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Foreword

January 19, 2017

To our clients and colleagues in the insurance sector:

We are pleased to announce our ninth 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 since last year's edition of this publication were (1) the issuance of proposed improvements to the accounting for long-duration insurance contracts, (2) the issuance of new guidance on short-duration insurance contract disclosures, 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. In addition, Appendix A contains a table that lists accounting pronouncements that became effective in 2016.

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.

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

Sincerely,



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Introduction

The insurance industry continues to be poised for growth and expansion. A stabilized economy and available capital have allowed insurers to focus on the development of new products and services as well as on entering into new markets. Accompanying these opportunities, however, are countless obstacles. For example, insurers are dealing with the ever-present risk of cybercrime, significant changes in consumer behavior, and a low-interest-rate environment that continues to squeeze investment margins. New and forthcoming regulations and accounting pronouncements also require insurers to quickly adapt to changes. With all of these moving pieces, industry executives have their hands full.

Economic Growth

To offset the bottom-line impact of low interest rates, insurers continue to look for opportunities for growth within new segments of the insurance market. They are doing this by developing new products, implementing new marketing strategies, and entering new markets through mergers and acquisitions.

Regulatory Reform

The regulatory landscape for insurance will continue to present significant challenges in 2017, with insurers facing new or modified rules and requirements that could significantly affect how they do business. In some regulatory areas, the requirements have been clarified over the past year, and companies are now focusing on compliance and refinement. In others, regulations are still emerging or evolving, and companies are looking for clues to help them prepare for the upcoming changes.

In 2015, U.S. insurers were called upon to implement the Own Risk and Solvency Assessment (ORSA), which required them to assess the adequacy of their risk management and current and prospective solvency positions. In 2016, we have continued to see insurers enhance their enterprise risk management frameworks to help them fulfill their annual ORSA reporting requirements.

At the federal level, laws such as the Dodd-Frank Act have given rise to a whole host of new regulators and regulatory influencers — including the Federal Insurance Office, the Financial Stability Oversight Council, and the Office of Financial Research — which are having a significant impact on the insurance business.

These new entities are actively working to define their roles and establish their authority, creating uncertainty and confusion for many insurers. In some cases, they are prompting state regulators to become more proactive and aggressive to avoid possible encroachment from federal authorities, particularly in areas such as capital requirements, governance, risk management, and consumer protection.

Insurance carriers should expect ongoing regulatory changes and uncertainty as authorities jockey for position and debate whose set of rules the industry must ultimately apply.

Accounting Changes

In September 2016, the FASB issued a [proposed ASU](#) that would improve the accounting for long-duration insurance contracts by amending both the accounting and disclosure requirements under U.S. GAAP for insurers that issue long-duration insurance contracts. The Board believes that the targeted improvements will provide more timely and useful information to users of the financial statements and will simplify certain aspects of the existing accounting model. Comments of the exposure draft were due by December 15, 2016. An effective date has not been provided.

The IASB's new insurance standard (expected to be issued in early 2017) is likely to establish an accounting model and disclosure requirements that differ significantly from those under U.S. GAAP.

For additional information about industry issues and trends, see Deloitte's [2016 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.

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

Short-Duration Insurance Contracts

- 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.
- 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.²
- Information about any significant changes in methods and assumptions used in the computation of the liability for unpaid claims and CAEs,³ including reasons for the changes and the impact of the changes on the most recent reporting period in the financial statements.
- 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 or the number of years for which claims incurred typically remain outstanding, 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.

² 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.

³ 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.

Further, under the ASU, insurers are not required to provide certain of the transition disclosures specified in ASC 250-10. As noted in paragraph BC38 of the ASU, “the Board decided that providing the transition disclosures about (a) the method of applying the change, (b) a description of the indirect effects of a change in accounting principle, (c) the change in the interim period of the change, if issuing interim financial statements, and (d) the annual period of the change would not be applicable because the guidance in the amendments in this Update relates only to disclosures.”

Preparing for Implementation

After the issuance of the ASU, certain implementation questions arose regarding how to reflect the impact of changes in foreign currency and the acquisition and disposition of products or businesses by insurance entities in the incurred and paid claims development table disclosures required by the ASU. In [meetings](#) with the AICPA’s Insurance Experts Panel (IEP) on November 1 and November 17, 2016, the SEC staff provided informal feedback on proposed alternatives related to such disclosure presentations (these alternatives had previously been submitted by the IEP).

As a result of these discussions, and as noted by members of the SEC staff at the [2016 AICPA conference](#), the following approaches for depicting such activities are viewed by the staff as consistent with the objectives of the ASU:

- *Foreign currency translation* — When an entity translates balances of its foreign operations into the reporting currency for inclusion in the incurred and paid claims development tables, it should apply a constant rate to all data in the development tables. Accordingly, an entity could (1) recast all data in the development tables by using the current period-end exchange rate or (2) present separate development tables for each functional currency.
- *Acquisitions* — An entity would reflect the acquired business on a retrospective basis in the incurred and paid claims development table disclosures. Alternatively, if it pursues a prospective approach, the entity would need to present the development information for the acquired business separately from the development information of the existing business, by underlying accident year, as of the acquisition date and subsequently.
- *Dispositions* — An entity would reflect dispositions retrospectively. Accordingly, the entity would recast all periods presented in the development tables to remove the balances associated with the disposed-of business from each accident year in the table.

The SEC staff encourages any filer that believes that an alternative approach would also be consistent with the ASU’s disclosure objectives to discuss its specific facts and circumstances with the staff.

Further, during the IEP meetings, the SEC staff indicated that as long as a filer provides all the disclosures required by the ASU, the staff would not object or comment if the filer chose to omit the 10-year development table that would otherwise be required under Industry Guide 6. This conclusion was documented in Section 11300 of the SEC’s [Financial Reporting Manual](#).

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, if insurers choose to continue to provide the disclosures under Industry Guide 6, they should also be able to explain differences between, or otherwise be able to reconcile, those disclosures 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* and December 2016 *Financial Reporting Alert*.

Financial Instruments

Impairment

Background

In June 2016, the FASB issued [ASU 2016-13](#), which amends guidance on the impairment of financial instruments. The ASU adds to U.S. GAAP an impairment model (known as the current expected credit loss (CECL) model) that is based on expected losses rather than incurred losses. Under the new guidance, an entity recognizes as an allowance its estimate of expected credit losses, which the FASB believes will result in more timely recognition of such losses. The ASU is also intended to reduce the complexity of U.S. GAAP by decreasing the number of credit impairment models that entities use to account for debt instruments.

Once effective (see the "Effective Date" discussion [below](#)), the new guidance will significantly change the accounting for credit impairment. Banks and certain asset portfolios (e.g., loans, leases, and debt securities) will need to modify their current processes for establishing an allowance for loan and lease losses and other-than-temporary impairments to ensure that they comply with the ASU's new requirements. To do so, they may need to make changes to their operations and systems associated with credit modeling, regulatory compliance, and technology.

Key provisions of the ASU are discussed below. For additional information, see Deloitte's June 17, 2016, *Heads Up*.



Thinking It Through

In late 2015, the FASB established a TRG for credit losses. Like the TRG for the new revenue recognition standard, the credit losses TRG does not issue guidance but provides feedback to the FASB on potential implementation issues. By analyzing and discussing such issues, the TRG helps the Board determine whether it needs to take further action (e.g., by clarifying or issuing additional guidance).

The CECL Model

Scope

The CECL model applies to most⁴ debt instruments (other than those measured at fair value), trade receivables, net investments in leases, reinsurance receivables that result from insurance transactions, financial guarantee contracts,⁵ and loan commitments. However, available-for-sale (AFS) debt securities are excluded from the model's scope and will continue to be assessed for impairment under the guidance in ASC 320 (the FASB moved the impairment model for AFS debt securities from ASC 320 to ASC 326-30 and has made limited amendments 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 its estimate of expected credit losses 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. However, the carrying amount of a financial asset that is deemed uncollectible will be written off in a manner consistent with existing U.S. GAAP.



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, the ASU states that “an entity is not required to measure expected credit losses on a financial asset . . . in which historical credit loss information adjusted for current conditions and reasonable and supportable forecasts results in an expectation that nonpayment of the [financial asset’s] amortized cost basis is zero.” U.S. Treasury securities and certain highly rated debt securities may be assets the FASB contemplated when it decided to allow an entity to recognize zero credit losses on an asset, but the ASU does not so indicate. Regardless, there are likely to be challenges associated with measuring expected credit losses on financial assets whose risk of loss is low.

Measurement of Expected Credit Losses

The ASU describes the impairment allowance as a “valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset.” An entity can use a number of measurement approaches to determine the impairment allowance. Some approaches project future principal and interest cash flows (i.e., a discounted cash flow method) while others project only future principal losses. Regardless of the measurement method used, an entity’s estimate of expected credit losses should reflect those losses occurring over the contractual life of the financial asset.

When determining the contractual life of a financial asset, an entity is required to consider expected prepayments either as a separate input in the determination or as an amount embedded in the credit loss experience that it uses to estimate expected credit losses. The entity is not allowed to consider

⁴ The following debt instruments would not be accounted for under the CECL model:

- 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 does not apply to financial guarantee contracts that are accounted for as insurance or measured at fair value through net income (FVTNI).

expected extensions of the contractual life unless it reasonably expects to execute a troubled debt restructuring with the borrower by the reporting date.

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



Thinking It Through

It will most likely be challenging for entities to measure expected credit losses. Further, one-time or recurring costs may be associated with the measurement, some of which may be related to system changes and data collection. While such costs will vary by institution, nearly all entities will incur some costs when using forward-looking information to estimate expected credit losses over the contractual life of an asset.

AFS Debt Securities

The CECL model does not apply to AFS debt securities. Instead, the FASB decided to make targeted improvements to the existing other-than-temporary impairment model in ASC 320 for certain AFS debt securities to eliminate the concept of “other than temporary” from that model.⁶ Accordingly, the ASU states that an entity:

- Must use an allowance approach (vs. permanently writing down the security’s cost basis).
- Must limit the allowance to the amount at which the security’s fair value is less than its amortized cost basis.
- May not consider the length of time fair value has been less than amortized cost.
- May not consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists.

PCD Assets

For purchased financial assets with credit deterioration (PCD assets),⁷ the ASU requires an entity’s method for measuring expected credit losses to be consistent with its method for measuring expected credit losses for originated and purchased non-credit-deteriorated assets. Upon acquiring a PCD asset, the entity would recognize its allowance for expected credit losses as an adjustment that increases the cost basis of the asset (the “gross-up” approach). After initial recognition of the PCD asset and its related allowance, the entity would continue to apply the CECL model to the asset — that is, any changes in the entity’s estimate of cash flows that it expects to collect (favorable or unfavorable) would be recognized immediately in the income statement. Interest income recognition would be based on the purchase price plus the initial allowance accreting to the contractual cash flows.

⁶ The amendments do not apply to an AFS debt security that an entity intends to sell or will more likely than not be required to sell before the recovery of its amortized cost basis. If an entity intends to sell or will more likely than not be required to sell a security before recovery of its amortized costs basis, the entity would write down the debt security’s amortized cost to the debt security’s fair value as required under existing U.S. GAAP.

⁷ The ASU defines PCD assets as “[a]cquired individual financial assets (or acquired groups of financial assets with similar risk characteristics) that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer’s assessment.”

Disclosures

Many of the disclosures required under the ASU are similar to those already required under U.S. GAAP as a result of [ASU 2010-20](#). Accordingly, entities must also disclose information about:

- Credit quality.⁸
- Allowances for expected credit losses.
- Policies for determining write-offs.
- Past-due status.
- Nonaccrual status.
- PCD assets.
- Collateral-dependent financial assets.

Effective Date and Transition

For public business entities that meet the U.S. GAAP definition of an SEC filer, the ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.

For public business entities that do not meet the U.S. GAAP definition of an SEC filer, the ASU is effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years.

For all other entities, the ASU is effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years beginning after December 15, 2021.

In addition, entities are permitted to early adopt the new guidance for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

For most debt instruments, entities must record a cumulative-effect adjustment to the statement of financial position as of the first reporting period in which the guidance is effective. However, the ASU provides instrument-specific transition guidance on other-than-temporarily impaired debt securities, PCD assets, and certain beneficial interests within the scope of ASC 325-40.

Classification and Measurement

Background

[ASU 2016-01](#) amends the guidance on the classification and measurement of financial instruments. 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.
- Disclosure requirements for financial assets and financial liabilities.

The ASU's key provisions are discussed below. For more information, see Deloitte's January 12, 2016, [Heads Up](#).

⁸ Short-term trade receivables resulting from revenue transactions within the scope of ASC 605 and ASC 606 are excluded from these disclosure requirements.

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, 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 or broker-dealers in securities.

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 indicators described in ASC 321-10-35-3. If, on the basis of the qualitative assessment, the equity investment is impaired, an entity would be required to record an impairment equal to the amount by which the carrying value exceeds fair value. The entity should no longer evaluate whether such impairment is other than temporary.



Thinking It Through

Under current U.S. GAAP, marketable equity securities that are not accounted for as equity-method investments are classified as either trading, with changes in fair value recognized in earnings, or AFS with changes in fair value recognized in other comprehensive income (OCI). For AFS investments, changes in fair value are accumulated in OCI and not recognized in earnings until the investment is sold or has an other-than-temporary impairment. Investments in nonmarketable equity securities other than equity method investments are measured at cost (less impairment) unless the fair value option is elected. Further, under current U.S. GAAP, insurance entities recognize in OCI changes in the fair value of nonmarketable equity securities. 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.

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 new standard is effective for fiscal years beginning after December 15, 2017, including interim periods therein. For all other entities, the standard is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years 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.

Effect of Derivative Contract Novations on Existing Hedge Accounting

Background

In March 2016, the FASB issued [ASU 2016-05](#), which clarifies the accounting for derivative contract novations on existing hedge accounting relationships. A derivative novation occurs when one party to the derivative contract assigns its rights and obligations to a new party (i.e., legally replaces itself with another party). Approval for the novation is typically required by the existing derivative counterparty. After the novation, the entity that was replaced by the new party no longer has any rights or obligations under the contract.

Derivative novations can occur for various reasons, including the following:

- As a result of a financial institution merger, to designate the surviving entity as the new counterparty.
- As a vehicle for exiting a line of business or moving risk exposures between different legal entities of the same parent company.
- To satisfy laws or regulatory requirements (e.g., as a means of complying with requirements to use central derivative clearing counterparties).

Under ASC 815, an entity must discontinue a hedging relationship if (1) the hedging derivative instrument expires or is sold, terminated, or exercised or (2) it wishes to change a critical term of the hedging relationship. Before ASU 2016-05 was issued, ASC 815 did not, however, explicitly address how a novation of a hedging derivative affected a hedging relationship, and this ambiguity resulted in inconsistent application in practice.

ASU 2016-05 (codified in ASC 815) clarifies that “a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, **in and of itself**, be considered a termination of the derivative instrument” (emphasis added) or “a change in a critical term of the hedging relationship.” As long as all other hedge accounting criteria in ASC 815 are met, a hedging relationship in which the hedging derivative instrument is novated would not be discontinued or require redesignation. This clarification applies to both cash flow and fair value hedging relationships.

Key Provisions of the ASU



Thinking It Through

The Basis for Conclusions of ASU 2016-05 states that “a reporting entity always is required to assess the creditworthiness of the derivative instrument counterparty in a hedging relationship (both in the normal course of the hedging relationship and upon a novation).” Although an entity would not be required to discontinue the hedging relationship solely as a result of a change in counterparty, the entity would need to consider the counterparty’s creditworthiness. If the new counterparty’s creditworthiness differs significantly from that of the original counterparty, the hedging relationship may no longer be a highly effective hedge, which would trigger discontinuation of the hedged relationship.

Effective Date and Transition

For public business entities, the ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, it is effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. An entity would apply the guidance prospectively unless it elects modified retrospective transition. Early adoption is permitted, including in an interim period.

Prospective Approach

Under the prospective approach, an entity would apply the amendments only to hedging relationships in which a counterparty to the hedging derivative is changed after the date the reporting entity adopted ASU 2016-05.

Modified Retrospective Approach

If elected, the modified retrospective approach will apply to all derivative instruments that satisfy **all** of the following conditions:

- “The derivative instrument was outstanding during all or a portion of the periods presented in the financial statements.”
- “The derivative instrument was previously designated as a hedging instrument in a hedging relationship.”
- “The hedging relationship was dedesignated solely due to a novation of the derivative instrument, and all other hedge accounting criteria [in ASC 815] would have otherwise continued to be met.”

For such hedging relationships, an entity would remove from the financial statements the effect of the hedge dedesignation that resulted from the novation for each period presented. The entity also would adjust beginning retained earnings to reflect the cumulative effect on the financial statements of derivatives that (1) meet the requirements above and (2) were dedesignated from hedging relationships as a result of novations that occurred before the beginning of the earliest period presented.



Thinking It Through

To apply the modified retrospective approach, an entity is required to assess hedge effectiveness and measure ineffectiveness as required by the original hedge documentation under ASC 815 for all periods between (1) the date on which the hedging relationship was dedesignated solely because of a novation and (2) the date on which the entity adopts ASU 2016-05.

Disclosure Requirements

Under either transition approach, an entity must provide the disclosures required by ASC 250-10-50-1(a) and 50-2 about the nature of and reason for the change in accounting principle, as applicable, in the period it adopts the ASU. An entity electing the modified retrospective approach must also provide the disclosures required by ASC 250-10-50-1(b)(1) and (b)(3) about the amounts retrospectively adjusted and the cumulative effect on retained earnings, as applicable.

Contingent Put/Call Options in Debt Instruments

To determine how to account for debt instruments with embedded features, including contingent put and call options, an entity is required to assess whether the embedded derivatives must be bifurcated from the host contract and accounted for separately. Part of this assessment consists of evaluating whether the embedded derivative features are clearly and closely related to the debt host. Before it was amended by [ASU 2016-06](#), ASC 815-15 stated that contingently exercisable options had to be indexed only to interest rates or credit risk to be considered clearly and closely related to a debt host.

ASU 2016-06 was issued to address inconsistent interpretations of whether the event that triggers an entity's ability to exercise the embedded contingent option must be indexed to interest rates or credit risk for that option to qualify as clearly and closely related. Diversity in practice had developed because the four-step decision sequence in ASC 815-15-25-42 focused only on whether the payoff was indexed to something other than an interest rate or credit risk. As a result, entities were uncertain whether they should (1) determine whether the embedded features are clearly and closely related to the debt host solely on the basis of the four-step decision sequence or (2) first apply the four-step decision sequence and then also evaluate whether the event triggering the exercisability of the contingent put or call option was indexed only to an interest rate or credit risk (and not some extraneous event or factor).

The ASU clarifies that in assessing whether an embedded contingent put or call option is clearly and closely related to the debt host, an entity is required to perform only the four-step decision sequence in ASC 815-15-25-42 as amended by the ASU. The entity does not have to separately assess whether the event that triggers its ability to exercise the contingent option is itself indexed only to interest rates or credit risk.

Effective Date and Transition

For public business entities, the ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, it is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods beginning after December 15, 2018. An entity can early adopt the ASU, including in an interim period; however, if it early adopts in an interim period, it should reflect any adjustment as of the beginning of the fiscal year that includes the interim period.

An entity will apply a modified retrospective transition approach that requires it to use the four-step decision sequence to determine for existing debt instruments whether an embedded derivative is clearly and closely related to the debt host and to take into account the economic characteristics and risks of the host contract and the embedded option that existed on the date it issued or acquired the instrument.

If bifurcation of an embedded derivative is no longer required as a result of application of the ASU, the entity will determine the carrying amount of the debt instrument on the date of adoption as the aggregate of the carrying amount of the debt host contract and the fair value of the previously bifurcated embedded derivative. Any premium or discount resulting from such aggregation will not

Leases

affect the entity's assessment of whether the call (put) option is clearly and closely related to the debt instrument. The entity will not make any cumulative-effect adjustments to beginning retained earnings.

