discussion topic this year. The staff in the SEC's Division of Corporation Finance (the "Division") reiterated that it continues to focus on the use of non-GAAP measures in determining whether such use complies with the disclosure requirements of Regulation S-K, Item 10(e). The Division staff highlighted that it is therefore focusing on whether non-GAAP measures have been given greater prominence than GAAP measures, and whether the labeling of adjustments between the two measures is clear.

For more information, see Deloitte's December 15, 2015, *Heads Up*.

Thinking It Through

In 2015, several insurance companies received comment letters from the SEC regarding their fair value disclosures, including the disaggregation of investment classes within those disclosures. The SEC also staff raised this topic at a December 17, 2015, meeting with the AICPA's Insurance Entities Expert Panel. At the meeting, the staff clarified that registrants should focus on the remarks made by Craig Olinger, deputy chief accountant in the SEC's Division of Corporation Finance, at the 2015 AICPA Conference rather than on the resolutions specified in the SEC's comment letters on this topic.

Mr. Olinger outlined recommendations for improving fair value disclosures that would help financial statement users assess the valuation techniques and inputs used to determine fair value. Further, the SEC staff provided several examples of inadequate fair value disclosures at the meeting:

- *Aggregation of several types of debt securities into a single class* — Registrants should only aggregate securities that have the same characteristics and are at the same level of the fair value hierarchy. Further, they should aggregate securities with different fair value inputs into different classes, such as agency and nonagency asset-based securities.
- *Disclosure of valuation approach only* — Registrants should disclose the specific valuation technique(s) they used, not merely their valuation approach.
- *Failure to disclose valuation techniques used by a third party* — Registrants should disclose the specific valuation technique(s) used by a third party.
- *Aggregation of all the valuation techniques and inputs that may be used for a class* — Registrants should clearly indicate which inputs they used for each valuation technique and which of the specific techniques and inputs apply to each class of investment. The staff further noted that registrants should not disclose valuation techniques they were not currently using in the periods presented.

Registrants should consider these comments when preparing their fair value disclosures.

Rulemaking

The SEC continues to focus on rulemaking, particularly in connection with its efforts to complete mandated actions under the Dodd-Frank Act. Key SEC rulemaking activities and other developments that have occurred since the last edition of this publication are discussed below.

SEC Issues Final Rule on Pay Ratio Disclosure

In August 2015, the SEC issued a final rule that requires a registrant to calculate and disclose (1) the median of the annual total compensation of all of its employees (excluding its principal executive officer (PEO)), (2) the PEO's annual total compensation, and (3) the ratio of (1) to (2). Starting with its first full fiscal year beginning on or after January 1, 2017, the registrant will include the disclosures in filings in which executive compensation information is required, such as proxy and information statements, registration statements, and annual reports. Emerging growth companies (EGCs), smaller reporting companies, foreign private issuers, registered investment companies, and filers under the U.S.-Canadian Multijurisdictional Disclosure System are exempt from the rule's requirements.

Thinking It Through

The rulemaking associated with the new requirements has been controversial, as demonstrated by the SEC's receipt of over 287,400 comment letters on the original rule proposal and the Commission's 3–2 vote on the final rule. To address concerns expressed by commenters about the costs of complying with the requirements, the rule provides certain accommodations.

We expect that during the first year or two after adoption, some registrants may change their method of computing the pay ratio as they find more efficient and accurate ways to identify the median employee and to calculate annual total compensation. Once registrants find a method that works for them, however, they are advised to stick with it. Some shareholders, analysts, or other parties may view frequent method changes as a red flag, thereby drawing unwarranted attention to a registrant's pay ratio disclosure.

The final rule became effective on October 19, 2015.

For more information, see the press release on the SEC's Web site. Also see Deloitte's August 6, 2015, journal entry and September 10, 2015, *Heads Up*.

SEC Proposes New Clawback Requirements

In July 2015, the SEC issued a proposed rule that would require companies to adopt "clawback" polices on executive compensation. Specifically, the proposal, which was released in response to a mandate in Section 954 of the Dodd-Frank Act, "would direct the national securities exchanges and national securities associations to establish listing standards that would require each issuer to develop and implement a policy providing for the recovery, under certain circumstances, of incentive-based compensation based on financial information required to be reported under the securities laws that is received by current or former executive officers, and require the disclosure of the policy." This proposal marks the completion of the SEC's issuance of proposed executive compensation rules under the Dodd-Frank Act.

