

EITF Snapshot.

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This *EITF Snapshot* summarizes the June 12, 2014, meeting of the Emerging Issues Task Force (EITF or “Task Force”).

Initial Task Force consensus (“consensus-for-exposure”) are exposed for public comment upon ratification by the Financial Accounting Standards Board (FASB). After the comment period, the Task Force considers comments received and redeliberates the issues at a scheduled meeting in order to reach a final consensus. Those final consensus are then provided to the FASB for final ratification and, ultimately, issuance as an Accounting Standards Update (ASU).

The FASB plans to consider the EITF’s June 2014 consensus for ratification in early July 2014. After that date, the official EITF minutes, including the results of the FASB’s ratification process, will be posted to Deloitte’s [Technical Library](#) and to the [FASB’s Web site](#) (note that the official EITF minutes may contain details that differ from those in this publication). EITF Issue Summaries (released before the meeting and used to frame the discussion) are also available on those sites.

Issue 12-G Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity

Status: Final consensus.

Affects: Entities that consolidate a collateralized financing entity (CFE).¹

Background: Under U.S. GAAP, reporting entities may be required to consolidate certain CFEs with which they are involved, such as collateralized debt obligation entities and collateralized loan obligation entities. Upon consolidation, those reporting entities initially measure the CFE’s financial assets and financial liabilities (i.e., beneficial interests) at fair value. In certain instances, the aggregate fair value of the CFE’s financial assets exceeds the fair value of its financial liabilities² (or vice versa) even though the CFE’s liabilities have recourse only to the assets of the CFE. Some have interpreted U.S. GAAP as requiring that this measurement difference be included in the reporting entity’s earnings despite concerns by others that, economically, this difference is attributable to the holders of the CFE’s liabilities. Such concerns have led to diversity in practice related to reporting entities’ accounting for this difference.

In March 2014, the Task Force discussed various approaches for clarifying the scope of its November 2013 consensus for exposure. While the Task Force ultimately did not reach a conclusion on the scope of the Issue, it did discuss an alternative approach under which reporting entities would treat the CFE measurement guidance as an optional practicability exception to applying the fair value measurement guidance in ASC 820³ when the financial assets and financial liabilities of a consolidated CFE are being accounted for at fair value under other U.S. GAAP (e.g., when the entity had elected the fair value option for the CFE’s financial assets and financial liabilities). The Task Force decided to continue discussing this approach at its June 2014 meeting.

Summary: At this meeting, the Task Force reached a final consensus to provide entities that consolidate a CFE with an optional practicability exception to applying the fair value measurement guidance in ASC 820 when all of the financial assets and financial liabilities of the consolidated CFE are measured at fair value through net

¹ The EITF’s May 23, 2014, [Issue Summary No. 1, Supplement No. 5](#), notes that a CFE is defined as “a variable interest entity that holds financial assets, issues beneficial interests in those financial assets, and has no more than nominal equity. The beneficial interests have recourse to the related financial assets of the CFE and are classified as financial liabilities. A CFE may hold nonfinancial assets temporarily as a result of default by the debtor on the underlying debt instruments held as assets by the CFE in an effort to restructure the debt instruments held as assets by the CFE.” The Task Force made incremental changes to this definition at the June meeting.

² The [minutes](#) of the EITF’s March 13, 2014, meeting note that differences “could result from any one of the following:

- Liquidity discounts that were inherent in the exit price for the CFE’s liabilities and not in the CFE’s assets
- Differences between the duration of the CFE’s assets and the duration of the CFE’s liabilities
- Principal markets for the assets and the liabilities that were not identical.”

³ For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte’s [“Titles of Topics and Subtopics in the FASB Accounting Standards Codification.”](#)

income under other U.S. GAAP (e.g., when the entity had elected the fair value option for all of the CFE's financial assets and financial liabilities). The Task Force also concluded that a CFE:

- May hold a financial instrument measured at cost as long as (1) the carrying amount of the financial instrument approximates fair value and (2) the financial instrument stems from the operations of the CFE (e.g., cash and other payables or receivables).⁴
- Would not be eligible for the practicability exception if the financial liabilities of the CFE have recourse to something other than the assets of the CFE (e.g., if there is a guarantee of the CFE's beneficial interests by the reporting entity).