An entity that is no longer required to bifurcate an embedded derivative from a debt instrument as a result of applying the guidance in the ASU also has a one-time option, as of the beginning of the fiscal year for which the amendments are effective, to irrevocably elect to measure that debt instrument in its entirety at fair value and recognize changes in fair value in earnings (if that instrument is within the scope of ASC 825-10-15-4 and 15-5). The effects of such an election would be reported as a cumulative-effect adjustment to the beginning retained earnings of the fiscal year of adoption. The entity should elect to apply the fair value option on an instrument-by-instrument basis.

See Deloitte's March 16, 2016, [Heads Up](#) for more information.

Leases

Background

After working for almost a decade, the FASB issued its new standard on accounting for leases, [ASU 2016-02](#), in February 2016. The primary objective of issuing the new leases standard was to address the off-balance-sheet treatment of lessees' operating leases. The standard's lessee model requires lessees to adopt a right-of-use (ROU) asset approach that brings 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 (in a manner similar to the current approach for capital leases).

The development of the new leases standard began as a convergence project between the FASB and the IASB. Although the project was a convergence effort and the boards conducted joint deliberations, there are several notable differences between the boards' respective leases standards.⁹ One of the more significant differences is related to a lessee's subsequent accounting of a lease. Under the FASB's approach, an entity may classify a lease as either an operating lease or a finance lease. Under the IASB's approach, however, an entity would classify all leases as finance 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 definition of an initial direct cost is more restrictive under the new standard and includes only those costs incremental to the arrangement and that the entity would not have incurred if the lease had not been obtained. The definition is consistent with that for incremental cost in the new revenue recognition standard (ASC 606). Thus, costs such as commissions and payments made to existing tenants to obtain the lease would be considered initial direct costs. By 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 the definition.

⁹ The IASB issued IFRS 16, *Leases*, in January 2016.

Lease and Nonlease Components

Lessees and lessors are 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 ASU states that as “a practical expedient, a lessee may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component.” The ASU also permits a similar accounting policy election from the lessor perspective, noting that it would “be reasonable for lessors to account for multiple components of a contract as a single component if the outcome from doing so would be the same as accounting for the components separately (for example, a lessor may be able to conclude that accounting for an operating lease and a related service element as a single component results in the same accounting as treating those two elements as separate components).” However, a lessor would need to consider presentation and disclosure requirements under other U.S. GAAP, as applicable (e.g., ASU 2014-09).



Thinking It Through

If an amount is identified as a lease component, the amount is included in the measurement of the ROU asset and liability. When evaluating whether an activity should be a separate nonlease component, an entity should consider whether the activity transfers a separate good or service to the lessee. For example, maintenance services (including common area maintenance services) and utilities paid 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, payments for property taxes or insurance would most likely be considered a part of the lease component because they do not transfer a separate good or service to the lessee.

Lessee Accounting

While the boards agreed that a lessee should record an ROU asset and a corresponding lease liability when the lease commences, they supported different approaches for the lessee's subsequent accounting. The FASB chose a dual-model approach under which a lessee classifies a lease by using criteria 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 leasing guidance could significantly affect insurance entities that currently account for their real estate leases as operating leases. Lessees are required to record these arrangements in their statement of financial position. The dual classification model does not drive “on” or “off” balance sheet treatment but rather the characterization of the corresponding expenses and cash flows.

Lessor Accounting

The boards considered constituent feedback and decided not to make significant changes to the existing lessor accounting model. Rather, they agreed to adopt an approach that is 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).



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 such 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.

Effective Date and Transition

ASU 2016-02 is effective for public business entities for annual years beginning after December 15, 2018, including interim periods therein. For all other entities, the standard is effective for annual periods beginning after December 15, 2019, and interim periods thereafter. Early adoption is permitted. Lessees and lessors are required to use a modified retrospective transition method for existing leases. Accordingly, they would apply the new accounting model for the earliest year presented in the financial statements.

For discussion of additional implementation considerations, see Deloitte’s March 1, 2016 (updated July 12, 2016), [Heads Up](#).

Revenue Recognition

Background

In May 2014, the FASB issued [ASU 2014-09](#), which 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](#).

Revenue Recognition

In response to concerns the FASB received related to applying the ASU's requirements, the Board in 2016 issued the following five ASUs, which amend the ASU's new revenue recognition guidance:

- [ASU 2016-08, Principal Versus Agent Considerations \(Reporting Revenue Gross Versus Net\)](#) — The ASU addresses issues related to how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. The amendments provide guidance on (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 ASU also clarifies 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 March 22, 2016, [Heads Up](#) for more information.
- [ASU 2016-10, Identifying Performance Obligations and Licensing](#) — The ASU's amendments clarify the guidance on an entity's identification of certain performance obligations. 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. See Deloitte's April 15, 2016, [Heads Up](#) for more information.
- [ASU 2016-11, Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting \(SEC Update\)](#) — The ASU rescinds the following guidance, which is based on announcements made by the SEC staff at the Emerging Issues Task Force's (EITF's) March 3, 2016, meeting, upon an entity's adoption of ASU 2014-09:
 - Revenue and expense recognition for freight services in process (ASC 605-20-S99-2).
 - Accounting for shipping and handling fees and costs (ASC 605-45-S99-1).
 - Accounting for consideration given by a vendor to a customer (ASC 605-50-S99-1).
 - Accounting for gas-balancing arrangements (ASC 932-10-S99-5).
- [ASU 2016-12, Narrow-Scope Improvements and Practical Expedients](#) — The guidance (1) clarifies how to assess whether collectibility is probable in certain circumstances to support the existence of a contract, (2) adds a practical expedient for the presentation of sales taxes on a net basis in revenue, (3) clarifies how to account for noncash consideration at contract inception and throughout the contract period, and (4) establishes a practical expedient to address contract modifications upon transition. See Deloitte's May 11, 2016, [Heads Up](#) for more information.
- [ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers](#) — The ASU made technical corrections (i.e., minor changes and improvements) to certain aspects of ASU 2014-09. Summaries of certain of those corrections are as follows (see Deloitte's January 5, 2017, [journal entry](#) for more information):
 - *Contract costs — impairment testing* — The amendments “clarify that when performing impairment testing an entity should (a) consider expected contract renewals and extensions and (b) include both the amount of consideration it already has received but has not recognized as revenue and the amount it expects to receive in the future.”
 - *Disclosure of remaining performance obligations* — The amendments (1) “provide optional exemptions from the disclosure requirement for remaining performance obligations for specific situations in which an entity need not estimate variable consideration to recognize

revenue” and (2) “expand the information that is required to be disclosed when an entity applies one of the optional exemptions.”

- *Disclosure of prior-period performance obligations* — The amendments clarify that the “disclosure of revenue recognized from performance obligations satisfied (or partially satisfied) in previous periods applies to all performance obligations and is not limited to performance obligations with corresponding contract balances.”
- *Contract modifications example* — The amendments “better align Example 7 with the [contract modifications] principles in Topic 606.”
- *Contract asset versus receivable* — The amendments “provide a better link between the analysis in Example 38, Case B and the receivables presentation guidance in Topic 606.”
- *Advertising costs* — The amendments “reinstate the guidance on the accrual of advertising costs and also move the guidance to Topic 720.”
- *Loan guarantee fees* — The amendments “clarify that guarantee fees within the scope of Topic 460 (other than product or service warranties) are not within the scope of Topic 606.”
- *Scope of ASC 606* — The amendments clarify the scope of ASC 606 to remove the term “insurance” from the scope exception to clarify that all contracts within the scope of ASC 944 are excluded from the scope of ASC 606.

ASU 2014-09 notes (and ASU 2016-20 clarifies) 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 the insurance company is offering administrative-services-only contracts or asset management services contracts to customers, without insurance coverage. However, if those services are offered with insurance coverage, an entity will need to consider whether ASC 944 or other ASC topics 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 have been mixed regarding whether such activities represent (1) a separate service to the customer that would be accounted for under ASC 606 or (2) 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 would therefore be accounted for with the insurance risk under ASC 944). Additional clarification on this scope issue was included in paragraph BC12 of the technical corrections ASU issued by the FASB in May 2016, which states that “if an entity reaches an appropriate conclusion that it has a contract entirely within the scope of Topic 944, then the entity would not apply the [bifurcation] guidance” in ASC 606. The Basis for Conclusions also states that the Board expects the scope assessment of contracts with more than one element (e.g., contracts with “insurance risk mitigation or cost containment activities that relate to costs to fulfill the contract within the scope of Topic 944”) to be assessed similarly upon adoption of the new revenue standard, as is currently done under

ASC 605 and ASC 944 today. One item that remains unclear, however, is how to assess the economics and nature of situations in which an entity enters into a contract (or contracts) within the scope of ASC 944 and concurrently enters into a contract (or contracts) within the scope of ASC 606 with the same counterparty (especially in situations in which there is evidence that pricing interdependency exists between the two separate contracts) and, if there is price interdependency, whether the contracts, collectively, need to be treated as one arrangement.

- *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 contracts from its scope, it has been 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. As noted in paragraphs BC10 through BC12 of the proposed technical corrections ASU in May, the amendment to the scope exception will apply to mortgage insurance contracts (i.e., mortgage insurance contracts will not be within the scope of ASC 606). Further, the Board indicates in paragraph BC12 that it does not expect there to be a change in accounting relative to current practice.

In addition to the issues described above, the AICPA's Insurance Entities Revenue Recognition Task Force continues to deliberate other industry-specific issues, including (1) issues related to investment contracts within the scope of ASC 944; (2) accounting for third party extended warranty contracts within the scope of ASC 606; and (3) the application of ASC 606 to asset management service fees associated with investment contracts within the scope of ASC 944.

These and other issues are expected to be the subject of several papers that have been, or are expected to be, written by the AICPA's revenue recognition task forces. A list of all of the issues currently on the task forces' agendas for discussion and their respective statuses is available on the [AICPA's Web site](#).

In addition, see the revenue recognition sections of Deloitte's 2016 *Banking and Securities — Accounting and Financial Reporting Update* and its 2016 *Investment Management — Accounting and Financial Reporting Update* for considerations regarding 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](#),¹⁰ 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.

¹⁰ For public business entities, the standard is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. 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.

Simplifying the Transition to the Equity Method of Accounting

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* newsletters), the AICPA's revenue recognition task forces, various firms, the SEC,¹¹ and the PCAOB. Preparers should continue to monitor the activities of these groups before their adoption of the new guidance. In addition, see Deloitte's January 14, 2016, *Heads Up* for additional adoption and transition observations.

Simplifying the Transition to the Equity Method of Accounting

The FASB issued [ASU 2016-07](#) in March 2016 as part of its simplification initiative. Under the guidance in U.S. GAAP before the ASU's amendments, an investor that meets the conditions for applying the equity method of accounting is required to retrospectively apply such method to all prior periods in which it had historically accounted for the investment under either the cost method or as an AFS security. The ASU removes the requirement to retrospectively apply the equity method of accounting. It also requires entities to recognize unrealized holding gains or losses in accumulated other comprehensive income (AOCI) related to an AFS security that becomes eligible for the equity method of accounting in earnings as of the date the investment qualifies for the equity method of accounting.

The guidance is effective for all entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The guidance must be applied prospectively to increases in the level of ownership interest or degree of influence occurring after the ASU's effective date. Early adoption is permitted.

Also as part of its simplification initiative, the FASB issued a [proposed ASU](#) in June 2015 that would have eliminated the requirement to separately account for basis differences (i.e., the difference between the cost of an investment and the amount of underlying equity in net assets). The proposed guidance would have also eliminated the requirement for an investor to allocate basis differences to specific assets and liabilities of the investee and account for them accordingly (e.g., additional depreciation for basis differences assigned to tangible assets). However, many commenters on the proposed ASU indicated that eliminating the allocation of basis differences could create different complexities and result in inflated values of investments that would no longer be amortized over time as well as increase the likelihood of impairment in future periods. Accordingly, in May 2016, the FASB decided to remove the project from its agenda because of "insufficient support to change the equity method of accounting."

¹¹ 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.



Thinking It Through

Application of the existing accounting requirements (i.e., before the ASU's amendments) can be particularly onerous because investments are often structured as partnerships or limited liability corporations, which may require use of the equity method at a relatively low ownership percentage, and investments in projects may evolve over time depending on stages of development, investment strategy, or changes in portfolio focus. For public companies, the existing U.S. GAAP requirements have been compounded by the SEC's guidance requiring registrants to provide (1) separate or summarized financial statements for prior periods once the equity method of accounting is applied to a significant investment (see paragraph 2405.5 of the SEC's *Financial Reporting Manual*) or (2) retroactively adjusted annual financial statements reflecting the equity method of accounting if a registration statement is filed after the first quarter in which the change to the equity method of accounting is reported but before the next annual report on Form 10-K is filed (see Topic 13 of the *Financial Reporting Manual*).

Accordingly, the ASU provides welcome relief from complex accounting considerations and SEC reporting requirements related to a transition to the equity method of accounting. However, the new ASU will also introduce new complexities after such transition. For example, application of the new method may result in additional basis differences if the earnings that would have affected the cost basis under existing U.S. GAAP are not recognized retrospectively.

Consolidation — Interests Held Through Related Parties That Are Under Common Control

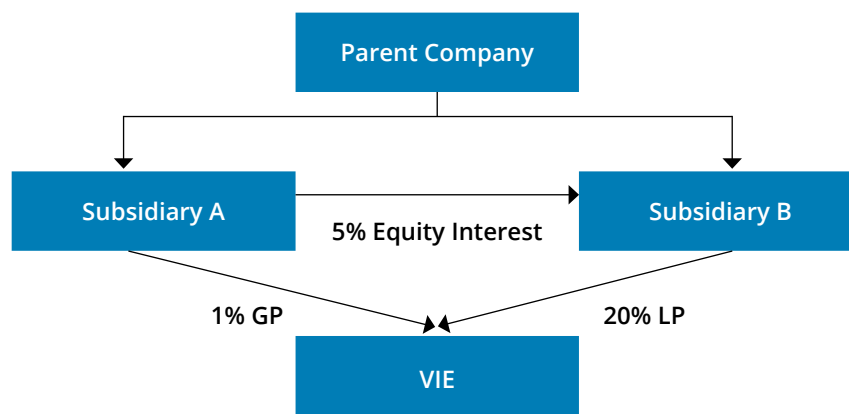
Background

In February 2015, the FASB issued [ASU 2015-02](#), which amends the guidance in ASC 810-10 to require, among other things, a reporting entity that is a single decision maker to consider interests held by its related parties only if the reporting entity has a direct interest in the related parties. If the related parties and the reporting entity are not under common control, the indirect economic interests in a variable interest entity (VIE) held through related parties would be considered on a proportionate basis in the determination of whether the reporting entity is the primary beneficiary of the VIE. Alternatively, if the related parties and the reporting entity are under common control, the reporting entity would be required to consider the interests of the related parties in their entirety (not on a proportionate basis). As a result, the reporting entity may satisfy the "power" criterion (i.e., the ability to direct the activities that most significantly affect the VIE's economic performance) in the consolidation analysis even if it has a relatively insignificant economic interest in the VIE.

In October 2016, the FASB issued [ASU 2016-17](#) to remove the last sentence of ASC 810-10-25-42, which states, "Indirect interests held through related parties that are under common control with the decision maker should be considered the equivalent of direct interests in their entirety." As a result of the ASU, a reporting entity would consider its indirect economic interests in a VIE held through related parties that are under common control on a proportionate basis in a manner consistent with its consideration of indirect economic interests held through related parties that are not under common control.

Example

A limited partnership (VIE) is formed to acquire a real estate property. The partnership has a GP (Subsidiary A) that holds a 1 percent interest in the partnership, an LP owned by the parent company of the GP (Subsidiary B) that holds a 20 percent interest in the partnership, and various unrelated investors that hold the remaining equity interests. In addition, A holds a 5 percent interest in B, and both A and B are wholly owned subsidiaries of Parent Company. Subsidiary A is the property manager and has full discretion to buy and sell properties, manage the properties, and obtain financing.



Under the guidance before ASU 2016-17, A and B must consider their own interests before evaluating which entity is the primary beneficiary of the VIE. Accordingly, A would conclude that it meets the power criterion as well as the economics criterion (i.e., the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE) because A must treat B's 20 percent interest in the VIE as its own since A has an interest in B, and both are under the common control of Parent Company.

Under the ASU, A will still conclude that it meets the power criterion on its own. However, in the evaluation of the economics criterion, since A owns a 5 percent interest in B, and B owns a 20 percent equity interest in the VIE, Subsidiary A will conclude that it has a 1 percent indirect interest in the VIE a result of its interest in B (5 percent interest in B multiplied by B's 20 percent interest in the VIE). Therefore, A will not meet the economics criterion on its own. However, since A and B are under common control and as a group will satisfy the power and economics criteria, they will need to perform the related-party tiebreaker test to determine which party is most closely associated with the VIE.



Thinking It Through

As a result of the ASU, the related-party tiebreaker test will be performed more frequently because, as illustrated in the example above, it will be less likely for the decision maker to meet the economics criterion on its own when considering its exposure through a related party under common control on a proportionate basis.¹² Many decision makers view the ASU's guidance favorably because they could otherwise automatically consolidate a legal entity with a small indirect interest. The ASU will instead require the decision maker to consider which party (the single decision maker or the related party under common control) is most closely associated with the VIE and therefore should consolidate. This guidance may have a significant impact on the individual financial statements of real estate subsidiaries because it could change which subsidiary consolidates a VIE.

¹² This outcome is because the FASB has proposed to change only the guidance in ASC 810-10-25-42. The Board also considered amending the guidance on determining whether fees paid to a decision maker or service provider represent a variable interest in the evaluation of a decision maker's indirect interests held through related parties under common control. While the proposal would retain that guidance, the Board will consider clarifying it, as well as other aspects of the guidance on common-control arrangements, as part of a separate initiative. The proposal therefore only affects the decision maker's consideration of indirect interests held through related parties under common control in the primary-beneficiary assessment.

Effective Date and Transition

For all reporting entities, the guidance is effective for annual periods beginning after December 15, 2016. Reporting entities that have not yet adopted the guidance in ASU 2015-02 will be required to adopt ASU 2016-17's amendments at the same time they adopt those in ASU 2015-02. Early adoption, including adoption in an interim period, is permitted as of October 26, 2016 (the ASU's issuance date).

Employee Share-Based Payment Accounting Improvements

Background

In March 2016, the FASB issued [ASU 2016-09](#), which simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new guidance, which is part of the Board's simplification initiative, also contains practical expedients for nonpublic entities.

Key Provisions of the ASU

Accounting for Income Taxes

Under current guidance, when a share-based payment award is granted to an employee, the fair value of the award is generally recognized over the vesting period, and a corresponding deferred tax asset (DTA) is recognized to the extent that the award is tax-deductible. The tax deduction is generally based on the intrinsic value at the time of exercise (for an option) or on the fair value upon vesting of the award (for restricted stock), and it can be either greater (excess tax benefit) or less (tax deficiency) than the compensation cost recognized in the financial statements. All excess tax benefits are recognized in additional paid-in capital (APIC), and tax deficiencies are recognized either in the income tax provision or in APIC to the extent that there is a sufficient "APIC pool" related to previously recognized excess tax benefits.

Under the ASU, an entity recognizes all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement. This change eliminates the notion of the APIC pool and significantly reduces the complexity and cost of accounting for excess tax benefits and tax deficiencies. In addition, excess tax benefits and tax deficiencies are considered discrete items in the reporting period in which they occur and are not included in the estimate of an entity's annual effective tax rate.

The ASU's guidance on recording excess tax benefits and tax deficiencies in the income statement also has a corresponding effect on the computation of diluted earnings per share when an entity applies the treasury stock method. An entity that applies such method under current guidance estimates the excess tax benefits and tax deficiencies to be recognized in APIC in determining the assumed proceeds available to repurchase shares. However, under the ASU, excess tax benefits and tax deficiencies are excluded from the calculation of assumed proceeds since such amounts are recognized in the income statement. In addition, the new guidance affects the accounting for tax benefits of dividends on share-based payment awards, which will now be reflected as income tax expense or benefit in the income statement rather than as an increase to APIC.