Thinking It Through

Because the proposal would create an accelerated timeframe for adopting a mandatory compensation recovery policy that could apply to unearned and unvested awards of incentive-based compensation granted before the effective date of the new listing rules (if earned or vested after the effective date), an affected registrant should:

- Monitor the timing of both the issuance of the final SEC rule and the adoption of the exchanges' new listing rules. This is because the registrant would have a limited amount of time (60 days as proposed) in which to amend its existing recovery policy or adopt a new policy once the listing rules have been approved.
- Establish a cross-functional team from its human resources and legal departments to:
    - Review the registrant's existing recovery policy and begin considering changes that may be necessary to comply with the SEC's final rule.
    - Review executive officers' employment and letter agreements to (1) determine whether there is any potential conflict between the terms of the agreements and the proposed SEC rule and (2) consider whether the company needs to amend those agreements.
    - Review the form of the registrant's stock award agreements, the terms of its annual bonus plan, and its long-term incentive plan to determine whether they permit the recovery of excess incentive-based compensation and whether they should be updated.

Comments on the proposed rule were due by September 14, 2015. For more information, see the press release on the SEC's Web site. Also see Deloitte's July 2, 2015, journal entry, and August 5, 2015, *Heads Up*.

SEC Issues Proposed Rule on Pay Versus Performance

In April 2015, the SEC issued a proposed rule that would require public companies — except foreign private issuers, registered investment companies, and EGCs — to disclose "the relationship between executive compensation actually paid and the financial performance of the registrant" in proxy or information statements in which executive compensation disclosures are required. In a public statement, SEC Chair Mary Jo White indicated that she believes that the proposed disclosure requirements would "assist shareholders in assessing a company's executive compensation practices and policies [and] inform [them] when voting in an election of directors and in connection with a shareholder's advisory vote on executive compensation."

Thinking It Through

Many registrants may find it challenging to determine (1) where to present this disclosure and (2) how to integrate it into the other extensive compensation disclosures already required by the SEC rules. The proposal acknowledges that placement of the disclosure in the compensation discussion and analysis (CD&A) section of a filing would suggest that the relationship of pay to total shareholder return was a factor in establishing compensation, which may not be the case. Therefore, under the proposed rule, registrants retain the flexibility to place the required disclosure wherever they believe it is most appropriate in the proxy. In addition, registrants may continue to compute and present other performance measures, such as realizable compensation (as defined), that will allow them to "tell their own story" elsewhere in the CD&A.

Comments on the proposed rule were due by July 6, 2015.

For more information, see the press release on the SEC's Web site. Also see Deloitte's April 30, 2015, journal entry, and May 29, 2015, *Heads Up*.

FAST Act Amends JOBS Act and SEC Disclosure Requirements

On December 4, 2015, President Obama signed the FAST Act into law. Among its many provisions, the FAST Act amends the JOBS Act and certain SEC disclosure requirements. It also establishes a new statutory exemption for private resales of securities. Specific provisions of the FAST Act include those related to JOBS Act changes for initial public offerings of EGCs, Form 10-K and Regulation S-K disclosure changes, a new Section 4(a)(7) exemption for private resales, incorporation by reference for smaller reporting companies, and an amendment to registration thresholds applicable to savings and loan holding companies.

Subsequently, during December 2015, the SEC issued a number of C&DIs related to the FAST Act. Topics addressed in the C&DIs include (1) whether, and if so in what circumstances, an EGC can omit interim financial statements or financial statements of other entities from its registration statement and (2) FAST Act requirements that affect savings and loan companies.

Further, in January 2016, the SEC issued interim final rules and form amendments to implement certain provisions of the FAST Act. Among other provisions, the rules revise Forms S-1 and F-1 to permit an EGC to omit financial information from registration statements filed before an initial public offering (or confidentially submitted to the SEC for review) for historical periods required by Regulation S-X if the EGC reasonably believes that it will not be required to include these historical periods at the time of the contemplated offering. The rules also revise Form S-1 and amend Regulation S-K to permit a smaller reporting company to incorporate by reference into its registration statement any documents filed by the issuer after the effective date of the registration statement. The rules and amendments became effective on January 19, 2016.

The SEC is requesting comments on any aspects of the interim final rules, including whether those rules should be extended to other registrants or forms. Comments are due by February 18, 2016.

See Deloitte's December 8, 2015, journal entry for more information about the FAST Act's effects on securities laws and regulations. Also see Deloitte's January 15, 2016, journal entry for further details on the interim final rules and its January 12, 2016, and December 18, 2015, journal entries for more information about the C&DIs.

SEC Issues Final Rule to Ease Smaller Companies' Access to Capital

In March 2015, the SEC issued a final rule that amends and expands Regulation A, which exempts certain offerings from registration under the Securities Act. The rule implements a mandate in Section 401 of the JOBS Act to ease smaller companies' access to capital.