If elected, the practicability exception would allow a reporting entity to measure both the financial assets and the financial liabilities of the CFE by using the more observable of the fair value of the financial assets and the fair value of the financial liabilities, effectively eliminating any measurement difference. See Deloitte's November 2013 *EITF Snapshot* for more information on how the measurement alternative would work.

The Task Force also concluded that the practicability exception would:

- Be available on a CFE-by-CFE basis.
- Have to be elected at initial consolidation of the CFE (or upon transition in connection with a reporting entity's adoption of the final consensus).
- No longer apply if, after initial consolidation, all of the CFE's financial assets are no longer measured at fair value through net income (e.g., the reporting entity subsequently transfers to the CFE financial assets measured at fair value through other comprehensive income or amortized cost).

A reporting entity would disclose (1) the fair value measurement information required by ASC 820 for both the financial assets and the financial liabilities of the CFE and (2) that it has elected the practicability exception.

If a reporting entity does not elect the practicability exception, it would record in net income (attributable to the parent) (1) any initial difference between the fair value of the financial assets and financial liabilities of the CFE and (2) all subsequent changes in fair value of the CFE's financial assets and financial liabilities.

Effective Date and Transition:

If the FASB ratifies the guidance in this Issue, it will be effective for public business entities for reporting periods (including interim periods) beginning after December 15, 2015. For all other entities, the guidance will be effective for annual reporting periods beginning after December 15, 2015, and interim and annual periods thereafter. Early adoption is permitted. Entities will have the option of applying the guidance by using either a modified retrospective approach (i.e., by recording a cumulative-effect adjustment as of the beginning of the annual period of adoption) or a full retrospective approach. In addition, at transition, entities that desire to apply the measurement alternative to a consolidated CFE can elect the fair value option for all of the CFE's financial assets and financial liabilities.

Next Steps:

FASB ratification is expected in July 2014, after which an ASU will be issued.

Issue 13-F

Classification of Certain Government-Guaranteed Residential Mortgage Loans Upon Foreclosure

Status:

Final consensus.

Affects:

Entities that hold government-insured mortgage loans collateralized by residential real estate.

Background:

Mortgage loans insured by a government entity protect the creditor (or loan holder) against losses that may result from the homeowner's (or borrower's) inability to continue making payments. In the United States, loans originated by approved lenders may be insured by a U.S. government agency such as the Federal Housing Administration of the U.S. Department of Housing and Urban Development or other U.S. government agencies. Under U.S. GAAP, lending entities such as banks must account for a "troubled debt restructuring that is in substance a repossession or foreclosure by the creditor, that is, the creditor receives physical possession of the debtor's" real estate by recording the real estate received initially at fair value less cost to sell and subsequently measuring the foreclosed real estate at fair value less cost to sell if it is

⁴ In addition, a CFE would continue to be permitted to hold nonfinancial assets (e.g., other real estate owned) temporarily.

held for sale.⁵ However, there is no explicit U.S. GAAP guidance on whether (or when) creditors should reclassify mortgage loans insured by a government entity, where the mortgage loan should be reclassified, or how it should be measured. Therefore, diversity in practice has evolved: some entities that foreclose on the real estate reclassify the mortgage loan as a receivable from the government entity, while others reclassify the loan as other real estate owned (OREO). In both cases, entities generally measure the asset (either a receivable or OREO) at the full amount of the government-entity guarantee.

Summary: At this meeting, the Task Force discussed the comment letters received on the exposure draft of its initial consensus for exposure and reached a final consensus to expand the Issue's scope to all loans — both residential and commercial — that contain a government guarantee that is not separable from the loan and for which the creditor has both the intent and ability to recover a fixed or determinable amount under the guarantee by conveying the property to the guarantor. That is, for loans that contain a government guarantee that contains a cap (i.e., partial guarantee), any associated foreclosed property would be within the scope of this guidance when the amount to be received from the government agency is fixed or determinable.

In addition, for loans within the scope of the Issue, the Task Force reached a final consensus that upon foreclosure the creditor should reclassify the mortgage loan as an other receivable that is separate from loans and should measure the receivable at the fixed or determinable amount expected to be received under the government guarantee. The Task Force also confirmed that no new disclosures will be required under this Issue.

Effective Date and Transition:

If the FASB ratifies the guidance in this Issue, it will be effective for public business entities for reporting periods (including interim periods) beginning after December 15, 2014. For all other entities, the guidance will be effective for annual reporting periods beginning after December 15, 2014, and interim and annual periods thereafter. Early adoption is permitted if the reporting entity has already adopted [ASU 2014-04](#).⁶ In addition, all entities must adopt the guidance by using the same transition method they apply when adopting ASU 2014-04 (i.e., by using either a modified retrospective approach or a prospective approach).