Further, the ASU eliminates the requirement to defer recognition of an excess tax benefit until the benefit is realized through a reduction to taxes payable.

In addition to addressing the recognition of excess tax benefits and tax deficiencies, the ASU provides guidance on the related cash flow presentation. Under existing guidance, excess tax benefits are viewed as a financing transaction and are presented as financing activities in the statement of cash flows. However, there is no cash receipt but only a reduction in taxes payable. Therefore, a reclassification is made in the statement of cash flows to reflect a hypothetical inflow in the financing section and a hypothetical outflow from the operating section.

Under the ASU, excess tax benefits no longer represent financing activities since they are recognized in the income statement; therefore, excess tax benefits are not separate cash flows and should be classified as operating activities in the same manner as other cash flows related to income taxes. Accordingly, the ASU eliminates the requirement to reclassify excess tax benefits from operating activities to financing activities.

Accounting for Forfeitures

The ASU allows an entity to elect as an accounting policy either to continue to estimate the total number of awards for which the requisite service period will not be rendered (as currently required) or to account for forfeitures when they occur. This entity-wide accounting policy election only applies to service conditions; for performance conditions, the entity continues to assess the probability that such conditions will be achieved. An entity must also disclose its policy election for forfeitures.



Thinking It Through

An entity that adopts a policy to account for forfeitures as they occur must still estimate forfeitures when an award is (1) modified (the estimate applies to the original award in the measurement of the effects of the modification) and (2) exchanged in a business combination (the estimate applies to the amount attributed to precombination service). However, the accounting policy for forfeitures will apply to the subsequent accounting for awards that are modified or exchanged in a business combination.

Statutory Tax Withholding Requirements

The ASU modifies the current exception to liability classification of an award when an employer uses a net-settlement feature to withhold shares to meet the employer's minimum statutory tax withholding requirement. Currently, the exception only applies when no more than the number of shares necessary for the minimum statutory tax withholding requirement to be met is repurchased or withheld. The new guidance stipulates that the net settlement of an award for statutory tax withholding purposes would not result, by itself, in liability classification of the award provided that the amount withheld for taxes does not exceed the maximum statutory tax rate in the employees' relevant tax jurisdictions. Further, to eliminate diversity in practice, the ASU requires that cash payments to tax authorities in connection with shares withheld to meet statutory tax withholding requirements be presented as a financing activity in the statement of cash flows because such payments represent an entity's cash outflow to reacquire the entity's shares.



Thinking It Through

Under current guidance, an entity is required to track the minimum statutory tax withholding requirement applicable to each specific award grantee in each applicable jurisdiction if shares are repurchased or withheld. Under the new guidance, the maximum rate is determined on a jurisdiction-by-jurisdiction basis even if that rate exceeds the highest rate applicable to a specific award grantee. However, the classification exception would not apply to entities that do not have a statutory tax withholding obligation; for such entities, any net settlement for tax withholding would result in a liability-classified award.

In addition, an entity may change the terms of its awards related to net settlement for withholding taxes from the minimum statutory tax rate to a higher rate up to the maximum statutory tax rate. While this change may be made to existing awards, the entity would not be required to account for such a change as a modification. However, this accounting treatment applies only in these narrow circumstances (i.e., solely to change the net-settlement provisions from the minimum statutory tax rate to a higher rate up to the maximum statutory tax rate for statutory tax withholding purposes) and should not be analogized to other situations.

Practical Expedients for Nonpublic Entities

Expected-Term Practical Expedient

The ASU allows nonpublic entities to use the simplified method to estimate the expected term for awards (including liability-classified awards measured at fair value) with service or performance conditions that meet certain requirements. Such entities would apply this practical expedient as follows:

- For awards with only a service condition, nonpublic entities can estimate the expected term as the midpoint between the requisite service period and the contractual term of the award.
- For awards with a performance condition, the estimate of the expected term would depend on whether it is probable that the performance condition will be achieved:
 - If it is probable that the performance condition will be achieved, nonpublic entities can estimate the expected term as the midpoint between the requisite service period and the contractual term.
 - If it is not probable that the performance condition will be achieved, nonpublic entities can estimate the expected term as (1) the contractual term if the award does not contain an explicit service period or (2) the midpoint between the requisite service period and the contractual term if the award does contain an explicit service period.

Intrinsic Value Practical Expedient

The ASU allows nonpublic entities to make a one-time election to switch from fair value measurement to intrinsic value measurement, without demonstrating preferability, for share-based payment awards classified as liabilities.

Nonpublic entities are not allowed to make this election on an ongoing basis after the effective date of the new guidance.

Transition and Related Disclosures

The following table outlines the transition methods for an entity's adoption of ASU 2016-09:

Type	Transition Method
Recognition of excess tax benefits and tax deficiencies (accounting for income taxes)	Prospective
Unrecognized excess tax benefits (accounting for income taxes)	Modified retrospective
Classification of excess tax benefits in the statement of cash flows	Retrospective or prospective
Accounting for forfeitures	Modified retrospective
Classification and statutory tax withholding requirements	Modified retrospective
Classification of employee taxes paid in the statement of cash flows when an employer withholds shares for tax withholding purposes	Retrospective
Nonpublic entity practical expedient for expected term	Prospective
Nonpublic entity practical expedient for intrinsic value	Modified retrospective



Thinking It Through

An entity's prior-year APIC pool is not affected because prior-year excess tax benefits and tax deficiencies have already been recognized in the financial statements, and the recognition of excess tax benefits and tax deficiencies in the income statement is prospective only in the fiscal year of adoption. As a result, there is no reclassification between APIC and retained earnings in the fiscal years before adoption. The modified retrospective transition guidance for taxes only applies to previously unrecognized excess tax benefits outstanding upon adoption of ASU 2016-09 with a cumulative-effect adjustment to retained earnings.

In the period of adoption, entities are required to disclose (1) the nature of and reason for the changes in accounting principle and (2) any cumulative effects of the changes on retained earnings or other components of equity as of the date of adoption.

In addition, because the change in presentation in the statement of cash flows related to excess tax benefits can be applied either prospectively or retrospectively, entities are required to disclose (1) "that prior periods have not been adjusted" if the change is applied prospectively or (2) the "effect of the change on prior periods retrospectively adjusted" if the change is applied retrospectively. For the change in presentation in the statement of cash flows related to statutory tax withholding requirements, entities are required to disclose the "effect of the change on prior periods retrospectively adjusted."

Effective Date

For public business entities, the ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual reporting periods. For all other entities, the ASU is effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual reporting periods beginning after December 15, 2018.

Early adoption will be permitted in any interim or annual period for which financial statements have not yet been issued or have not been made available for issuance. If early adoption is elected, all amendments in the ASU that apply must be adopted in the same period. In addition, if early adoption is elected in an interim period, any adjustments should be reflected as of the beginning of the annual period that includes that interim period.

Example

Entity A, an SEC registrant, adopts ASU 2016-09 in its third fiscal quarter. Entity A had \$50 of excess tax benefits in each quarter in its current fiscal year to date and is not affected by adopting any of the other provisions of ASU 2016-09. In its previously issued financial statements in Form 10-Q, A recognized a total of \$100 (\$50 in each quarter) of excess tax benefits in APIC. In its third fiscal quarter, the period in which the ASU is adopted, A recognizes \$50 of excess tax benefits in its income statement. That is, the quarter-to-date income tax provision will only include the third fiscal quarter excess tax benefits (\$50). In addition, the year-to-date income tax provision will include excess tax benefits of \$150 to reflect the reversal of the excess tax benefits recognized in APIC for the first two fiscal quarters (\$100) and the recognition of those benefits in the income statement in those prior quarters (the \$100 in excess tax benefits related to the first and second fiscal quarters are not recognized in the third quarter but are reflected on a recasted basis in the applicable prior quarters). In the quarterly information footnote of its subsequent Form 10-K filing, A will present a schedule reflecting the first and second fiscal quarters' excess tax benefits (\$50 each quarter) in the income statement even though these amounts were reported in APIC in previously issued financial statements in Form 10-Q. Finally, A's financial statements in Form 10-Q issued in the year after A's adoption of the ASU will reflect the prior-year quarterly excess tax benefits (i.e., first and second fiscal quarters of the prior year) on a recasted basis in the income statement rather than in APIC.

Classification of Deferred Taxes

Background and Key Provisions

In November 2015, the FASB issued [ASU 2015-17](#), which will require entities to present DTAs and deferred tax liabilities (DTLs) as noncurrent in a classified balance sheet. The ASU simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and noncurrent in a classified balance sheet.

The project on simplifying the balance sheet presentation of deferred taxes is part of the FASB's simplification initiative. Launched in June 2014, the simplification initiative is intended to improve U.S. GAAP by reducing costs and complexity while maintaining or enhancing the usefulness of the related financial information.

Under current guidance (ASC 740-10-45-4), entities "shall separate deferred tax liabilities and assets into a current amount and a noncurrent amount. Deferred tax liabilities and assets shall be classified as current or noncurrent based on the classification of the related asset or liability for financial reporting." Stakeholder feedback indicated that the separate presentation of deferred taxes as current or noncurrent provided little useful information to financial statement users and resulted in additional costs to preparers. Therefore, the FASB issued the ASU to simplify the presentation of deferred taxes in a classified balance sheet. Netting of DTAs and DTLs by tax jurisdiction will still be required under the new guidance.

Noncurrent balance sheet presentation of all deferred taxes eliminates the requirement to allocate a valuation allowance on a pro rata basis between gross current and noncurrent DTAs, which constituents had also identified as an issue contributing to complexity in accounting for income taxes.



Thinking It Through

The ASU will align with the current guidance in IAS 12, which requires entities to present DTAs and DTLs as noncurrent in a classified balance sheet.

Classification of Deferred Taxes

The example below compares the classification of DTAs and DTLs under current U.S. GAAP with their classification under the new guidance.

Example

Company ABC has a net DTA of \$100 million as of December 31, 20X1, as shown in the table below (amounts in millions):

Balance Sheet as of 12/31/X1	
	DTA/(DTL)
Inventory	\$ 50
Net operating loss (NOL) carryforward	350
Fixed assets	<u>(300)</u>
Total DTA/(DTL)	<u>\$ 100</u>

Company ABC expects that \$100 million of the NOL carryforward will be used in the following year. Below are the current and noncurrent classifications of the DTA/(DTL) as of December 31, 20X1 (amounts in millions):

Description	Current U.S. GAAP		ASU 2015-17	
	Current	Noncurrent	Current	Noncurrent
Inventory	\$ 50			\$ 50
NOL carryforward	100	\$ 250		350
Fixed assets	<u> </u>	<u>(300)</u>	<u> </u>	<u>(300)</u>
Total DTA/(DTL)	<u>\$ 150</u>	<u>\$ (50)</u>	<u>\$ 0</u>	<u>\$ 100</u>

Effective Date and Transition

The ASU requires the following:

- For public business entities, the ASU is effective for annual periods beginning after December 15, 2016, and interim periods within those years.
- For entities other than public business entities, the ASU will be effective for annual reporting periods beginning after December 15, 2017, and interim reporting periods within annual reporting periods beginning after December 15, 2018.

The Board decided to allow all entities to early adopt the ASU for any interim or annual financial statements that have not been issued. In addition, entities are permitted to apply the amendments either prospectively or retrospectively.

In the period the ASU is adopted, an entity will need to disclose “the nature of and reason for the change in accounting principle.” If the new guidance is applied prospectively, the entity should disclose that prior balance sheets were not retrospectively adjusted. However, if the new presentation is applied retrospectively, the entity will need to disclose the quantitative effects of the change on the prior balance sheets presented.

Accounting for Income Taxes: Intra-Entity Asset Transfers

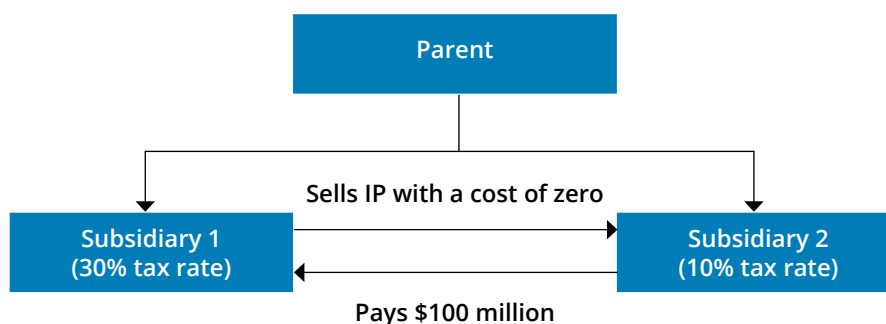
Background

In October 2016, the FASB issued [ASU 2016-16](#), which amends the guidance in ASC 740 to remove the exception that prohibits the immediate recognition of the current and deferred tax effects of intra-entity transfers of assets. The ASU retains the exception specifically for intra-entity asset transfers of inventory. Consequently, in a manner consistent with the current requirements of ASC 740, entities are prohibited from recognizing the current and deferred tax effects of intra-entity transfers of inventory.

For intra-entity transfers of assets other than inventory, the selling (transferring) entity is required to recognize a current tax expense or benefit upon transfer of the asset. Similarly, the purchasing (receiving) entity is required to recognize a DTA or DTL, as well as the related deferred tax benefit or expense, upon receipt of the asset. The purchasing (receiving) entity measures the resulting DTA or DTL by (1) computing the difference between the tax basis of the asset in the buyer's jurisdiction and the financial reporting carrying value of the asset in the consolidated financial statements and (2) multiplying such difference by the enacted tax rate in the buyer's jurisdiction.

The example below compares the income tax accounting for intra-entity transfers of assets other than inventory before and after the ASU.

Example



Before ASU 2016-16

In the transaction above, Subsidiary 1 recognizes a gain of \$100 million on the sale of intellectual property (IP) to Subsidiary 2, which is equal to the proceeds received (\$100 million) less the carrying value of the IP (zero). However, in accordance with ASC 740-10-25-3(e), Subsidiary 1 is prohibited from recognizing the current tax expense associated with that \$100 million gain. Therefore, upon sale, Subsidiary 1 would record the following journal entry:

Prepaid taxes	30,000,000	
Current taxes payable		30,000,000

Further, Subsidiary 2 receives a tax basis in the IP of \$100 million, which is equal to the amount that it paid to Subsidiary 1. This tax basis of \$100 million is greater than the carrying value of the IP in the consolidated financial statements (zero), which would generally result in a DTA. However, in accordance with ASC 740-10-25-3(e), Subsidiary 2 is prohibited from recognizing the DTA (benefit) associated with its tax-over-book basis difference. Therefore, Subsidiary 2 would not recognize any tax expense (benefit) associated with this transaction.

Example (continued)**After ASU 2016-16**

Under the ASU, the exception to recognizing current and deferred taxes on intra-entity transfers of assets is removed (unless the assets are inventory). Therefore, Subsidiary 1 is required to recognize the current tax expense associated with the gain on the sale of the IP by recording the following journal entry:

Current tax expense	30,000,000	
Current taxes payable		30,000,000

In addition, Subsidiary 2 is required to recognize the deferred tax effects associated with its purchase of the IP by recording the following journal entry:

DTA	10,000,000	
Deferred tax benefit		10,000,000

Transition Method

Entities will adopt the new guidance on a modified retrospective basis with a cumulative-effect adjustment directly to retained earnings as of the beginning of the year of adoption. Since the period of adoption is not comparable to the prior periods presented, entities will need to disclose the effects of the accounting change on the financial statements of the period of adoption.

Effective Date and Early Adoption

The guidance in the ASU is effective for public business entities for annual periods beginning on or after December 15, 2017, including interim and annual periods. For other entities, the amendments are effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted for all entities as of the beginning of an annual period.

Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments

Background

In August 2016, the FASB issued [ASU 2016-15](#), which amends ASC 230 to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows. ASC 230 lacks consistent principles for evaluating the classification of cash payments and receipts in the statement of cash flows. This has led to diversity in practice and, in certain circumstances, financial statement restatements. Therefore, the FASB issued the ASU with the intent of reducing diversity in practice with respect to eight types of cash flows.

Key Provisions of the ASU

The ASU is a result of consensus reached by the EITF on issues related to the eight types of cash flows. Key provisions of the amendments are summarized below.

Cash Flow Issues	Amendments
Debt prepayment or debt extinguishment costs	Cash payments for debt prepayment or extinguishment costs (including third-party costs, premiums paid, and other fees paid to lenders) must “be classified as cash outflows for financing activities.”
Settlement of zero-coupon bonds	The cash outflows for the settlement of a zero-coupon bond must be bifurcated into operating and financing activities. The portion of the cash payment related to accreted interest should be classified in operating activities, while the portion of the cash payment related to the original proceeds (i.e., the principal) should be classified in financing activities.
Contingent consideration payments made after a business combination	Contingent consideration payments that were not made soon after a business combination (on the basis of the consummation date) must be separated and classified in operating and financing activities. Cash payments up to the amount of the contingent consideration liability recognized as of the acquisition date, including any measurement-period adjustments, should be classified in financing activities, while any excess cash payments should be classified in operating activities.
Proceeds from the settlement of insurance claims	Cash proceeds from the settlement of insurance claims should be classified on the basis of the nature of the loss. For insurance proceeds received in a lump-sum settlement, an entity should determine the classification on the basis of the nature of each loss included in the settlement.
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 policies must be classified in investing activities. However, an entity is 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).
Distributions received from equity method investees	<p>An entity is required to make an accounting policy election to classify distributions received from equity method investees under either of the following methods:</p> <ul style="list-style-type: none"> <i>Cumulative-earnings approach</i> — Under this approach, distributions are presumed to be returns on investment and classified as operating cash inflows. However, if the cumulative distributions received, less distributions received in prior periods that were determined to be returns on investment, exceed the entity’s cumulative equity in earnings, such excess is a return of capital and should be classified as cash inflows from investing activities. <i>Nature of the distribution approach</i> — Under this approach, each distribution is evaluated on the basis of the source of the payment and classified as either operating cash inflows or investing cash inflows. <p>If an entity whose chosen policy is the nature of the distribution approach cannot apply the approach because it does not have enough information to determine the appropriate classification (i.e., the source of the distribution), the entity must apply the cumulative-earnings approach and report a change in accounting principle on a retrospective basis. The entity is required to disclose that a change in accounting principle has occurred as a result of the lack of available information as well as the information required under ASC 250-10-50-2, as applicable.</p> <p>The amendments do not address equity method investments measured under the fair value option.</p>

(Table continued)

Cash Flow Issues	Amendments
Beneficial interests in securitization transactions	A transferor's beneficial interests received as proceeds from the securitization of an entity's financial assets must be disclosed as a noncash activity. Subsequent cash receipts of beneficial interests from the securitization of an entity's trade receivables must be classified as cash inflows from investing activities.
Separately identifiable cash flows and application of the predominance principle	<p>The guidance provides a three-step approach for classifying cash receipts and payments that have aspects of more than one class of cash flows:</p> <ol style="list-style-type: none"> 1. An entity should first apply specific guidance in U.S. GAAP, if applicable. 2. If there is no specific guidance related to the cash receipt or payment, an entity should bifurcate the cash payment or receipt into "each separately identifiable source or use [of cash] on the basis of the nature of the underlying cash flows." Each separately identifiable source or use of cash will be classified as operating, investing, or financing activities by applying the guidance in ASC 230. 3. If the cash payment or receipt cannot be bifurcated, the entire payment or receipt should be classified as operating, investing, or financing activities on the basis of the activity that is likely to be the predominant source or use of cash.



Thinking It Through

The FASB's objective in the ASU is to eliminate the diversity in practice related to the classification of certain cash receipts and payments. As a result, there could be significant changes for some entities under the revised guidance, particularly with respect to the issues discussed below.

Settlement of Zero-Coupon Bonds

The lack of guidance on the classification of payments to settle zero-coupon bonds in the statement of cash flows has led to diversity in the classification of the cash payment made by a bond issuer at the settlement of a zero-coupon bond. Some entities bifurcate the settlement payment between the principal (the amount initially received by the entity) and accreted interest. In those situations, the portion of the repayment related to principal is classified in financing activities, and the portion related to accreted interest is classified in operating activities. However, other entities do not bifurcate the settlement payment between principal and accreted interest and present the entire repayment in financing activities.