Under Regulation A before the amendments, a company could offer up to $5 million of securities in a 12-month period and no more than $1.5 million of those securities could be offered by the company's securityholders. Under the new rule, a company can offer and sell up to $50 million of securities in a 12-month period if it meets specified eligibility, disclosure, and reporting requirements. The rule creates the following two tiers of offerings under Regulation A:

- "Tier 1: annual offering limit of $20 million, including no more than $6 million on behalf of selling securityholders that are affiliates of the issuer."
- "Tier 2: annual offering limit of $50 million, including no more than $15 million on behalf of selling securityholders that are affiliates of the issuer."

The final rule establishes offering and reporting requirements for issuers under both tiers; however, such requirements are more extensive for Tier 2 issuers, which must provide audited financial statements in their offering documents and file annual, semiannual, and current reports with the SEC. The rule also preserves, "with some modifications, existing provisions regarding issuer eligibility, offering circular contents, testing the waters, and 'bad actor' disqualification."

The final rule became effective on June 19, 2015.

For more information, see Deloitte's March 27, 2015, journal entry as well as the press release on the SEC's Web site.

SEC Staff Issues Guidance on Amendments to Regulation A

In June 2015, the SEC staff issued guidance on its March 2015 amendments to Regulation A.

The SEC staff also recently issued and revised a number of C&DIs to provide additional guidance on Regulation A. Specifically, the staff added questions 182.01 through 182.11 to the Securities Act Rules section and withdrew questions 128.01 and 128.03 from the Securities Act Forms section.

SEC Updates Financial Reporting Manual

In August 2015, the staff in the SEC's Division of Corporation Finance (the "Division") updated paragraphs 1320.3 and 1320.4 of its Financial Reporting Manual (FRM) to clarify that "[g]enerally, the Division of Corporation Finance will not issue comments asking a delinquent registrant to file separately all of its delinquent filings if the registrant files a comprehensive annual report on Form 10-K that includes all material information that would have been included in those filings." Previously, registrants would have sought such an accommodation in writing from the Division's OCA.

The updates also reiterated that a registrant's filing of a comprehensive annual report on Form 10-K in those circumstances does not (1) absolve it of any Exchange Act liability arising from its failure to file all required reports or shield it from any related enforcement actions; (2) make it "current" for Regulation S, Rule 144, or Form S-8 filings; or (3) affect its inability to use Form S-3 until it satisfies the timely-filer requirements.

For more information, see the FRM page on the SEC's Web site.

SEC Releases Cybersecurity Publications

In February 2015, the SEC issued the following two publications related to cybersecurity risks at brokerage and advisory firms:

- *Risk alert* — Summarizes the findings associated with an examination of over 100 investment advisers and broker-dealers conducted by the SEC's Office of Compliance Inspections and Examinations (OCIE). The OCIE observed the entities' practices related to "identifying risks related to cybersecurity; establishing cybersecurity governance, including policies, procedures, and oversight processes; protecting firm networks and information; identifying and addressing risks associated with remote access to client information and funds transfer requests; identifying and addressing risks associated with vendors and other third parties; and detecting unauthorized activity."

- *Investor bulletin* — Provides investors with advice on how to protect their online investment accounts (e.g., selecting a strong password, two-step verification, careful use of public networks).

While these publications are not specific to insurance entities, registrants in the industry may find them helpful. For more information, see the press release on the SEC's Web site.

Appendixes

Appendix A — Glossary of Standards and Other Literature

The standards and literature below were cited or linked to in this publication.

FASB ASC References

For titles of *FASB Accounting Standards Codification* references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

FASB Accounting Standards Updates and Other FASB Literature

See the FASB's Web site for the titles of:

- Accounting Standards Updates.
- Proposed Accounting Standards Updates (exposure drafts and public comment documents).
- Pre-Codification literature (Statements, Staff Positions, EITF Issues, and Topics).
- Concepts Statements.

Private Company Council Literature

PCC Issue No. 14-01, *Definition of a Public Business Entity*

NAIC Literature

AG 48, *Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued Under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model 830)*

INT 15-01: *ACA Risk Corridors Collectibility*

SSAP No. 107, *Risk-Sharing Provisions of the Affordable Care Act*

SSAP No. 69, *Statement of Cash Flow*

SSAP No. 40R, *Real Estate Investment*

SEC Regulation S-K

Item 10(e), "Use of Non-GAAP Financial Measures in Commission Filings"

SEC Regulation S-X

Article 6, "Registered Investment Companies"

SEC Final Rules

33-9877, *Pay Ratio Disclosure*

33-9741, *Amendments to Regulation A*

SEC Interim Final Rule

33-10003, *Simplification of Disclosure Requirements for Emerging Growth Companies and Forward Incorporation by Reference on Form S-1 for Smaller Reporting Companies*

SEC Proposed Rules

34-74835, *Pay Versus Performance*

33-9922, *Comment Period for Investment Company Reporting Modernization Release*

33-9861, *Listing Standards for Recovery of Erroneously Awarded Compensation*

33-9776, *Investment Company Reporting Modernization*

IA-4091, *Amendments to Form ADV and Investment Advisers Act Rules*

SEC Staff Accounting Bulletins

SAB Topic 5.J, "New Basis of Accounting Required in Certain Circumstances" (rescinded by SAB 115)

SAB Topic 13, "Revenue Recognition"

SEC Office of Compliance Inspections and Examinations

Examination Priorities for 2015

SEC Financial Reporting Manual

Section 1320, "Financial Statements Required"

SEC Guidance

Amendments to Regulation A: A Small Entity Compliance Guide

International Standards

See Deloitte's IAS Plus Web site for the titles of:

- International Financial Reporting Standards.
- International Accounting Standards.
- Exposure documents.