Under the ASU, entities are required to bifurcate the repayment of zero-coupon bonds into principal and accreted interest, with the principal portion classified in financing activities and the accreted interest portion classified in operating activities. As a result, entities that currently classify the entire repayment of zero-coupon bonds in financing activities will need to identify the portion of such payments that are related to accreted interest and apply the provisions of the ASU accordingly.

Distributions Received From Equity Method Investees

While ASC 230 distinguishes between returns of investment (which should be classified as inflows from investing activities) and returns on investment (which should be classified as inflows from operating activities), it does not prescribe a method for differentiating between the two.

With respect to distributions from equity method investees, entities make this determination by applying a cumulative-earnings approach or a nature of the distribution approach. The ASU formalizes each of these methods and allows an entity to choose either one as an accounting policy election.

Beneficial Interests in Securitization Transactions

There is no specific guidance in ASC 230 on how to classify cash receipts associated with beneficial interests in securitization transactions. As a result, entities have classified the subsequent cash receipts from payments on beneficial interests obtained by the transferor in a securitization of the transferor's trade receivables as either operating activities or investing activities in the statement of cash flows. Although there is diversity in practice, we believe that entities have predominantly presented cash receipts from payments on a transferor's beneficial interests in securitized trade receivables as a cash inflow from operating activities. Accordingly, the requirement to present such cash receipts as a cash inflow from investing activities could change practice significantly.

Separately Identifiable Cash Flows and Application of the Predominance Principle

ASC 230 acknowledges that certain cash inflows and outflows may have characteristics of more than one cash flow class (e.g., financing, investing, or operating) and states that the "appropriate classification shall depend on the activity that is likely to be the predominant source of cash flows for the item." Although ASC 230 gives examples illustrating the application of the predominance principle, entities often have difficulty applying the guidance.

As a result, when cash flows have aspects of more than one cash flow class, the ASU requires that entities first determine the classification of those cash receipts and payments by applying the specific guidance in ASC 230 and other applicable ASC topics. Further, the ASU notes that "[i]n the absence of specific guidance, a reporting entity shall determine each separately identifiable source or each separately identifiable use within the cash receipts and cash payments on the basis of the nature of the underlying cash flows." The ASU goes on to observe that "[i]n situations in which cash receipts and payments have aspects of more than one class of cash flows and cannot be separated by source or use . . . the appropriate classification shall depend on the activity that is likely to be the predominant source or use of cash flows for the item." However, because the ASU does not define the term "separately identifiable" in this context, we believe that challenges may be presented related to identifying separately identifiable cash receipts and payments as well as applying the term "predominant."

Effective Date and Transition

For public business entities, the guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, it is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption will be permitted for all entities.

Entities must apply the guidance retrospectively to all periods presented but may apply it prospectively if retrospective application would be impracticable.

Restricted Cash

Background

In November 2016, the FASB issued [ASU 2016-18](#), which amends ASC 230 to clarify guidance on the classification and presentation of restricted cash. The ASU is the result of the following consensus reached by the EITF:

- An entity should include in its cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. The Task Force decided not to define the terms “restricted cash” and “restricted cash equivalents” but observed that an entity should continue to provide appropriate disclosures about its accounting policies pertaining to restricted cash in accordance with other GAAP. The Task Force also observed that any change in accounting policy will need to be assessed under ASC 250.
- A reconciliation between the statement of financial position and the statement of cash flows must be disclosed when the statement of financial position includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents.
- Changes in restricted cash and restricted cash equivalents that result from transfers between cash, cash equivalents, and restricted cash and restricted cash equivalents should not be presented as cash flow activities in the statement of cash flows.
- An entity with a material balance of amounts generally described as restricted cash and restricted cash equivalents must disclose information about the nature of the restrictions.

Effective Date and Transition

For public business entities, the guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, it is effective for annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019. Early adoption of the guidance in the ASU is permitted. A reporting entity will apply the guidance retrospectively.

Clarifying the Definition of a Business

Background

In January 2017, the FASB issued [ASU 2017-01](#), which provides guidance in connection with the first phase of its project on the definition of a business. The ASU is in response to concerns that the current definition of a business has been interpreted too broadly and that many transactions are accounted for as business combinations when they are more akin to asset acquisitions.

The ASU:

- Provides a “screen” for entities to use in determining whether an integrated set of assets and activities (commonly referred to as a “set”) is a business. When substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. The objective of the screen is to reduce the number of transactions that need to be further evaluated.

Clarifying the Definition of a Business

- Requires that if the screen's criteria are not met, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs.
- Removes the evaluation of whether a market participant could replace missing elements.
- Narrows the definition of outputs to be consistent with ASC 606.



Thinking It Through

The 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.

Single or Similar Asset Concentration

Under the ASU, cash and cash equivalents, DTAs, and goodwill resulting from the effects of DTLs would be excluded from an entity's assessment of gross asset concentration. If the fair value of the gross assets cannot be concentrated, the entity would apply the ASU's framework for evaluating whether an input and a substantive process are both present and together contribute to the ability to produce outputs.



Thinking It Through

In the determination of gross asset concentration, neither a financial asset and a nonfinancial asset (e.g., premium deposits on insurance contracts and customer relationships) nor different major classes of financial assets (e.g., investments, cash, and accounts receivable) could be combined. Also, identifiable assets within the same major asset class that have significantly different risk characteristics could not be combined.

Input and Substantive Process Requirement

The ASU provides a framework for determining whether a set has an input and a substantive process that collectively contribute to the ability to create outputs. When a set does not yet have outputs, the set would have a substantive process only if it has an organized workforce (or an acquired contract that provides access to 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. For a set with outputs, the ASU includes less stringent criteria for determining that the set has a substantive process. An organized workforce may represent a substantive process. However, a set may have a substantive process even without an organized workforce if an acquired process or processes contribute to the ability to continue producing outputs and cannot be replaced without significant cost, effort, or delay or are considered unique or scarce.

Definition of Outputs

Under current guidance (ASC 805-10-55-4), 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 ASU clarifies this definition to be the "result of inputs and processes applied to those inputs that provide goods or services to customers, investment income (such as dividends or interest), or other revenues." The revised definition of outputs aligns the definition with the new revenue guidance in ASC 606.

Effective Date and Transition

The ASU is effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those periods. For all other entities, the ASU is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

Early application is permitted as follows:

- For transactions for which the acquisition date occurs before the issuance date or effective date of the ASU, application is permitted only when the transaction has not been reported in financial statements that have been issued or made available for issuance.
- For transactions in which a subsidiary is deconsolidated or a group of assets is derecognized that occur before the issuance date or effective date of the ASU, application is permitted only when the transaction has not been reported in financial statements that have been issued or made available for issuance.

For additional information, see Deloitte's January 13, 2017, [Heads Up](#).

Alternatives for Private Companies

Background

The following guidance (developed in 2014 by the Private Company Council (PCC)) is effective in 2016:

- *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 existing goodwill (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.

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

In March 2016, the FASB issued [ASU 2016-03](#), which gives private companies a one-time unconditional option to forgo a preferability assessment the first time they elect a PCC accounting alternative within the ASU's scope. However, private companies would still be required to perform a preferability assessment in accordance with ASC 250 for any subsequent change to their accounting policy election in a manner consistent with all accounting policy changes under ASC 250.

The ASU also eliminates the effective dates of PCC accounting alternatives that are within the ASU's scope and extends the transition guidance for such alternatives indefinitely. The new guidance is effective immediately and affects all private companies within the scope of [ASU 2014-02](#) (goodwill), [ASU 2014-03](#) (derivatives and hedging), [ASU 2014-07](#) (common-control leasing arrangements), and [ASU 2014-18](#) (identifiable intangible assets). While the new standard extends the transition guidance in ASU 2014-07 and ASU 2014-18, it does not change the manner in which such guidance is applied. See Deloitte's March 16, 2016, [Heads Up](#) for more information.

Other Private-Company Matters

Throughout 2016, the PCC has discussed aspects of financial reporting that are complex and costly for private companies, including the application of VIE guidance to common-control arrangements, balance-sheet classification of debt, and liabilities and equity short-term improvements. During its April 2016 meeting, the PCC voted to recommend that the FASB add to its agenda [PCC Issue 15-02, "Applying Variable Interest Entity Guidance to Entities Under Common Control."](#)

Technical Corrections and Improvements — Fair Value Measurement

Background

In December 2016, the FASB issued [ASU 2016-19](#), which makes minor amendments to certain aspects of the Codification, including a change that clarifies the difference between a “valuation approach” and a “valuation technique” under ASC 820. The amendment also requires an entity to disclose when there has been a change in a valuation approach, a valuation technique, or both.

Effective Date and Transition

The amendments are effective upon issuance of the ASU. The transition guidance for the amendment to ASC 820 must be applied prospectively because it could potentially involve the use of hindsight that includes fair value measurements.

On the Horizon

Long-Duration Insurance Contracts

Background

In September 2016, the FASB issued a [proposed ASU](#) that would amend the accounting and disclosure model under U.S. GAAP for long-duration insurance contracts. The Board believes that its proposal will improve the following areas of financial reporting for long-duration insurance contracts:

- Measurement of the liability for future policy benefits.
- Market risk benefits.
- Measurement of the additional liability for contracts with annuitization or death or other insurance benefits.
- Amortization and impairment of deferred acquisition cost (DAC).
- Disclosures.

The proposed amendments would not change the scope of ASC 944. Therefore, they would not change the types of entities that are subject to the long-duration insurance contract accounting and disclosure guidance under ASC 944.

Comments on the proposal (see Deloitte's [comments](#)) were due by December 15, 2016. The proposed ASU's key provisions are discussed below. For additional information about the proposed ASU, see Deloitte's October 2016 [Insurance Spotlight](#).

Key Provisions

Measurement of the Liability for Future Policy Benefits

The proposed amendments would introduce a number of changes related to the measurement of the liability for future policy benefits for traditional, limited-payment, and participating long-duration contracts. The changes would affect the cash flow assumptions that insurers use to initially measure the liability, the discount rate used for measurement, the frequency of updating the cash flow and discount rate assumptions, and the accounting for those updates. In addition to these updates, the accounting model for certain types of participating contracts would be updated to expand the use of assumptions to measure the liability for future policy benefits beyond the assumptions used in the existing model.

Other proposed changes include the following:

- An insurer would measure the liability for future policy benefits by using a discount rate that (1) is based on the yield of a high-quality, fixed-income instrument and (2) reflects the duration characteristics of the liability. In determining the rate, which is concluded to be based on an AA bond yield rate, the insurer would "maximize the use of relevant observable inputs and minimize the use of unobservable inputs."
- An insurer would update the cash flow assumptions used to measure the liability for future policy benefits annually (at the same time each year), or more frequently if actual experience

or other evidence indicated that another update was warranted. These assumptions would not include provisions for adverse deviation. Updates to the cash flow assumptions would be accounted for retrospectively, with the impacts of the changes in assumptions on the liability recorded in the income statement.

- An insurer would update its discount rate assumptions in both annual and interim reporting periods (i.e., quarterly for public business entities). In addition, an insurer would account for updates to its cash flow assumptions by using an “immediate approach,” with the impact of the change in the discount rate assumption on the liability recorded in OCI.



Thinking It Through

Under the proposed model, an insurer would update its cash flow assumptions on a retrospective basis and would update its discount rate assumptions by using an immediate approach. Accordingly, the impact of each assumption would need to be isolated.

Therefore, to determine the impact of the change in cash flow assumptions, an insurer would perform the calculation by using the discount rate at contract inception. In performing the calculation, the insurer would use its actual historical experience since contract inception and its updated future cash flow assumptions to recalculate a revised net premium ratio, which is computed as the ratio of (1) the present value (based on the discount rate at contract inception) of the total expected benefits (including policyholder dividends) and expenses (excluding acquisition costs and costs required to be charged to expense as incurred) to (2) the present value of total expected gross premiums. The insurer would then (1) compute revised estimates of net premiums by applying the new net premium ratio, (2) compute an updated liability for future policy benefits, and (3) compare that updated liability (which is based on the discount rate at contract inception) with the liability's previous carrying amount (excluding the effect of previous discount rate changes) and recognize a cumulative catch-up adjustment in current-period earnings. Thereafter, the insurer would accrue the liability for future policy benefits by using the revised net premium ratio (until the next assumption update). However, if the revised cash flow assumptions indicate that the present value of future benefits and expenses would exceed gross premiums, the insurer must recognize an immediate charge in the benefit expense for the period so that net premiums will equal gross premiums (i.e., the net premium ratio cannot exceed 100 percent). Unlike current U.S. GAAP, the revised accounting model does not prescribe a premium deficiency test.

For updates to the discount rate under the immediate approach, the insurer would compute the impact of the discount rate change as the difference between (1) the present value of the liability based on the updated cash flow assumptions and the inception discount rate (as calculated above) and (2) the present value of the liability based on the updated cash flow assumptions and the updated discount rate. The insurer would then recognize the difference as an adjustment to OCI at the time the discount rate is updated (i.e., in the current period); however, the liability's interest accretion rate would remain the discount rate that was in effect at contract issuance.

Market Risk Benefits

The proposed amendments would introduce new accounting requirements for certain market risk benefits that meet both of the following criteria:

- a. Contract: The contract holder has the ability to direct funds to one or more separate account investment alternatives maintained by the insurance entity, and investment performance, net of contract fees and assessments, is passed through to the contract holder. The separate account need not be legally recognized or legally insulated from the general account liabilities of the insurance entity.
- b. Benefit: The insurance entity provides a benefit protecting the contract holder from adverse capital market performance, exposing the insurance entity to other-than-nominal capital market risk.¹¹

Specifically, under the proposed amendments:

- An insurer would be required to initially measure a liability (or possibly an asset) for market risk benefits² at fair value. The insurer would recognize subsequent changes in fair value in current earnings; however, any changes in fair value attributable to changes in the instrument-specific credit risk would be recognized in OCI.
- An insurer would separately present (1) the carrying amount of market risk benefits in the statement of financial position and (2) the change in fair value related to market risk benefits in net income (other than that portion of the fair value change attributable to changes in the instrument-specific credit risk, which would be reported in OCI).



Thinking It Through

While the Board's focus was on guaranteed minimum benefit features related to variable annuity products, the new definition of a market risk benefit may encompass additional benefits and products. In the proposal's Basis for Conclusions, the Board acknowledged that other products offered by insurance entities, such as equity-indexed annuities, may contain benefits similar to the market risk benefits in variable products but are not within the scope of a market risk benefit. The Board believes that improving the accounting for variable products will address most stakeholder concerns; however, the proposed ASU's questions for respondents solicited stakeholder views on whether the scope of the market risk benefits guidance is appropriate.

Measurement of the Additional Liability for Contracts With Annuitization or Death or Other Insurance Benefits

The proposed amendments also would modify certain aspects of how the additional liability for annuitization or death or other insurance benefits of qualifying benefit features is computed. Under the proposed amendments:

- An insurer would be required to perform an assessment on a periodic basis (at least annually) to determine whether recognition of an additional liability is required.
- For annuitization benefits, an insurer would compute the numerator of the benefit ratio as the "present value of expected annuitization payments to be made and related incremental claim adjustment expenses, discounted at a high-quality fixed income instrument yield applicable to

¹ The proposal states that a "nominal risk . . . is a risk of insignificant amount or [a risk that] has a remote probability of occurring. A benefit is presumed to have other-than-nominal capital market risk if the net amount at risk (that is, the guaranteed benefit in excess of the account balance, cash value, or similar amount) varies [by] more than an insignificant amount in response to capital market volatility. Capital market risk includes equity, interest rate, and foreign exchange risk."

² When a long-duration contract has multiple market risk benefits, an insurer must bundle those benefits together into a single, compound market risk benefit.

Long-Duration Insurance Contracts

the payout phase of the contract, minus the expected accrued account balance at the expected annuitization date The excess of the present value payments to be made during the payout phase of the contract over the expected accrued account balance at the expected annuitization date shall be discounted at the contract rate.” To calculate the denominator of the benefit ratio, the insurer would also discount the present value of total expected assessments during the accumulation phase of the contract by using the contract rate.

- Total expected assessments would (1) exclude any assessments included in the measurement of market risk benefits but (2) include investment margin for those contracts whose assets are reported in the general account (i.e., the anticipated investment returns on policyholder balances less amounts credited to those balances).
- The benefit ratio would be capped at 100 percent. At any point during the life of the contract, an insurer would recognize an immediate loss to the extent that it expects the present value of excess payments to exceed the present value of assessments.
- Experience assumptions would be updated in subsequent periods.

Deferred Acquisition Costs

Although the proposed amendments would not change the types of acquisition costs that qualify for capitalization or the level of contract aggregation at which DAC are determined, the amendments would change the manner and timing of DAC amortization.

Under the proposed amendments:

- Most DAC would be amortized “[i]n proportion to the undiscounted amount of insurance in force.” If the insurer cannot reasonably estimate the amount of insurance in force over the expected term of the related contract,³ it would amortize the DAC on a straight-line basis.⁴ No interest would accrue on the balance of unamortized DAC.
- An insurer would amortize DAC by using termination or in-force assumptions that are consistent with those used to determine the liability for future policy benefits or related balances for the associated contracts.
- The insurer would also (1) adjust the DAC balance to reflect actual experience that exceeds expected experience (e.g., an unexpected contract termination; however, changes in a contract’s profitability would not trigger an adjustment to DAC) and (2) prospectively treat the effects of any changes in future estimates (e.g., a change in lapse or mortality assumptions) as a change in accounting estimate. Moreover, when the insurer determines amortization expenses, it would ignore any anticipated future renewal expenses until such expenses are actually incurred.
- Insurers that write certain investment contracts with specified features would continue to amortize the DAC for those contracts by “using an accounting method that recognizes costs as expenses at a constant rate applied to net policy liabilities and that is consistent with the interest method.”
- Under the proposal, an insurer would not assess DAC for impairment.

³ This might be the case with universal-life-type or investment contracts.

⁴ The proposed amendments to ASC 944-30-35-3 would clarify that “[f]or contracts with accumulation and payout phases, the payout phase shall be viewed as a separate contract . . . and shall not be combined with the accumulation phase for amortization of capitalized acquisition costs.”

Disclosures

The proposed amendments would require enhanced disclosure for both interim and annual financial statements about the liability for future policy benefits, the liability for policyholders' account balances, market risk benefits, DAC, sales inducements, and separate accounts. The proposed amendments would require insurers to disclose disaggregated tabular rollforward of the opening to closing balance for specified accounts and provide other quantitative and qualitative disclosures about certain inputs, judgments, assumptions and methods, as well as other specified types of information.

Next Steps

The FASB will host a public roundtable meeting to discuss the proposed ASU on March 15, 2017. Registration information is available on the [FASB's Web site](#).

Financial Instruments

Hedging

In September 2016, the FASB issued a [proposed ASU](#) that would amend the hedge accounting recognition and presentation requirements of ASC 815 to (1) reduce their complexity and simplify their application by preparers and (2) improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities by better aligning those activities with the entity's financial reporting for hedging relationships.

Although the changes proposed by the FASB are significant, constituents also should take note of those aspects of existing hedge accounting that the Board decided to retain. The proposal still would require all hedging relationships to be highly effective. Moreover, an entity would retain the ability to voluntarily dedesignate a hedging relationship, designate certain component risks of the hedged item as the hedged risk, and apply the critical-terms-match method or the shortcut method.

The FASB will determine the effective date of the proposed amendments after it considers constituent feedback; however, it has tentatively determined that earlier application of the proposed amendments will be permitted at the beginning of any fiscal year before the effective date. Comments on the proposal (see Deloitte's [comments](#)) were due by November 22, 2016.

The sections below summarize the proposed ASU's key provisions. For additional information about the proposed ASU, see Deloitte's September 14, 2016, [Heads Up](#).

Key Proposed Changes to the Hedge Accounting Model

Hedge Documentation and Qualitative Assessments of Hedge Effectiveness

Under the proposed model, an entity would be required to perform an initial prospective quantitative assessment of hedge effectiveness at hedge inception (unless the hedging relationship qualifies for application of one of the expedients that permit an assumption of perfect hedge effectiveness, such as the shortcut method or critical-terms-match method); however, the entity generally would have until its first quarterly hedge effectiveness assessment date (i.e., up to three months) to complete this quantitative assessment. All other hedge documentation still would need to be in place at hedge inception. The entity could elect to perform subsequent prospective and retrospective hedge effectiveness assessments qualitatively if certain criteria are satisfied; however, the entity could be forced to revert to quantitative assessments if, because facts and circumstances have changed, the

entity may no longer assert qualitatively that the hedging relationship was and continues to be highly effective. Once an entity is forced to perform a quantitative assessment, it would be prohibited from performing qualitative assessments in future periods.

Cash Flow Hedges of Forecasted Purchases or Sales of Nonfinancial Items

For a forecasted purchase or sale of a nonfinancial item, the proposed model would permit an entity to designate the variability in cash flows attributable to changes in a contractually specified component as the hedged risk if certain criteria are satisfied. An entity could also hedge exposures arising from a contractually specified component of an agreement to purchase or sell a nonfinancial item for a period that extends beyond the contractual term or when a contract does not yet exist if the qualifying criteria will be met in a future contract and all the other cash flow hedging requirements are met.

Recognition and Presentation of the Effects of Hedging Instruments

The proposed amendments would eliminate the concept of separately recognizing periodic hedge ineffectiveness (although under the mechanics of fair value hedging, economic ineffectiveness would still be reflected in current earnings for those hedges).

For highly effective fair value hedging relationships, all changes in the fair value of the hedging instrument, including any amounts excluded from the assessment of hedge effectiveness, would be recorded in current earnings in the same income statement line as the earnings effect of the hedged item.

For highly effective cash flow hedging relationships, the change in the fair value of the hedging instrument used to assess hedge effectiveness would initially be recorded in OCI and would be reclassified out of AOCI into earnings and presented in the same income statement line as the earnings effect of the hedged item when the hedged item affects earnings. Any amounts excluded from the assessment of hedge effectiveness would be recognized immediately in earnings in the same income statement line as the earnings effect of the hedged item. Furthermore, an entity would immediately reclassify out of AOCI amounts associated with any hedged forecasted transaction whose occurrence is not probable. Such amounts would be presented in current earnings in the same income statement line in which the earnings effect of the hedged item would have been recorded had the hedged forecasted transaction occurred.

For highly effective net investment hedges, the change in the fair value of the hedging instrument used to assess hedge effectiveness would initially be recorded in the cumulative translation adjustment in OCI. When the hedged net investment affects earnings (i.e., upon a sale or liquidation), amounts would be reclassified out of the cumulative translation adjustment and be presented in the same income statement line in which the earnings effect of the net investment is presented. The portion (if any) of the hedging instrument's change in fair value that is excluded from the hedge effectiveness assessment would be recognized immediately in income (although the income statement presentation would not be prescribed).

Financial Hedging Relationships

For hedges of financial items, the proposed model (1) allows the contractually specified index rate in a variable-rate hedged item to be the designated interest rate risk, (2) retains the existing benchmark interest rate definition for fixed-rate hedged items with minor modifications to eliminate inconsistencies, and (3) designates the SIFMA Municipal Swap index as a permitted benchmark interest rate.

Fair Value Hedges of Interest Rate Risk

Under the proposal, for a fair value hedge of interest rate risk, an entity would be allowed to:

- Designate the change in only the benchmark component of total coupon cash flows attributable to changes in the benchmark interest rate as the hedged risk in a hedge of a fixed-rate financial asset or liability. However, if the current market yield of the hedged item is less than the benchmark interest rate at hedge inception (i.e., a “sub-benchmark” hedge), the entity would be required to use the total contractual coupon cash flows for its calculation.
- Consider, for prepayable financial instruments, only how changes in the benchmark interest rate affect a decision to settle a debt instrument before its scheduled maturity in calculating the change in the fair value of the hedged item attributable to interest rate risk.
- Designate as the hedged risk only a portion of the hedged item’s term and measure the change in the fair value of the hedged item attributable to changes in the benchmark interest rate by “using an assumed term that begins with the first hedged cash flow and ends with the last hedged cash flow.” The hedged item’s assumed maturity would be the date on which the last hedged cash flow is due and payable.

Shortcut Method and Critical-Terms-Match Method

The proposal would retain both the shortcut and critical-terms-match methods and provide additional relief for entities applying those methods. It would amend the shortcut accounting requirements to allow an entity to specify, at the inception of the hedging relationship, the quantitative (long-haul) method it will use to assess hedge effectiveness and measure hedge results if it later determines that application of the shortcut method was not or no longer is appropriate. In addition, the proposal would amend certain shortcut-method criteria to allow partial-term fair value hedges to qualify for the shortcut method.

Further, the proposal would expedite an entity’s ability to apply the critical-terms-match method to cash flow hedges of groups of forecasted transactions. If all other critical-terms-match criteria were satisfied, such hedges would qualify for the critical-terms-match method if all the forecasted transactions occurred within 31 days of the hedging derivative’s maturity.

Disclosure Requirements

The proposed ASU would add new disclosure requirements and amend existing ones. Also, to align the disclosure requirements with the proposed changes to the hedge accounting model, the proposal would remove the requirement for entities to disclose amounts of hedge ineffectiveness. In addition, an entity would be required to provide:

- Tabular disclosure of (1) the total amounts reported in the statement of financial performance for each income and expense line item that is affected by hedging and (2) the effects of hedging on those line items.
- Disclosures about the carrying amounts and cumulative basis adjustments of items designated and qualifying as hedged items in fair value hedges.
- Qualitative disclosures describing (1) quantitative hedging goals, if any, established in developing its hedging objectives and strategies and (2) whether those goals were met.

These disclosures would be required for every annual and interim reporting period for which a statement of financial position and statement of financial performance are presented.

Adoption and Transition

Entities would adopt the proposal's provisions by applying a modified retrospective approach to existing hedging relationships as of the adoption date. After adoption, in all interim and annual periods, entities would begin to apply the new accounting and presentation model and provide the new and amended disclosures.

In each annual and interim reporting period in the fiscal year of adoption, entities would also be required to furnish certain disclosures required by ASC 250 about (1) the nature and reason for the change in accounting principle and (2) the cumulative effect of the change on the components of equity or net assets as of the date of adoption.

The proposal also describes (1) specific transition considerations related to the accounting for fair value hedges of interest rate risk, (2) one-time transition elections that allow entities to amend the documentation for existing hedging relationships and to take advantage of the guidance on qualitative assessments and the shortcut method of accounting, and (3) a one-time transition election that allows entities, for certain existing cash flow hedging relationships, to take advantage of the amendments that permit designation of a contractually specified interest rate (for variable-rate instruments) or a contractually specified component (for forecasted purchases or sales of nonfinancial items).

Liabilities and Equity — Targeted Improvements

Background

The FASB added a project to its technical agenda in 2014 to consider making targeted improvements to its guidance on the classification of financial instruments as either liabilities or equity. The objective of the project was to simplify the guidance in existing U.S. GAAP on distinguishing liabilities from equity, which involves the application of numerous complex rules and is one of the most common sources of errors and restatements.

However, the FASB tentatively decided in February 2016 to largely abandon the project after concluding that targeted improvements would not adequately address the pervasive problems related to this topic. Instead, the Board decided to seek feedback on whether it should recommence a comprehensive project on distinguishing liabilities from equity to holistically examine the associated issues.

Nevertheless, the FASB issued an [Invitation to Comment](#) in August 2016 to determine whether it should undertake such a project. As a result, the Board decided to proceed with making targeted improvements related to two narrow issues and issued a [proposed ASU](#) in December 2016.

The proposed changes would affect the guidance in U.S. GAAP on:

- The accounting for instruments with “down-round” provisions.
- The indefinite deferral of certain pending content in ASC 480-10.

Down-Round Provisions

Background

A down-round provision is a term 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 then-current 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.

Under current U.S. GAAP, a contract (or embedded equity conversion feature) that contains a down-round provision does not qualify as equity because such an arrangement 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). As a result, contracts and features that include down-round provisions do not currently qualify for the scope exception from derivative accounting in ASC 815-10 for contracts that are indexed to, and classified in, stockholders' equity. Therefore, freestanding contracts on an entity's own equity that contain a down-round feature and meet the definition of a derivative (including net settlement) are accounted for at fair value with changes in fair value recognized in earnings. Similarly, features embedded in an entity's own equity that contain down-round provisions must be separated and accounted for as derivative instruments at fair value if they meet the bifurcation criteria in ASC 815-15.

Proposed Changes

The proposed changes would apply to issuers of financial instruments (e.g., a warrant or a convertible instrument) with down-round features. Specifically excluded from the scope would be (1) freestanding financial instruments and embedded conversion options that are accounted for at fair value with changes in fair value recognized in earnings (e.g., freestanding and bifurcated embedded derivative instruments within the scope of ASC 815 and debt for which the issuer has elected the fair value option in ASC 825-10) and (2) convertible debt instruments that are separated into liability and equity components (e.g., convertible debt with beneficial conversion features or cash conversion features pursuant to ASC 470-20).

Under the proposed approach, a down-round provision would not preclude an entity from concluding that the instrument or feature that includes the provision is indexed to the entity's own stock. For example, when an entity evaluates whether it is required to classify a freestanding warrant that gives the counterparty the right to acquire the entity's common stock as a liability or equity under ASC 815-40, the existence of the down-round feature would not affect the analysis. If the warrant otherwise meets the condition for equity classification, it would be classified as equity. Similarly, in the analysis of whether an embedded conversion feature in a debt host contract must be bifurcated as an embedded derivative under ASC 815-15, the existence of a down-round provision would not prevent the contract from qualifying for the scope exception in ASC 815-10-15-74 for contracts indexed to an entity's own stock and classified in stockholders' equity.

While instruments that contain down-round features would no longer be expressly precluded from equity classification, such instruments may still not qualify for equity classification for other reasons (e.g., if the issuer could be forced to net cash settle the contract). The classification of instruments as liabilities or equity would not, under the proposal, be dictated by the down-round feature. Instead, the down-round feature would affect the accounting only if it were "triggered" (i.e., the entity issued shares at a price below the strike price). Once the feature was triggered, entities would determine the value that was transferred to the holder when the price adjustment occurred. They would determine this value in accordance with the fair value measurement guidance in ASC 820 by using a "with and without method," under which the fair values the instrument would have with and without the feature would be compared.

In addition, the accounting for the down-round adjustment differs depending on whether the instrument containing the down-round adjustment is classified as equity or as a liability.



Thinking It Through

Under current U.S. GAAP, down-round protection often results in instruments being accounted for as liabilities, with changes in fair value recorded through earnings. Under the proposed changes, fewer instruments are expected to require such classification and resulting fair value treatment. However, many instruments or embedded features are precluded from equity classification because of the existence of other terms (e.g., warrants on contingently redeemable preferred stock) and would therefore be unaffected by this proposed change.

Further, entities that present fair value financial statements (e.g., in accordance with ASC 946) would be largely unaffected by this change.

Disclosures

Under the proposed ASU, entities would be required to disclose the following:

- a. The fact that [a down-round] feature has been triggered
- b. The value of the effect of the down round feature being triggered
- c. The financial statement line item in which that effect is recorded.

Effective Date and Transition

The FASB will determine an effective date for the final guidance after the end of the proposal's comment period. The cumulative effect of the change would be recognized as an adjustment to the opening balance of retained earnings in the period of adoption.

Removal of the Indefinite Deferral Under ASC 480

The transition guidance in ASC 480-10 indefinitely defers the application of some of its requirements for 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.

ASC 480-10 requires issuers to classify mandatorily redeemable financial instruments as liabilities. Because of the indefinite deferral noted above, these requirements are labeled "pending content" in the Codification, but the transition guidance in ASC 480-10-65 provides no effective date for them. Therefore, the transition requirements under the proposed guidance would effectively provide scope exceptions for parts of the guidance in ASC 480-10 for affected entities and instruments.

For more information, see Deloitte's December 8, 2016, *Heads Up* on the proposal.

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

Background and Key Provisions of the Proposed ASU

In September 2016, the FASB issued for public comment a [proposed ASU](#) that would amend the amortization period for callable debt securities purchased at a premium. The proposal would shorten the amortization period for such securities to the earliest call date.

Under current U.S. GAAP, the premium on a callable debt security is generally amortized as an adjustment of yield over the contractual life (to maturity date) of the instrument. Accordingly, there is

no consideration of early payment of principal, and any unamortized premium is recorded as a loss in earnings upon the debtor's exercise of a call on a callable debt security purchased at a premium.

The FASB's proposed amendments would require the premium to be amortized to the earliest call date but would retain the accounting for the amortization of discounts on purchased callable debt securities (i.e., the discount would continue to be amortized to maturity).

Constituents have noted that under current guidance, (1) the amortization of premiums does not reflect the economics of the underlying transaction and (2) the model for pricing securities in the United States includes consideration for calls. In addition, investors generally price a security to the call date when the security is trading at a premium.

The proposed ASU states that the amendments would "more closely align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities."

Comments on the proposed ASU were due by November 28, 2016. For more information, see Deloitte's September 23, 2016, [Heads Up](#).

Effective Date and Transition

The FASB plans to determine an effective date for the final guidance after considering stakeholder feedback on the proposed ASU.

To apply the guidance, entities would use a modified retrospective approach, with the cumulative-effect adjustment recognized to retained earnings as of the beginning of the first reporting period in which the guidance is effective. Entities would also be required to provide disclosures about a change in accounting principle in the period they adopt the final standard.

Simplifying the Balance Sheet Classification of Debt

Background

In January 2017, the FASB issued a [proposed ASU](#) that would simplify the classification of debt as either current or noncurrent on the balance sheet. The guidance currently in ASC 470-10 consists of an assortment of fact-specific rules and exceptions, the application of which varies according to the terms and conditions of the debt arrangement, management's expectations of when debt may be settled or refinanced, and certain post-balance-sheet events. The objective of the proposed ASU is to reduce the cost and complexity of applying this guidance while maintaining or improving the usefulness of the information provided to financial statement users.

Principles-Based Approach

The FASB's proposed approach would replace the current, fact-specific guidance with a unified principle for determining the classification of a debt arrangement in a classified balance sheet as either current or noncurrent. Specifically, an entity would classify a debt arrangement as noncurrent if *either* of the following criteria is met as of the financial reporting date:⁵

- "The liability is contractually due to be settled more than one year (or operating cycle, if longer) after the balance sheet date."
- "The entity has a contractual right to defer settlement of the liability for at least one year (or operating cycle, if longer) after the balance sheet date."

⁵ Quoted text is from the FASB's [summary](#) of tentative Board decisions reached at its January 28, 2015, meeting.

As an exception to this classification principle, debt that is due to be settled within 12 months as a result of a covenant violation as of the balance sheet date would be classified as noncurrent if the debtor receives a waiver that meets certain conditions after the balance sheet date (see [Covenant Violations](#) below).

Scope

The FASB has proposed to clarify that the balance sheet classification guidance in ASC 470-10 applies not only to nonconvertible debt arrangements but also to convertible debt and to mandatorily redeemable financial instruments that are classified as liabilities under ASC 480-10.

Short-Term Obligations Expected to Be Refinanced on a Long-Term Basis

Under current guidance, entities that have the intent and ability to refinance a short-term obligation on a long-term basis *after* the financial reporting date — as evidenced by the post-balance-sheet-date issuance of a long-term obligation, equity securities, or a qualifying refinancing agreement — are required to present the obligation as a noncurrent liability as of the financial reporting date. The proposed approach, however, would require such short-term obligations to be classified within current liabilities because the refinancing of debt after the financial reporting date would be viewed as a new transaction that should not be retroactively reflected in the balance sheet as of that date.

Subjective Acceleration Clauses and Debt Covenants

Under existing GAAP, the classification of long-term obligations depends in part on whether they are governed by subjective acceleration clauses (SACs) for which exercise is probable (e.g., because of recurring losses or liquidity problems). Under the Board's proposed approach, however, SACs and covenants within long-term obligations would affect the classification of long-term obligations only when triggered or violated, in which case certain disclosures would be required.



Thinking It Through

Under the Board's proposed approach, some liabilities that are now classified as noncurrent would be classified as current, and vice versa. For example, as a result of the proposed change to the treatment of the refinancing of short-term obligations, an entity would not be allowed to consider refinancing events after the financial reporting date but before the financial statements were issued. Thus, such debt obligations would be classified as current liabilities as of the financial reporting date. Entities should consider the timing of refinancing plans and the potential effect on the classification of short-term obligations.

Covenant Violations

Under current guidance, if the creditor can demand the repayment of a long-term obligation as of the financial reporting date because of the debtor's violation of a debt covenant, the corresponding debt obligation is classified as noncurrent if the debtor obtains a covenant waiver *before* the date the financial statements are issued and certain other conditions are met. While the Board's proposed approach would retain similar guidance, it would classify such debt as current if the waiver results in the debt's being accounted for as having been extinguished. Because debt extinguishment accounting treats the debt as a newly issued instrument, the original debt obligation, as of the balance sheet date, should be classified within current liabilities since the debtor could demand repayment as of that date.

In addition, under the proposed approach entities would continue to be required to assess whether a violation of any other covenant not covered by the waiver is probable within 12 months from the reporting date. If so, the related debt would be required to be classified as current.

Presentation and Disclosure

Under the Board's proposed approach, debt that is classified as noncurrent in accordance with the exception for debt covenant waivers would be presented separately in the balance sheet. Further, as previously noted, the proposed approach would require entities to disclose certain information about debt covenants and SACs upon violation or trigger.

Effective Date and Transition

The Board will determine an effective date for the guidance after it considers feedback on the proposed ASU. Once finalized, the proposed approach will be applicable on a prospective basis to debt that exists as of the effective date. Early adoption will be permitted.

Next Steps

Comments on the proposed ASU are due by May 5, 2017.

Accounting for Partial Sales of Nonfinancial Assets

Background

In June 2016, the FASB issued a [proposed ASU](#) that would clarify the scope of the Board's recently established guidance on nonfinancial asset derecognition (ASC 610-20) as well as the accounting for partial sales of nonfinancial assets. The proposed guidance is in response to stakeholder feedback indicating that (1) the meaning of the term "in-substance nonfinancial asset" is unclear because the Board's new revenue standard does not define it and (2) the scope of the guidance on nonfinancial assets is complex and does not specify how a partial sales transaction should be accounted for or which model entities should apply. The proposed ASU would conform the derecognition guidance on nonfinancial assets with the model for revenue transactions in ASC 606. Comments on the proposed guidance were due on August 5, 2016, and the FASB is analyzing the comment letters received.

The proposed ASU would require entities to apply the guidance in ASC 610-20 to the derecognition of all nonfinancial assets and in-substance nonfinancial assets. While the concept of in-substance assets resided in ASC 360-20, this guidance would not have applied to transactions outside of real estate. The FASB is therefore proposing to add to the ASC master glossary the following definition of an in-substance nonfinancial asset:

An asset of a reporting entity that is included in either of the following:

- a. A contract in which substantially all the fair value of the assets (recognized and unrecognized) promised to a counterparty is concentrated in nonfinancial assets
- b. A consolidated subsidiary in which substantially all the fair value of the assets (recognized and unrecognized) in the subsidiary is concentrated in nonfinancial assets.

An in substance nonfinancial asset does not include:

- a. A group of assets or a subsidiary that is a business or nonprofit activity
- b. An investment of a reporting entity that is being accounted for within the scope of Topic 320 on investments — debt securities, Topic 321 on investments — equity securities, Topic 323 on investments — equity method and joint ventures, or Topic 325 on other investments regardless of whether the assets underlying the investment would be considered in substance nonfinancial assets.



Thinking It Through

The clarification that a business or nonprofit activity would not be considered an in-substance nonfinancial asset is based on another [proposed ASU](#) that would clarify and narrow the definition of a business and most likely reduce the number of real estate transactions that would be considered businesses.