Appendix B — Abbreviations

Abbreviation	Description
ABS	asset-backed security
AFS	available for sale
AICPA	American Institute of Certified Public Accountants
APIC	additional paid-in capital
ASC	FASB Accounting Standards Codification
ASU	FASB Accounting Standards Update
BOLI	bank-owned life insurance
C&DI	SEC Compliance and Disclosure Interpretation
CAE	claim adjustment expenses
CD&A	compensation discussion and analysis
CECL	current expected credit loss
CFTC	U.S. Commodity Futures Trading Commission
COLI	corporate-owned life insurance
DAC	deferred acquisition costs
DTA	deferred tax asset
ED	exposure draft
EGC	emerging growth company
EITF	Emerging Issues Task Force
ETF	exchange-traded fund
FASB	Financial Accounting Standards Board
FRM	SEC's Financial Reporting Manual
FVTNI	fair value through net income
GP	general partner
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IBNR	incurred but not reported
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard

Abbreviation	Description
IM	investment management
IPO	initial public offering
LLC	limited liability company
M&A	merger and acquisition
MD&A	Management's Discussion & Analysis
NAIC	National Association of Insurance Commissioners
NAV	net asset value
OCA	SEC's Office of the Chief Accountant
OCI	other comprehensive income
OCIE	SEC's Office of Compliance Inspections and Examinations
ORSA	Own Risk and Solvency Assessment
PBR	principles-based reserving
PCAOB	Public Company Accounting Oversight Board
PCC	Private Company Council
PCD	purchased credit-deteriorated
PEO	principal executive officer
REIT	real estate investment trust
ROU	right of use
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SIFMA	Securities Industry and Financial Markets Association
SSAP	NAIC Statement of Statutory Accounting Principles
TIS	Technical Inquiry Service
TRG	FASB-IASB joint revenue recognition transition resource group
U.S. GAAP	United States generally accepted accounting principles
VIE	variable interest entity
XBRL	eXtensible Business Reporting Language

The following is a list of short references for the Acts mentioned in this publication:

Abbreviation	Act
Dodd-Frank Act	The Dodd-Frank Wall Street Reform and Consumer Protection Act
Exchange Act	Securities Exchange Act of 1934
FAST Act	Fixing America's Surface Transportation Act
JOBS Act	Jumpstart Our Business Startups Act
Securities Act	Securities Act of 1933

Appendix C — Other Resources

Deloitte Publications

Register to receive other Deloitte industry-related publications by going to www.deloitte.com/us/subscriptions. Publications pertaining to your selected industry (or industries), along with any other Deloitte publications or webcast invitations you choose, will be sent to you by e-mail.

Dbriefs

We also offer *Dbriefs* webcasts, which feature discussions by Deloitte professionals and industry specialists on critical issues that affect your business. Aimed at an executive-level audience, *Dbriefs* are designed to be timely, relevant, interactive, convenient, and supportive of your continuing professional education objectives. For more information about *Dbriefs*, please visit www.deloitte.com/us/dbriefs.

Technical Library and US GAAP Plus

Deloitte makes available, on a subscription basis, access to its online library of accounting and financial disclosure literature. Called Technical Library: The Deloitte Accounting Research Tool, the library includes material from the FASB, EITF, AICPA, PCAOB, IASB, and SEC, in addition to Deloitte's own accounting and SEC manuals and other interpretive accounting and SEC guidance.

Updated every business day, Technical Library has an intuitive design and navigation system that, together with its powerful search features, enable users to quickly locate information anytime, from any computer. Technical Library subscribers also receive *Technically Speaking*, the weekly publication that highlights recent additions to the library. For more information, including subscription details and an online demonstration, visit www.deloitte.com/us/techlibrary.

In addition, be sure to visit US GAAP Plus, our free Web site that features accounting news, information, and publications with a U.S. GAAP focus. It contains articles on FASB activities and updates to the *FASB Accounting Standards Codification*™ as well as developments of other U.S. and international standard setters and regulators, such as the PCAOB, AICPA, SEC, IASB, and IFRS Interpretations Committee. Check it out today!