Further, such transactions are likely to include significant financial assets, such as investments, cash, and premiums receivable, and therefore would not be within the scope of the nonfinancial assets derecognition guidance in ASC 610-20.

Effective Date and Transition

The effective date of the new guidance and the transition methods would be aligned with the requirements in the new revenue standard as amended by [ASU 2015-14](#), which delays the effective date of the new revenue standard by one year and permits early adoption on a limited basis. However, an entity would be permitted to use a transition approach to adopt ASC 610-20 that is different from the one it uses to adopt ASC 606 (e.g., the entity may use the modified retrospective approach to adopt ASC 610-20 and the full retrospective approach to adopt ASC 606). If different methods are used, an entity would need to provide the transition-method disclosures required by ASC 606 and indicate the method it used to adopt ASC 610-20.

For additional information, see Deloitte's June 14, 2016, [Heads Up](#).

Stock-Based Compensation and Employee Benefits

Nonemployee Share-Based Payment Accounting Improvements

Background

In December 2015, the FASB decided to add to its agenda a project on improving the accounting for nonemployee share-based payment arrangements. When the Board previously deliberated its initial share-based payment simplification project, it decided that potential improvements to the nonemployee model could involve broader changes and take longer to complete than other simplification projects. As a result, the Board concluded that reconsideration of the accounting for nonemployee share-based payments should be moved to a separate project.

Tentative Decisions

In May 2016, the FASB tentatively decided to expand the scope of ASC 718 to include all share-based payment arrangements related to acquiring both goods and services from nonemployees. The Board's tentative decision would require an entity to apply the classification and measurement guidance in ASC 718 to nonemployee share-based payments. For example, the expected term should be used to measure the fair value of stock options or similar instruments granted to nonemployees. In addition, a nonpublic entity would be permitted to use certain practical expedients, including the use of (1) calculated value to measure certain nonemployee awards and (2) intrinsic value to measure liability-classified nonemployee awards. Further, nonemployee share-based payments initially within the scope of ASC 718 would remain within the scope of that guidance for classification and measurement purposes (even after the nonemployee awards have vested) unless the awards are modified after performance is complete.

However, the FASB tentatively decided that attribution of any cost associated with nonemployee share-based payments would continue to be accounted for under other applicable accounting literature as though the issuer had paid cash for the goods or services.



Thinking It Through

Nonemployee share-based payments issued for goods and services are accounted for under ASC 505-50. The guidance in ASC 505-50 differs significantly from ASC 718, including the (1) determination of the measurement date, (2) accounting for performance conditions, (3) ability to use nonpublic entity practical expedients, and (4) classification of awards after vesting. The tentative decisions of this project would align such guidance.

Transition

The Board tentatively decided that a modified retrospective transition approach, with a cumulative-effect adjustment to retained earnings, would generally be required for outstanding nonemployee awards at the time of adoption. However, in allowing nonpublic companies to use calculated values to measure certain nonemployee awards, the Board tentatively decided that a prospective approach should be used for all nonemployee awards that are measured at fair value after the date of adoption.

Disclosures

With the exception of disclosures specifying the income statement effects of the change in principle in the year of adoption (or interim periods therein), the Board tentatively decided that an entity should apply the disclosure requirements in ASC 250 related to a change in accounting principle.

Finally, the Board tentatively decided that the disclosure requirements for nonemployee awards should be aligned with those in ASC 718 and that these requirements did not need to be modified.

Next Steps

The FASB staff is soliciting feedback on a draft of the proposed ASU.

Employee Benefit Plan Master Trust Reporting (EITF 16-B)

Many employee benefit plans hold investments in master trusts, in which a regulated financial institution serves as the trustee or custodian of the plan's assets as well as assets of other plans of the same employer or group of employers under common control. Because defined contribution pension plans with interests in master trusts are becoming more common, additional presentation and disclosure guidance on such trusts is needed.

In July 2016, the FASB issued a [proposed ASU](#) that seeks to improve the presentation and disclosure guidance for employee benefit plans that have investments held in master trusts. The proposed ASU addresses the following subissues related to employee benefit plan master trust reporting:

- *Presentation of master trust balances and activity on the face of the plan's financial statement* — When an employee benefit plan has investments in a master trust, the plan must disclose the balances and activity of its interest in the master trust on the face of the financial statements as well as in the footnotes. However, presentation guidance is not consistently provided within U.S. GAAP and has led to some diversity in practice in presentation of the master trust balances and activity within both the statement of net assets available for benefits and the statement of changes in net assets. To eliminate this diversity, the proposed ASU requires that a plan present

its total interest in master trust balances and related changes in such balances as one single line item in both the statement of net assets available for benefits and the statement of charges in net assets.

- *Disclosure for plans with divided interests* — The proposed ASU requires that plans with divided interests in master trusts disclose both a list of master trust investment balances by general types of investments and the dollar amount of the individual plan's interest in each of those types of investments.
- *Disclosure of investment-related accruals* — The proposed ASU requires a plan to disclose both the investment-related other asset and liability balances for the master trust and the dollar amount of the individual plan's interest in such balances.
- *Section 401(h) account investment disclosures* — A 401(h) plan is a postretirement benefit plan that may have assets funded through the entity's defined benefit pension plan assets. The proposed ASU removes the required disclosures for Section 401(h) account assets in a health and welfare plan and instead requires the health and welfare plan to provide the name of the defined benefit pension plan with which the account asset disclosures are associated.
- *Consistency among ASC topics* — Under current U.S. GAAP, benefit plan guidance is located in ASC 960, ASC 962, and ASC 965, which contain (with the exception of ASC 965) certain guidance on master trusts. The proposed ASU aligns the guidance in these ASC topics when applicable.

The amendments in the proposed ASU would be applied retrospectively to all periods presented. Further, 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 were due by September 26, 2016.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In January 2016, the FASB issued a [proposed ASU](#) on the presentation of net periodic benefit cost as part of the Board's 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.

The FASB received more than 35 comment letters (which were due by April 25, 2016) on the proposal from various respondents, including preparers, users, professional and trade organizations, and accounting firms. At its meeting on August 24, 2016, the FASB discussed a summary of the comments received and directed its staff to perform research on particular aspects of the proposed ASU. For additional information about the proposed ASU, see Deloitte's January 28, 2016, [Heads Up](#).

Disclosures by Business Entities About Government Assistance

Background and Key Provisions of the Proposed Guidance

In November 2015, the FASB issued for public comment a [proposed ASU](#) to increase transparency in financial reporting by requiring specific disclosures about government assistance received by businesses. Government assistance arrangements are legally enforceable agreements under which the government provides value to the entity (e.g., grants, loan guarantees, tax incentives). The objective of the proposed disclosure requirements is to enable financial statement users to better assess (1) the nature of the government assistance, (2) the accounting policies for the government assistance, (3) the impact of the government assistance on the financial statements, and (4) the significant terms and conditions of the government assistance arrangements.

There is no explicit guidance in current U.S. GAAP on the recognition, measurement, and disclosure of government assistance received by business entities. As a result, there is diversity in practice related to how business entities account for, and disclose information about, government assistance arrangements.

The proposed ASU would require business entities to disclose the following information about government assistance arrangements in their annual financial statements:

1. Information about the nature of the assistance, including a general description of the significant categories and the related accounting policies adopted or the method applied to account for government assistance
2. Which line items on the balance sheet and income statement are affected by government assistance and the amounts applicable to each line item
3. Significant terms and conditions of the agreement, including commitments and contingencies
4. Unless impracticable, the amount of government assistance received but not recognized directly in the financial statements. The amount of government assistance received but not recognized includes value that was received by an entity for which no amount has been recorded directly in any financial statement line item (for example, a benefit of a loan guarantee, a benefit of a below-market rate loan, or a benefit from tax or other expenses that have been abated).

Such disclosures would provide financial statement users with information about the effect of government assistance on an entity's financial results and prospects for future cash flows. In addition, the disclosures would help users better assess the nature of the assistance.

The proposed amendments would apply to entities (other than not-for-profit entities within the scope of ASC 958, employee benefit plans, and entities that have entered into government assistance agreements within the scope of ASC 740) that have entered into a "legally enforceable agreement with a government to receive value." However, such provisions would not apply to transactions in which the government is (1) "legally required to provide a nondiscretionary level of assistance to an entity simply because the entity meets applicable eligibility requirements that are broadly available without specific agreement between the entity and the government" or (2) "solely a customer" of the entity.

Effective Date and Transition

The FASB plans to determine an effective date for the final guidance after considering stakeholder feedback on the proposed ASU. To apply the guidance, entities would use a prospective approach; however, retrospective application would be allowed.

Redeliberations and Next Steps

Since the conclusion of the comment letter period on February 10, 2016, the FASB has held redeliberation sessions to discuss comments received from constituents. The tentative decisions reached as a result of the Board's redeliberations at its meeting on June 8, 2016, are reflected above.

The Board will continue to conduct additional redeliberations at future meetings before issuing a final ASU.

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 "FASB's decision process" and the "entity's decision process" for evaluating disclosure requirements.

FASB's Decision Process

Overview

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.

In February 2015, the Board tentatively decided that the disclosure section of each Codification subtopic (1) would state that an entity should apply materiality as described in the proposed amendments to ASC 235 in complying with the disclosure requirements and (2) would not contain language that precludes an entity from exercising discretion in determining what disclosures are necessary (e.g., "shall at a minimum provide").

In September 2015, in response to feedback from outreach activities and to maintain consistency with both current practice and the FASB's [proposed ASU](#) on the omission of immaterial disclosures (see [Entity's Decision Process](#) below for discussion of the proposed ASU), the Board issued a [proposal](#) to modify the definition of materiality in Concepts Statement 8. The proposal would replace the original discussion of materiality in Concepts Statement 8 with the U.S. Supreme Court's definition. See Deloitte's September 28, 2015, [Heads Up](#) for additional information.

Comments on the proposed changes to Concepts Statement 8 have been provided to the FASB.

Entity's Decision Process

As discussed above, the FASB issued a [proposed ASU](#) in September 2015 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 have been provided to the FASB.

Next Steps

The FASB will continue deliberating concerns raised in comment letters and will review feedback received as a result of its outreach activities, which include testing the Board's and entity's decision processes against various Codification topics. A final concepts statement is expected to be issued after the outreach process is complete.

Topic-Specific Disclosure Reviews

In addition to proposing amendments to guidance, the FASB is analyzing ways to "further promote [entities'] appropriate use of discretion"⁶ in determining proper financial statement disclosures. The Board is applying the concepts in both the entity's and the Board's decision processes in considering topic-specific modifications. 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).

Proposed changes to the disclosure requirements 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.

⁶ Quoted from "[What You Need to Know About Disclosure Framework](#)" on the FASB's Web site.

In addition, the proposed ASU would make changes (eliminations, modifications, and additions) to the fair value disclosure requirements in ASC 820, as discussed below.

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 disclosure requirements for Level 3 fair value measurements would be amended as follows:

- *Valuation process* — The proposed ASU would 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 has proposed 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* — The proposed ASU would 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, it would 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* — The proposed ASU would 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. A private company would be exempt from such a disclosure requirement.

- *Level 3 rollforward* — The proposed ASU would retain the Level 3 rollforward requirement for entities that are not private companies. For entities that are private companies, the proposed ASU would modify the Level 3 rollforward requirement and remove the requirement to disclose the change in unrealized appreciation or depreciation 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 (and issues) 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 (or issues) of Level 3 investments in a sentence rather than in a full rollforward as required today.



Thinking It Through

In its outreach on the Level 3 rollforward, the Board 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.

Net Asset Value 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.”

If the timing is unknown, the entity would be required to disclose that fact.



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 net asset value practical expedient.

New Disclosure Requirements — Unrealized Gains and Losses

Entities that are not private companies 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 required only for the Level 3 amounts within net income under ASC 820-10-50-2(c) and (d). This requirement would not apply to private companies 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 guidance.

Comments on the proposed ASU were due by February 29, 2016, and were discussed at the FASB's meeting on June 1, 2016, at which it was decided that additional outreach would be conducted with investors and other financial statement users.

Income Taxes

Background

In July 2016, the FASB issued a [proposed ASU](#) that would modify or eliminate certain disclosure requirements related to income taxes as well as establish new requirements. The proposed ASU is the result of the application of the Board's March 2014 proposed concepts statement to disclosures about income taxes. Comments on the proposed ASU were due by September 30, 2016.

Key Provisions of the Proposed ASU

Scope

Although many of the amendments would apply to all entities that are subject to income taxes, certain amendments would apply only to public business entities.

As part of the proposal, the FASB decided that it would also replace the term "public entity," as defined in the glossary in ASC 740-10, with "public business entity," as defined in the ASC master glossary. The definition of a public business entity includes certain types of entities that the definition of a public entity under ASC 740 does not include. Thus, the disclosure requirements in ASC 740 that currently apply only to public entities would apply to other entities as well.

Indefinitely Reinvested Foreign Earnings

The proposed ASU would require all entities to explain any change to an indefinite reinvestment assertion made during the year, including the circumstances that caused such change in assertion. All entities would also be required to disclose the amount of earnings for which there was a change in assertion made during the year. In addition, all entities would be required to disclose the aggregate of cash, cash equivalents, and marketable securities held by their foreign subsidiaries.

Such information is intended to give financial statement users information that will help them predict the likelihood of future repatriations and the associated income tax consequences related to foreign indefinitely reinvested earnings.

Unrecognized Tax Benefits

The proposed ASU would modify the disclosure requirements for a public business entity related to unrecognized tax benefits. It would also add a requirement for entities to disclose, in the tabular reconciliation of the total amount of unrecognized tax benefits required by ASC 740-10-50-15A(a), settlements disaggregated by those that have been (or will be) settled in cash and those that have been (or will be) settled by using existing DTAs (e.g., settlement by using existing net operating loss or tax credit carryforwards).

A public business entity would also be required to provide a breakdown (i.e., a mapping) of the amount of total unrecognized tax benefits shown in the tabular reconciliation by the respective balance-sheet lines in which such unrecognized tax benefits are recorded. If an unrecognized tax benefit is not

included in a balance-sheet line, such amount would be disclosed separately. In addition, a public business entity would be required to disclose the total amount of unrecognized tax benefits that are offset against existing DTAs for net operating loss and tax credit carryforwards.

Under the guidance currently in ASC 740-10-50-15(d), all entities must disclose details of tax 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. The proposed ASU would eliminate this disclosure requirement.

Further, the proposed ASU would amend the example in ASC 740-10-55-217 to illustrate the applicability of the proposed disclosure requirements related to unrecognized tax benefits.

Operating Loss and Tax Credit Carryforwards

Currently, entities are required to disclose the amount and expiration dates of operating losses and tax credit carryforwards for tax purposes. Historically, there has been diversity in practice related to this disclosure requirement. The proposed ASU would reduce this diversity by requiring a public business entity to disclose the total amount of:

- Federal, state, and foreign gross net operating loss and tax credit carryforwards (i.e., not tax effected) by period of expiration for each of the first five years after the reporting date and a total for any remaining years.
- Federal, state, and foreign DTAs related to net operating loss and tax credit carryforwards (i.e., tax effected) before any valuation allowance.



Thinking It Through

Generally, an entity should measure a DTA in accordance with the recognition and measurement criteria in ASC 740. While the proposed ASU uses the term “deferred tax asset,” it is unclear whether that term as used in the proposal refers to a DTA measured under the ASC 740 criteria or simply the tax-effected amount of the net operating loss and tax credit carryforwards as reflected on the income tax returns as filed.

As discussed previously, a public business entity would also be required to disclose the total amount of unrecognized tax benefits that are offset against existing DTAs for net operating loss and tax credit carryforwards.

In addition, the proposed ASU would modify the disclosure requirement related to net operating loss and tax credit carryforwards for entities other than public business entities. An entity other than a public business entity would be required to disclose the total gross amounts of federal, state, and foreign net operating loss and tax credit carryforwards (i.e., not tax effected) along with their expiration dates. The example in ASC 740-10-55-218 through 55-222 (as amended) would illustrate the applicability of these disclosure requirements.

Rate Reconciliation

ASC 740-10-50-12 currently requires a public business entity to disclose a reconciliation of the reported amount of income tax expense (or benefit) from continuing operations to the amount of income tax expense (or benefit) that would result from multiplying the pretax income (or loss) from continuing operations by the domestic federal statutory tax rate. The proposed ASU would amend the requirement for a public business entity to disclose the income tax rate reconciliation in a manner consistent with SEC Regulation S-X, Rule 4-08(h).

As amended, ASC 740-10-50-12 would continue to require a public business entity to disclose a reconciliation of the reported amount of income tax expense (or benefit) from continuing operations to the amount of income tax expense (or benefit) that would result from multiplying the pretax income (or loss) from continuing operations by the domestic federal statutory tax rate. However, the amendment would modify the requirement to disaggregate and separately present components in the rate reconciliation that are greater than or equal to 5 percent of the tax at the statutory rate in a manner consistent with the requirement in Rule 4-08(h).

Government Assistance

As a result of deliberations on its November 2015 [proposed ASU](#) on government assistance, the FASB decided to require an entity to disclose certain information related to assistance received from a governmental unit that reduces the entity's income taxes. Accordingly, the proposed ASU on income tax disclosures would require all entities that receive income tax-related government assistance to disclose a "description of a legally enforceable agreement with a government, including the duration of the agreement and the commitments made with the government under that agreement and the amount of benefit that reduces, or may reduce, its income tax burden." This disclosure requirement would apply only when the government determined whether, under such agreement, the entity would receive assistance and, if so, how much it would receive even if it met the applicable eligibility requirements. In the absence of a specific agreement between the entity and the government, the entity would not be required to disclose this information if the entity obtained the government assistance because it met eligibility requirements that apply to all taxpayers.

Other Income Tax Disclosure Requirements

The proposed ASU would require all entities to disclose the following:

- The amount of pretax income (or loss) from continuing operations disaggregated by foreign and domestic amounts.
- The amount of income tax expense (or benefit) from continuing operations disaggregated by foreign and domestic amounts.
- The amount of income taxes paid disaggregated by foreign and domestic amounts. A further disaggregation would be required for any country that is significant to the total amount of income taxes paid.
- An enacted tax law change if it is probable that such change would have an effect on the entity in the future.

In the determination of pretax income (or loss), foreign income tax expense (or benefit), or foreign income taxes paid, "foreign" refers to any country outside the reporting entity's home country.

In addition, the proposal would require public business entities to explain any valuation allowance recognized or released during the year along with the corresponding amount.

The proposed ASU is also aligned with the guidance in the [proposed ASU](#) on assessing the materiality of disclosures, which allows an entity to consider materiality when assessing income tax disclosure requirements.

Transition Guidance and Effective Date

The proposed ASU's amendments would be applied prospectively. The FASB will determine an effective date for the final guidance after it has considered feedback from stakeholders.

Defined Benefit Plans

In January 2016, the FASB issued a [proposed ASU](#) that would modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The proposed ASU contains an overall objective for the disclosures and guidance on how an entity would consider materiality in determining the extent of its defined benefit plan disclosures. The proposed ASU would add to or remove from ASC 715 a number of disclosure requirements related to an entity's defined benefit pension and other postretirement plans. The Board believes that additional costs incurred by entities as a result of implementing the proposed new disclosure requirements would be offset by cost reductions associated with the elimination of other disclosure requirements as well as the omission of immaterial disclosures.

The amendments in the proposed ASU would be applied retrospectively to all periods presented, except for those related to disclosures about plan assets that entities measure by using the net asset value practical expedient. Such changes would be applied beginning with the initial period of adoption.

The FASB received more than 30 comment letters (which were due by April 25, 2016) on the proposal from various respondents, including preparers, professional and trade organizations, and accounting firms. At its meeting on July 13, 2016, the FASB discussed a summary of the comments received and directed its staff to perform research on particular aspects of the proposed ASU. For additional information about the proposed ASU, see Deloitte's January 28, 2016, [Heads Up](#).

Other Topics

Statutory Developments (NAIC)

Revised Measurement Guidance in SSAP 41 on Surplus Notes

In April 2016, the NAIC adopted revisions to SSAP 41 that replace the formulaic approach of valuing nonrated surplus notes with a valuation approach based on rating. The new valuation approach requires surplus notes rated by an NAIC credit-rating provider with a designation of NAIC 1 or NAIC 2 to be measured and reported at amortized cost. The revisions also require nonrated surplus notes and surplus notes with a designation of NAIC 3 through NAIC 6 to be measured and reported at the lower of amortized cost or fair value. In addition, the revisions clarify that changes in value are reported as unrealized valuation changes in surplus. The NAIC also adopted a related issue paper that documents the analysis for the adopted changes. The revisions became effective on January 1, 2017.

Revisions in SSAP 51 Related to Principle-Based Reserving

In June 2016, the NAIC adopted a revision to SSAP 51 that adds references to the Valuation Manual guidance on principle-based reserving (PBR). Further, in August 2016, the NAIC adopted revisions to SSAP 51 that provide guidance on accounting for the change in valuation of reserves when PBR is implemented. The current requirements for setting reserves are based on formulas and assumptions prescribed by state regulation. Under PBR, the total reserve will be based on the greater of (1) the reserve as determined by using prescribed factors or (2) the reserve that takes into consideration a wide range of future economic conditions on the basis of company experience. The Valuation Manual established in the Standard Valuation Law adopted by the state will be used to detail the reserve calculation requirements.

Specifically, the revised guidance provides for the following:

- *Reporting* — Continue current reporting of the impact of a change in valuation basis in surplus in the change in valuation basis annual statement line.
- *Items included as a change in valuation basis* — Items that represent changes in method or voluntary choices in the application of the method.
- *Items excluded from a change in valuation basis* — Updates to reserving assumptions based on experience as required under the existing method are not proposed to be reflected as a change in valuation basis. For example, a change from any of the three calculated reserves types (net premium reserve, deterministic, or stochastic) to another as required by the PBR method would not be considered a change in valuation basis.
- *Transition guidance* — Explicit guidance on the initial adoption and application of PBR is proposed to assist with implementation questions. The Valuation Manual requires prospective application for policies issued on or after the operative date (January 1, 2017). Therefore, the change in valuation basis is not expected to result in a day-one impact on surplus.

Adoption of Revisions to Guidance in SSAP 103 and SSAP 86 on Short-Sale Transactions

In June 2016, the NAIC adopted revisions to the accounting and reporting guidance in SSAP 103 and SSAP 86 on short-sale transactions. Generally, a short sale of stock occurs when an investor sells a stock that is not owned at the time of the sale. Short-sale transactions are usually accompanied by a secured-borrowing transaction to settle the sale. Investors typically enter into short-sale transactions when it is believed that the price of the stock will fall. The adopted revisions require entities to account for the proceeds as an asset and to account for the obligation to deliver securities sold short as a contra asset. In addition, changes in value should be recognized as unrealized gain or loss until settlement, and interest should be recognized as interest expense. The revisions are to be applied prospectively beginning January 1, 2017.

Changes to Requirements for Asset Recognition Criteria Related to the Recording of a Guaranty Fund Assessment Obligation

In December 2016, the NAIC adopted revisions to SSAP 35 that allow an entity to consider expected renewals of short-term contracts in determining the assets recognized from accrued guaranty fund liability assessments. Health insurers that write short-duration contracts but may be assessed for long-term care insolvencies are affected by the changes. The previous guidance was adopted from U.S. GAAP and required that in determining the retrospective premium for long-duration contracts, an entity would recognize an asset if it was probable that an accrued liability assessment would result in a recoverable amount. In addition, the entity would exclude consideration of renewals for short-term contracts. Under the revised guidance, entities will consider expected renewals of in-force short-term contracts in determining the assets recognized (premium tax credits) from accrued guaranty fund liability assessments on long-duration contracts (e.g., long-term care). Accordingly, there will be differences between U.S. GAAP and statutory accounting upon the effective date of the new guidance. Regulators will separately consider the discounting of guaranty fund reserves in the future. The revisions became effective on January 1, 2017.

PBR for Accident and Health Products

In December 2016, the NAIC adopted revisions to SSAP 54 to add references to the Valuation Manual guidance on health reserving requirements. The first phase of PBR implementation for health products does not change health reserving requirements. The revisions also update the change in valuation-basis guidance to allow insurers to use an entity's own experience as reflected in the actuarial guidelines. The revisions became effective on January 1, 2017.

Measurement and Reporting Revisions for Money Market Mutual Funds

In December 2016, the NAIC adopted revisions to SSAP 2 that will change the classification of investments in money market mutual funds from short-term investments to cash equivalents. In addition, it adopted revisions that prescribe measurement that is more appropriate for an investment classified as a cash equivalent. Under the changes, money market mutual funds will be measured at fair value and may use a reported net asset value as a practical expedient. Changes in value will be reported as unrealized gains and losses for insurers that are required to maintain an asset valuation reserve. For other insurers, changes in value will be reported as a direct credit or charge to surplus. Although industry stakeholders requested an earlier effective date for the changes, the earliest that insurers can apply them is December 31, 2017.

SEC Update

Background

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

Non-GAAP Measures

Press coverage and SEC scrutiny of non-GAAP measures have resulted from the SEC's concerns about (1) the increased use and prominence of such measures, (2) their potential to be misleading, and (3) the progressively larger difference between the amounts reported for them and for GAAP measures. In a [speech](#) on June 27, 2016, SEC Chair Mary Jo White reiterated the SEC's concerns about practices that can result in misleading non-GAAP disclosures. She exhorted companies "to carefully consider [SEC guidance on this topic] and revisit their approach to non-GAAP disclosures." She also urged "that appropriate controls be considered and that audit committees carefully oversee their company's use of non-GAAP measures and disclosures."

In May 2016, the SEC staff issued new and updated [Compliance and Disclosure Interpretations \(C&DIs\)](#) that clarify the SEC's guidance on non-GAAP measures. The updated guidance was intended to change certain practices about which the SEC has expressed concern. In remarks after the issuance of the C&DIs, the SEC staff strongly encouraged registrants to "self-correct" before the staff considers any further rulemaking or enforcement action related to non-GAAP measures.

For more information, see Deloitte's [A Roadmap to Non-GAAP Financial Measures](#).



Thinking It Through

For the 12 months ended July 31, 2016, non-GAAP measures ranked second in the top-ten list of topics frequently commented on by the SEC's Division of Corporation Finance (the "Division") as part of its filing review process, moving up from fourth place for the comparable prior year. Over the next year, we expect the number of SEC comments to continue to remain high and even increase until the guidance in the updated C&DIs has been fully incorporated into practice. The SEC staff's most recent comment letters have particularly focused on the use and prominence of non-GAAP measures in press releases. Comments on press releases and filed documents have also centered on disclosures, including reconciliation requirements and the purpose and use of such measures. In addition, we expect to see more comments about the use of misleading measures, including measures that use individually tailored accounting principles, and the tax effect of non-GAAP adjustments. For more information about SEC comment letter trends, see Deloitte's [SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us](#) and the [2016 supplement](#).

SEC Adopts Rules to Modernize Information Reported by Funds, Require Liquidity Risk Management Programs, and Permit Swing Pricing

In October 2016, the SEC voted to adopt changes to modernize and enhance the reporting and disclosure of information by registered investment companies and to enhance liquidity risk management by open-end funds, including mutual funds and exchange traded funds. The new rules will enhance the quality of information available to investors and will allow the SEC to more effectively collect and use data reported by funds. The rules will also promote effective liquidity risk management across the open-end-fund industry and will enhance disclosure regarding fund liquidity and redemption practices. The new rules permit the use of “swing pricing” by certain open-end management investment companies.

The changes are part of the Commission’s initiative to enhance its monitoring and regulation of the asset management industry.

For more information, see the [press release](#) on the SEC’s Web site.

SEC Issues Rules for Securities Clearing Agencies

In September 2016, the SEC issued a [final rule](#) and a [proposed rule](#) related to covered clearing agencies.

The final rule establishes “enhanced standards for the operation and governance” of covered clearing agencies. The final rule’s scope includes “SEC-registered securities clearing agencies that have been designated as systemically important by the Financial Stability Oversight Council . . . or that are involved in more complex transactions.” Such clearing agencies “will be subject to new requirements regarding, among other things, their financial risk management, governance, recovery planning, operations, and disclosures to market participants and the public.”

Under the proposed rule, a covered clearing agency would be defined as “any registered clearing agency that provides the services of a central counterparty, central securities depository, or a securities settlement system.” The proposal would also define various terms related to covered clearing agencies.

For more information, see the [press release](#) on the SEC’s Web site.

SEC Reminds Registrants of Best Practices for Implementing New Revenue, Lease, and Credit Loss Accounting Standards

In recent speeches, the SEC staff has reminded registrants about best practices to follow in the periods leading up to the adoption of ASU 2014-09 (on revenue), ASU 2016-02 (on leases), and ASU 2016-13 (on credit losses). The staff’s comments, which reiterated themes the Commission has addressed over the past year, focused on internal control over financial reporting (ICFR), auditor independence, and disclosures related to implementation activities.

For more information, see Deloitte’s September 2016 [Financial Reporting Alert](#).

SEC Proposes to Shorten Standard Settlement Cycle for Broker-Dealer Securities Transactions

In September 2016, the SEC issued a [proposed rule](#) that would “shorten the standard settlement cycle for most broker-dealer transactions from three business days after the trade date (‘T+3’) to two business days after the trade date (‘T+2’).” The purpose of the proposed amendments is “to reduce a number of risks, including credit risk, market risk, and liquidity risk and, as a result, reduce systemic risk for U.S. market participants.”

For more information, see the [press release](#) on the SEC’s Web site.

SEC Publishes Final Rule on Cross-Border Security-Based Swaps

In February 2016, the SEC issued a [final rule](#) related to cross-border security-based swaps (SBSs). Under the final rule, which is being issued in response to a mandate of the Dodd-Frank Act, “a non-U.S. company that uses personnel located in a U.S. branch or office to arrange, negotiate, or execute a security-based swap transaction in connection with its dealing activity [must] include that transaction in determining whether it is required to register as a security-based swap dealer.”

For more information, see the [press release](#) on the SEC’s Web site.

SEC Issues Final Rule to Establish Trade Acknowledgment and Verification Requirements for SBS Transactions

In June 2016, the SEC issued a [final rule](#) to establish trade acknowledgment and verification requirements for SBS transactions. Under the final rule, which is being issued in response to a mandate of the Dodd-Frank Act, an SBS entity that enters into an SBS transaction is required to do the following:

- “Provide a trade acknowledgment electronically to its transaction counterparty promptly, and no later than the end of the first business day following the day of execution.”
- “Promptly verify or dispute with its counterparty the terms of a trade acknowledgment it receives.”
- “Have written policies and procedures in place that are reasonably designed to obtain verification of the terms outlined in any trade acknowledgment that it provides.”

In addition, certain broker-dealers that are SBS entities will be exempt from the requirements in Exchange Act Rule 10b-10 if they meet the requirements of the final rule. The final rule became effective on August 16, 2016.

For more information, the [press release](#) on the SEC’s Web site.

SEC Issues Final Rule on Regulation SBSR

In July 2016, the SEC issued a [final rule](#) that amends Regulation SBSR on the reporting and dissemination of SBS information. The purpose of the final rule, which implements requirements in Title VII of the Dodd-Frank Act, is to “increase transparency in the security-based swap market.” The final rule became effective on October 11, 2016.

For more information, see the [press release](#) on the SEC’s Web site.

SEC Issues Final Rule Granting Regulatory Access to Data Held by SBS Data Repositories

In August 2016, the SEC issued a [final rule](#) that amends Rule 13n-4 of the Exchange Act to give certain regulators and other authorities access to SBS data repositories. Specifically, the final rule:

- Requires “either a memorandum of understanding or other arrangement between the Commission and the recipient of the data to address the confidentiality of the security-based swap data provided to the recipient.”
- Identifies “the five prudential regulators named in the statute, as well as the Federal Reserve banks and the Office of Financial Research, as being eligible to access data.”
- Addresses “factors that the Commission may consider in determining whether to permit other entities to access data.”

For more information, see the [press release](#) on the SEC’s Web site.

SEC Issues Proposed and Final Rules Related to Investment Advisers

In June 2016, the SEC issued a [proposed rule](#) that would require “SEC-registered investment advisers to adopt and implement written business continuity and transition plans reasonably designed to address operational and other risks related to a significant disruption in the investment adviser’s operations.” Further, such advisers would need to “make and keep all business continuity and transition plans that are currently in effect or at any time within the past five years were in effect.”

In August 2016, the SEC issued a [final rule](#) (effective October 31, 2016) to improve the reporting and disclosure requirements for investment advisers. Specifically, the final rule amends:

- Form ADV to (1) require investment advisers to disclose additional information (e.g., about their “separately managed account business”), (2) include an approach under which “private fund adviser entities operating a single advisory business” can use a single Form ADV to register, and (3) make certain technical corrections to “Form ADV items and instructions.”
- Investment Advisers Act rules to (1) require advisers to maintain additional records of performance-related calculations and communications and (2) “remove transition provisions that are no longer necessary.”

Advisers will need to begin complying with the amendments on October 1, 2017.

For more information on the [proposed rule](#) and [final rule](#), see the respective press releases on the SEC’s Web site.

SEC Requests Comments on Regulation S-K

In April 2016, the SEC issued a [concept release](#) that seeks feedback from constituents on modernizing certain business and financial disclosure requirements of Regulation S-K. The main requirements of Regulation S-K, which is the central repository for nonfinancial statement disclosure requirements for public companies, were established more than 30 years ago, and the modernization and optimization of these requirements may be called for as a result of evolving business models, new technology, and changing investor interests.

SEC Update

The release is part of the SEC's ongoing [disclosure effectiveness initiative](#), which is a broad-based review of the Commission's disclosure, presentation, and delivery requirements for public companies. It follows the SEC's issuance last fall of a request for comment that sought feedback on the effectiveness of financial disclosure requirements in Regulation S-X that apply to certain entities other than the registrant.

For more information, see Deloitte's April 18, 2016, [Heads Up](#).

SEC Requests Comments on Certain Regulation S-K Disclosure Requirements

In August 2016, the SEC published a [request for comment](#) (with an October 31, 2016, comment deadline) as part of its disclosure effectiveness initiative. The request for comment seeks feedback on certain disclosure requirements in Subpart 400 of Regulation S-K related to management, certain security holders, and corporate governance matters. The Commission plans to take the comments received into account when it develops its study on Regulation S-K, which is required by the FAST Act.

For more information, see the [press release](#) on the SEC's Web site.

SEC Proposes to Eliminate Outdated and Duplicative Disclosure Requirements

In July 2016, the SEC issued a [proposed rule](#) that would amend certain of the Commission's disclosure requirements that may be redundant, duplicative, or outdated, or may overlap with other SEC, U.S. GAAP, or IFRS disclosure requirements. The proposal also seeks comment on whether certain of the SEC's disclosure requirements that overlap with requirements under U.S. GAAP should be retained, modified, eliminated, or referred to the FASB for potential incorporation into U.S. GAAP.

The proposed amendments are the next step in the SEC's ongoing disclosure effectiveness initiative. As part of the initiative, the SEC in April 2016 also issued a [concept release](#) that sought feedback on modernizing certain business and financial disclosure requirements of Regulation S-K (see discussion above).



Thinking It Through

The implications of the proposal are likely to vary depending on the category of change (e.g., duplicate, overlapping, superseded). The effect of some changes may not be significant if their purpose is only to eliminate a duplicated or superseded requirement. Changes to address overlapping requirements could have a more significant effect since they can result in what the SEC describes as (1) disclosure location considerations and (2) bright-line threshold considerations.

For more information, see Deloitte's July 18, 2016, [Heads Up](#) and the [press release](#) on the SEC's Web site.

SEC Staff Updates C&DIs Related to Regulation S-K, the Securities Act, and Other Topics

In October 2016, the Division updated C&DIs related to Regulation S-K, Item 402(u), and added the following new questions:

- **Question 128C.01** — Clarifies what type of consistently applied compensation measure (CACM) a registrant should select to identify the median employee when a registrant does not use annual total compensation calculated in accordance with Regulation S-K, Item 402(c)(2)(x).
- **Question 128C.02** — Clarifies whether a registrant may use hourly or annual rates of pay in determining its CACM.
- **Question 128C.03** — Clarifies the time period a registrant may use when it uses a CACM to identify the median employee.
- **Question 128C.04** — Clarifies the treatment of furloughed employees by registrants in the identification of the median employee.
- **Question 128C.05** — Clarifies the circumstances under which a worker is considered an independent contractor or a leased worker.

In September 2016, the Division issued the following C&DIs:

- **Question 139.33 and Question 126.41 related to Securities Act sections and forms** — Include guidance on self-directed “brokerage windows.”
- **Question 301.03 related to Regulation AB** — Clarifies whether a funding-agreement-backed note with certain characteristics should be considered an “asset-backed security,” as that term is defined in either Item 1101(c) of Regulation AB or Section 3(a)(79) of the Exchange Act.

In July 2016, the Division issued the following C&DIs:

- **Question 103.11 related to filing Schedules 13D and 13G (Rule 13d-1)** — Addresses whether a shareholder is exempt from filing Schedule 13G on the basis of the provisions in the Hart-Scott-Rodino Act.
- **Question 111.02 and Question 125.13 related to Securities Act sections and forms** — Contain questions related to an issuer’s representation about the absence of a distribution of the securities received in an exchange.
- **Question 140.02 related to Regulation S-K** — Discusses how, in situations in which “a selling security holder is not a natural person,” a registrant should “satisfy the obligation in Item 507 of Regulation S-K to disclose the nature of any position, office, or other material relationship that the selling security holder has had within the past three years with the registrant or any of its predecessors or affiliates.”

In June 2016, the Division updated Section 271 of its [C&DIs](#) on rules related to the Securities Act. The updated guidance addresses questions about the completion of a merger transaction.

SEC Proposes Amendments to Broker-Dealers' Disclosures About Order Handling Information

In July 2016, the SEC issued a [proposed rule](#) that would enhance the requirements related to broker-dealers' disclosures about order handling information. Specifically, the proposal would require broker-dealers to "disclose the handling of institutional orders to customers" and to include additional information in their existing retail order disclosures.

For more information, see the [press release](#) on the SEC's Web site.

SEC Proposes Amendments to the Definition of Smaller Reporting Company

In June 2016, the SEC issued a [proposed rule](#) that "would expand the number of companies that qualify as smaller reporting companies, thus qualifying for certain existing scaled disclosures provided in Regulation S-K and Regulation S-X." Specifically, the proposal would increase the qualification threshold from less than \$75 million of public float to less than \$250 million. Further, companies with public float of zero "would be permitted to provide scaled disclosures if [their] annual revenues are less than \$100 million, as compared to the current threshold of less than \$50 million in annual revenues."

For more information, see Deloitte's June 29, 2016, [journal entry](#) and the [press release](#) on the SEC's Web site.



Thinking It Through

The proposal does not change the \$75 million public float threshold in the SEC's definition of "accelerated filer." Therefore, a company could qualify as a smaller reporting company and be eligible for the scaled disclosures but may also be an accelerated filer and subject to those requirements, including the shorter deadlines for periodic filings and the requirement to include an auditor's attestation report on ICFR.

SEC and Other Organizations Propose Guidance on Incentive-Based Compensation Arrangements

In May 2016, the SEC and several other government agencies, including the Federal Reserve Board, OCC, FDIC, FHFA, and NCUA, jointly issued a [proposed rule](#) on incentive-based compensation arrangements to implement Section 956 of the Dodd-Frank Act. The proposed rule would:

- Prohibit "incentive-based payment arrangements that the Agencies determine encourage inappropriate risks by certain financial institutions by providing excessive compensation or that could lead to material financial loss."
- Require "financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate Federal regulator."

For more information, see the [press release](#) on the SEC's Web site.

SEC Updates *Financial Reporting Manual*

In March 2016, the Division updated its *Financial Reporting Manual* to clarify or add guidance on the following topics:

- *Paragraph 2410.8* — Significance testing related to equity method investments.
- *Topic 10* — Requirements as a result of the FAST Act.
- *Topic 11* — Implementation of the FASB's and IASB's new revenue standard.

In November 2016, the Division updated its *Financial Reporting Manual* to clarify or add guidance on the following topics:

- *Paragraphs 1140.3 and 10220.7* — The number of years of a target company's financial statements that an emerging growth company (EGC) should present.
- *Paragraph 1330.5* — Filings required after Form 10 is effective.
- *Paragraph 5120.1* — Effect of loss of smaller reporting company status on accelerated filer determination and filing due dates.
- *Paragraph 8110.2* — The May 2016 C&DI updates on non-GAAP financial measures.
- *Paragraph 10220.5* — EGC guidance on the financial statements of entities other than the registrant; pro forma information.
- *Paragraph 11120.4, Index* — Implementation of the FASB's and IASB's new revenue standard.
- *Section 11200, Index* — Implementation of the FASB's and IASB's new leases standard.
- *Section 11300, Index* — Implementation of the FASB's new standard on disclosures about short-duration insurance contracts.

For more information, see Deloitte's [March 22, 2016](#), and [November 22, 2016](#), journal entries.

SEC and FDIC Issue Proposed Rule on Covered Broker-Dealer Provisions

In February 2016, the SEC and FDIC issued a [proposed rule](#) that establishes certain “provisions applicable to the orderly liquidation of covered brokers and dealers.” The proposal is being issued in response to a mandate of the Dodd-Frank Act.

SEC Publishes Examination Priorities for 2016

In January 2016, the SEC's Office of Compliance Inspections and Examinations published its [examination priorities](#) for 2016. New priorities include liquidity controls, public pension advisers, product promotion, exchange-traded funds, and variable annuities. Further, the priorities “reflect a continuing focus on protecting investors in ongoing risk areas such as cybersecurity, microcap fraud, fee selection, and reverse churning.”

For more information, see the [press release](#) on the SEC's Web site.

SEC Proposes Rule on Use of Derivatives

In December 2015, the SEC issued a [proposed rule](#) on use of derivatives by registered investment companies and business development companies. The proposal would “place restrictions on funds, such as mutual funds and exchange-traded funds . . . that would limit their use of derivatives and require funds to put in place risk management measures resulting in better protection for investors.”

For more information, see the [press release](#) on the SEC’s Web site.

SEC Proposes Enhancements to Disclosure Requirements for Alternative Trading Systems

In November 2015, the SEC issued a [proposed rule](#) that would amend the requirements for alternative trading systems under the Exchange Act. Specifically, the proposal would require alternative trading systems that “trade stocks listed on a national securities exchange (NMS stocks), including ‘dark pools,’ to publicly disclose detailed information about the operations and activities of a broker-dealer operator and its affiliates.”

For more information, see the [press release](#) on the SEC’s Web site.

Appendixes

Appendix A — Summary of Accounting Pronouncements Effective in 2016

The table below lists ASUs that became effective for calendar year 2016. (Note that it is assumed that the ASUs were not early adopted before 2016 if early adoption was permitted.)

ASU (Issuance Month)	Affects	Effective Date for Public Business Entities	Effective Date for All Other Entities
ASU 2016-03, <i>Intangibles — Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance</i> — a consensus of the Private Company Council (March 2016)	Private entities.	Not applicable.	Upon issuance.
ASU 2015-16, <i>Simplifying the Accounting for Measurement-Period Adjustments</i> (September 2015)	Entities that have reported provisional amounts for items in a business combination for which the accounting is incomplete by the end of the reporting period in which the business combination occurs and during the measurement period have an adjustment to provisional amounts recognized.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	Fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017.
ASU 2015-12, <i>(Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient</i> — consensus of the FASB Emerging Issues Task Force (July 2015)	Reporting entities within the scope of ASC 960, ASC 962, or ASC 965. Effective for fiscal years beginning after December 15, 2015.		

(Table continued)

ASU (Issuance Month)	Affects	Effective Date for Public Business Entities	Effective Date for All Other Entities
ASU 2015-10, <i>Technical Corrections and Improvements</i> (June 2015)	All entities.	Transition guidance varies on the basis of the amendments in the ASU. The amendments that require transition guidance are effective for all entities for fiscal years and interim periods within those fiscal years beginning after December 15, 2015.	
ASU 2015-09, <i>Disclosures About Short-Duration Contracts</i> (May 2015)	All insurance entities that issue short-duration contracts as defined in ASC 944. The amendments do not apply to the holder (i.e., policyholder) of short-duration contracts.	Fiscal years beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016.	Fiscal years beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017.
ASU 2015-07, <i>Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)</i> — a consensus of the FASB Emerging Issues Task Force (May 2015)	All entities.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	Fiscal years (and interim periods therein) beginning after December 15, 2016.
ASU 2015-06, <i>Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions</i> — a consensus of the FASB Emerging Issues Task Force (April 2015)	All entities.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	
ASU 2015-05, <i>Customer's Accounting for Fees Paid in a Cloud Computing Arrangement</i> (April 2015)	All entities.	Annual periods (and interim periods therein) beginning after December 15, 2015.	Annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016.
ASU 2015-04, <i>Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets</i> (April 2015)	All entities.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	Fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017.

(Table continued)

ASU (Issuance Month)	Affects	Effective Date for Public Business Entities	Effective Date for All Other Entities
ASU 2015-03, <i>Simplifying the Presentation of Debt Issuance Costs</i> (April 2015)	All entities.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	Fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016.
ASU 2015-02, <i>Amendments to the Consolidation Analysis</i> (February 2015)	Entities that are required to evaluate whether they should consolidate certain legal entities.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	Fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017.
ASU 2015-01, <i>Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items</i> (January 2015)	All entities.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	
ASU 2014-18, <i>Accounting for Identifiable Intangible Assets in a Business Combination</i> — a consensus of the Private Company Council (December 2014)	All entities except public business entities and not-for-profit entities, as those terms are defined in the ASC master glossary.	Not applicable.	If the first in-scope transaction occurs in the first fiscal year beginning after December 15, 2015, the elective adoption will be effective for that fiscal year's annual financial reporting and all interim and annual periods thereafter. If the first transaction occurs in fiscal years beginning after December 15, 2016, the elective adoption will be effective in the interim period that includes the date of the transaction and subsequent interim and annual periods thereafter.

(Table continued)

ASU (Issuance Month)	Affects	Effective Date for Public Business Entities	Effective Date for All Other Entities
ASU 2014-16, <i>Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity</i> — a consensus of the FASB Emerging Issues Task Force (November 2014)	Entities that are issuers of, or investors in, hybrid financial instruments that are issued in the form of a share.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	Fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016.
ASU 2014-13, <i>Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity</i> — a consensus of the FASB Emerging Issues Task Force (August 2014)	A reporting entity that is required to consolidate a collateralized financing entity under the variable interest entities subsections of ASC 810-10 and that measures assets and liabilities of the collateralized financing entity by using fair value.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	Fiscal years ending after December 15, 2016, and interim periods beginning after December 15, 2016.
ASU 2014-12, <i>Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period</i> — a consensus of the FASB Emerging Issues Task Force (June 2014)	Reporting entities that grant their employees share-based payments in which the terms of the award stipulate that a performance target that affects vesting could be achieved after the requisite service period.	Fiscal years (and interim periods therein) beginning after December 15, 2015.	

Appendix B — Glossary of Standards and Other Literature

The following are the titles of standards and other literature mentioned in this publication:

FASB ASUs

ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers*

ASU 2016-19, *Technical Corrections and Improvements*

ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* — a consensus of the FASB Emerging Issues Task Force

ASU 2016-17, *Consolidation (Topic 810): Interests Held Through Related Parties That Are Under Common Control*

ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* — a consensus of the Emerging Issues Task Force

ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

ASU 2016-12, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

ASU 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)*

ASU 2016-10, *Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing*

ASU 2016-09, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*

ASU 2016-08, *Revenue From Contracts With Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*

ASU 2016-07, *Investments — Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*

ASU 2016-03, *Intangibles — Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance* — a consensus of the Private Company Council

ASU 2016-02, *Leases (Topic 842)*

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ASU 2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

ASU 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*

ASU 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*

ASU 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*

ASU 2015-12, *Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): (Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient* — consensuses of the FASB Emerging Issues Task Force

ASU 2015-10, *Technical Corrections and Improvements*

ASU 2015-09, *Financial Services — Insurance (Topic 944): Disclosures About Short-Duration Contracts*

ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)* — a consensus of the FASB Emerging Issues Task Force

ASU 2015-06, *Earnings per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions* — a consensus of the FASB Emerging Issues Task Force

ASU 2015-05, *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*

ASU 2015-04, *Compensation — Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets*

ASU 2015-03, *Interest — Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*

ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*

ASU 2015-01, *Income Statement — Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*

ASU 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination* — a consensus of the Private Company Council

ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-13, *Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-12, *Compensation — Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*

ASU 2014-07, *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements* — a consensus of the Private Company Council

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ASU 2014-03, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps — Simplified Hedge Accounting Approach* — a consensus of the Private Company Council

ASU 2014-02, *Intangibles — Goodwill and Other (Topic 350): Accounting for Goodwill* — a consensus of the Private Company Council

ASU 2014-01, *Investments — Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects* — a consensus of the FASB Emerging Issues Task Force

ASU 2010-20, *Receivables (Topic 310): Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*

ASU 2010-10, *Consolidation (Topic 810): Amendments for Certain Investment Funds*

ASU 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved With Variable Interest Entities*

FASB ASC Topics and Subtopics

ASC 230, *Statement of Cash Flows*

ASC 235, *Notes to Financial Statements*

ASC 250, *Accounting Changes and Error Corrections*

ASC 250-10, *Accounting Changes and Error Corrections: Overall*

ASC 320, *Investments — Debt and Equity Securities*

ASC 321-10, *Investments — Equity Securities: Overall*

ASC 325-40, *Investments — Other: Beneficial Interests in Securitized Financial Assets*

ASC 326-30, *Financial Instruments — Credit Losses: Available-for-Sale Debt Securities*

ASC 360-20, *Property, Plant, and Equipment: Real Estate Sales*

ASC 460, *Guarantees*

ASC 470-10, *Debt: Overall*

ASC 470-20, *Debt: Debt With Conversion and Other Options*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 480-10, *Distinguishing Liabilities From Equity: Overall*

ASC 505-50, *Equity: Equity-Based Payments to Non-Employees*

ASC 605, *Revenue Recognition*

ASC 605-20, *Revenue Recognition: Services*

ASC 605-45, *Revenue Recognition: Principal Agent Considerations*

ASC 605-50, *Revenue Recognition: Customer Payments and Incentives*

ASC 606, *Revenue From Contracts With Customers*

ASC 610-20, *Other Income: Gains and Losses From the Derecognition of Nonfinancial Assets*

ASC 715, *Compensation — Retirement Benefits*

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ASC 715-20, *Compensation — Retirement Benefits: Defined Benefit Plans — General*

ASC 718, *Compensation — Stock Compensation*

ASC 720, *Other Expenses*

ASC 740, *Income Taxes*

ASC 740-10, *Income Taxes: Overall*

ASC 805-10, *Business Combinations: Overall*

ASC 810-10, *Consolidation: Overall*

ASC 815, *Derivatives and Hedging*

ASC 815-10, *Derivatives and Hedging: Overall*

ASC 815-15, *Derivatives and Hedging: Embedded Derivatives*

ASC 815-40, *Derivatives and Hedging: Contracts in Entity's Own Equity*

ASC 820, *Fair Value Measurement*

ASC 820-10, *Fair Value Measurement: Overall*

ASC 825, *Financial Instruments*

ASC 825-10, *Financial Instruments: Overall*

ASC 840, *Leases*

ASC 932-10, *Extractive Activities — Oil and Gas: Overall*

ASC 944, *Financial Services — Insurance*

ASC 946, *Financial Services — Investment Companies*

ASC 958, *Not-for-Profit Entities*

ASC 960, *Plan Accounting — Defined Benefit Pension Plans*

ASC 962, *Plan Accounting — Defined Contribution Pension Plans*

ASC 965, *Plan Accounting — Health and Welfare Benefit Plans*

ASC 970-605, *Real Estate — General: Revenue Recognition*

FASB Proposed ASUs

Proposed ASU 2017-200, *Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current Versus Noncurrent)*

Proposed ASU 2016-370, *Distinguishing Liabilities From Equity (Topic 480): I. Accounting for Certain Financial Instruments With Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception*

Proposed ASU 2016-330, *Financial Services — Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*

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Proposed ASU 2016-310, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

Proposed ASU 2016-270, *Income Taxes (Topic 740): Disclosure Framework — Changes to the Disclosure Requirements for Income Taxes*

Proposed ASU 2016-250, *Other Income — Gains and Losses From the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*

Proposed ASU 2016-210, *Compensation — Retirement Benefits — Defined Benefit Plans — General (Subtopic 715-20): Changes to the Disclosure Requirements for Defined Benefit Plans*

Proposed ASU 2015-350, *Fair Value Measurement (Topic 820): Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement*

Proposed ASU 2015-330, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

Proposed ASU 2015-340, *Government Assistance (Topic 832): Disclosures by Business Entities About Government Assistance*

Proposed ASU 2015-310, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*

Proposed ASU 2015-280, *Investments — Equity Method and Joint Ventures (Topic 323): Simplifying the Equity Method of Accounting*

Proposed ASU 2013-290, *Leases (Topic 834)*

Other FASB Proposals

Invitation to Comment 2016-290, *Agenda Consultation*

Proposed Concepts Statement 2015-300, *Conceptual Framework for Financial Reporting: Chapter 3: Qualitative Characteristics of Useful Financial Information*

Proposed Concepts Statement 2014-200, *Conceptual Framework for Financial Reporting: Chapter 8: Notes to Financial Statements*

Invitation to Comment 2012-220, *Disclosure Framework*

FASB Concepts Statement

CON 8, *Conceptual Framework for Financial Reporting*

EITF Issue

16-B, "Employee Benefit Plan Master Trust Reporting"

NAIC Literature

SSAP No. 103, *Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

SSAP No. 86, *Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions*

SSAP No. 54, *Individual and Group Accident and Health Contracts*

SSAP No. 51, *Life Contracts*

SSAP No. 41, *Surplus Notes*

SSAP No. 35, *Guaranty Fund and Other Assessments*

SSAP No. 2, *Cash, Drafts and Short-term Investments*

Private Company Council Literature

PCC Issue No. 15-02, "Applying Variable Interest Entity Guidance to Entities Under Common Control"

SEC Division of Corporation Finance *Financial Reporting Manual*

Topic 1, "Registrant's Financial Statements"

Topic 2, "Other Financial Statements Required"; Section 2400, "Equity Method Investments, Including Fair Value Option"

Topic 5, "Smaller Reporting Companies"

Topic 8, "Non-GAAP Measures of Financial performance Liquidity and Net Worth"

Topic 10, "Emerging Growth Companies"

Topic 11, "Reporting Issued Related to Adoption of New Revenue Recognition Standard"

Topic 13, "Effects of Subsequent Events on Financial Statements Required in Filings"

SEC Regulation AB (Asset-Backed Securities)

Item 1101(c), "Definitions; Asset-Backed Security"

SEC Regulation S-X

Rule 4-08(h), "General Notes to Financial Statements: Income Tax Expense"

SEC Regulation S-K

Item 402(c), "Executive Compensation; Summary Compensation Table"

Item 402(u), "Executive Compensation; Pay Ratio Disclosure"

Item 507, "Selling Security Holders"

SEC Final Rules

34-78961, *Standards for Covered Clearing Agencies*

34-78716, *Access to Data Obtained by Security-Based Swap Data Repositories*

34-78321, *Regulation SBSR — Reporting and Dissemination of Security-Based Swap Information*

34-78011, *Trade Acknowledgment and Verification of Security-Based Swap Transactions*

34-77104, *Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception*

IA-4509, *Form ADV and Investment Advisers Act Rules*

SEC Proposed Rules and Concept Releases

34-78963, *Definition of "Covered Clearing Agency"*

34-78962, *Amendment to Securities Transaction Settlement Cycle*

34-78309, *Disclosure of Order Handling Information*

33-10110, *Disclosure Update and Simplification*

IA-4439, *Adviser Business Continuity and Transition Plans*

33-10107, *Amendments to Smaller Reporting Company Definition*

33-10064, *Business and Financial Disclosure Required by Regulation S-K*

34-77776, *Incentive-Based Compensation Arrangements*

34-77157, *Covered Broker-Dealer Provisions Under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act*

IC-31933, *Use of Derivatives by Registered Investment Companies and Business Development Companies*

34-76474, *Regulation of NMS Stock Alternative Trading Systems*

Other SEC Proposal

33-10198, *Request for Comment on Subpart 400 of Regulation S-K Disclosure Requirements Relating to Management, Certain Security Holders and Corporate Governance Matters*

SEC Staff Accounting Bulletin

SAB Topic 13, "Revenue Recognition"

SEC Office of Compliance Inspections and Examinations

Examination Priorities for 2016

SEC C&DI Topics

Exchange Act Section 3(a)

Non-GAAP Financial Measures

Regulation AB and Related Rules

Regulation S-K

Securities Act Forms

Securities Act Rules

Securities Act Sections

Securities Exchange Act of 1934 Rules

Rule 10b-10 “Manipulative and Deceptive Devices and Contrivances; Confirmation of Transactions”

Rule 13n-4, “Regulation SBSR; Duties and Core Principles of Security-Based Swap Data Repository”

SEC Industry Guide

SEC Securities Act Industry Guide No. 6, *Disclosures Concerning Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Insurance Underwriters*

International Standards

IFRS 16, *Leases*

IAS 17, *Leases*

IAS 12, *Income Taxes*

Appendix C — Abbreviations

Abbreviation	Description	Abbreviation	Description
AFS	available for sale	GP	general partner
AICPA	American Institute of Certified Public Accountants	IAS	International Accounting Standard
AOCI	accumulated other comprehensive income	IASB	International Accounting Standards Board
APIC	additional paid-in capital	IBNR	incurred but not reported
ASC	FASB Accounting Standards Codification	ICFR	internal control over financial reporting
ASU	FASB Accounting Standards Update	IEP	AICPA's Insurance Experts Panel
BOLI	bank-owned life insurance	IFRS	International Financial Reporting Standard
C&DI	SEC compliance and disclosure interpretation	LP	limited partner
CACM	consistently applied compensation measure	MD&A	Management's Discussion & Analysis
CAE	claim adjustment expense	NAIC	National Association of Insurance Commissioners
CECL	current expected credit loss	NCUA	National Credit Union Administration
COLI	corporate-owned life insurance	NMS	National Market System
DAC	deferred acquisition cost	NOL	net operating loss
DTA	deferred tax asset	OCC	Office of the Comptroller of the Currency (U.S. Department of the Treasury)
DTL	deferred tax liability	OCI	other comprehensive income
EGC	emerging growth company	ORSA	Own Risk and Solvency Assessment
EITF	Emerging Issues Task Force	PBR	principle-based reserving
FASB	Financial Accounting Standards Board	PCAOB	Public Company Accounting Oversight Board
FDIC	Federal Deposit Insurance Corporation	PCC	Private Company Council
FHFA	Federal Housing Finance Agency	PCD asset	purchased financial assets with credit deterioration
FVTNI	fair value through net income	ROU	right of use
GAAP	generally accepted accounting principles		

Appendix C — Abbreviations

Abbreviation	Description
SAB	SEC Staff Accounting Bulletin
SAC	subjective acceleration clause
SBS	security-based swap
SEC	Securities and Exchange Commission
SIFMA	Securities Industry and Financial Markets Association
SSAP	NAIC Statement of Statutory Accounting Principles
TRG	transition resource group
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	Dodd-Frank Wall Street Reform and Consumer Protection Act
Exchange Act	Securities Exchange Act of 1934
FAST Act	Fixing America's Surface Transportation Act
Hart-Scott-Rodino Act	Hart-Scott-Rodino Antitrust Improvements Act
Investment Advisers Act	Investment Advisers Act of 1940
JOBS Act	Jumpstart Our Business Startups Act
Securities Act	Securities Act of 1933

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