Next Steps: FASB ratification is expected in July 2014, after which an ASU will be issued.

Issue 13-G 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

Status: Ongoing redeliberations.

Affects: Entities that issue or hold hybrid financial instruments issued in the form of a share.

Background: When performing an embedded derivative analysis, entities generally look to the SEC staff's guidance in ASC 815-10-S99-3 in evaluating whether the host contract of a financial instrument that contains embedded features is more akin to debt or to equity.⁷ This guidance has led to two generally accepted methods for determining the nature of a host contract: the whole-instrument⁸ approach and the chameleon⁹ approach. Whether an entity uses the whole-instrument or the chameleon approach may affect whether an embedded feature is considered clearly and closely related to the host contract. If it is determined that an embedded feature is not clearly and closely related to the host contract, the embedded feature may have to be bifurcated and accounted for as a derivative if certain other criteria are met.¹⁰ Because an entity may choose, as an accounting policy election, which approach it will use, and given that there are different interpretations under the whole-instrument approach, diversity in practice exists. This Issue was added to the EITF's agenda to address that diversity in practice.

⁵ See ASC 310-40-40-6.

⁶ FASB Accounting Standards Update No. 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure*.

⁷ In ASC 815-10-S99-3, the SEC staff expressed its position that an entity must consider all "stated and implied substantive terms and features" of a hybrid instrument issued in the form of a share when determining whether a host contract is more akin to equity or to debt. However, the SEC staff also acknowledged that some registrants have an accounting policy in which the terms and features pertaining to the individual embedded derivative being evaluated are excluded from the determination of the nature of the host contract for that embedded derivative.

⁸ Under the whole-instrument approach, an entity determines the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid instrument, **including** the embedded feature being analyzed for bifurcation. When the whole-instrument approach is used to analyze a hybrid instrument with multiple embedded features, the nature of the host contract should not change as each embedded feature is analyzed separately.

⁹ Under the chameleon approach, an entity determines the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid instrument, **except for** the particular embedded feature being analyzed for bifurcation. When the chameleon approach is used to analyze a hybrid instrument with multiple embedded features, the nature of the host contract may change as each embedded feature is analyzed separately.

¹⁰ Under ASC 815-15-25-1, an embedded feature is bifurcated and accounted for as a derivative if it does not qualify for any of the scope exceptions in ASC 815 and (1) the embedded derivative is not clearly and closely related to the host contract, (2) the hybrid instrument is not accounted for at fair value with changes in fair value recognized in net income, and (3) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative instrument.

Summary: At this meeting, the Task Force discussed whether and, if so, how to provide implementation guidance that helps reporting entities apply the Task Force’s previously reached consensus-for-exposure that entities with instruments within the scope of the Issue would be required to apply the whole-instrument approach when determining the nature of the host contract in a hybrid financial instrument issued in the form of a share. (The chameleon approach would no longer be permitted.) The Task Force discussed several alternatives, including:

- Providing implementation guidance on how to determine the nature of the host, which would focus on (1) the characteristics of the instrument, (2) the degree to which each characteristic is debt- or equity-like, and (3) the expected outcome of the instrument (e.g., whether the issuer expects to settle the instrument by issuing shares or transferring assets).
- Establishing a rebuttable presumption that “a fixed-price, noncontingent redemption option held by the investor leads to a determination that the host contract is debt-like.”
- Reaffirming “the Task Force’s original consensus for exposure without providing additional implementation guidance.”¹¹

The majority of the Task Force favored the first alternative; however, the Task Force was not able to reach a consensus on the specific nature of the implementation guidance.

Effective Date and Transition:

The Task Force did not discuss the effective date or transition alternatives for this Issue. It is expected that the effective date and transition will be discussed at the EITF’s September 18, 2014, meeting.

Next Steps:

The Task Force will continue deliberating this Issue at its September 18, 2014, meeting.

Administrative Matters

The next EITF meeting is scheduled for September 18, 2014. Comments on Issue 12-F, “Recognition of New Accounting Basis (Pushdown) in Certain Circumstances,” which was discussed at a previous meeting and for which a consensus-for-exposure was reached, are due by July 31, 2014.

¹¹ Quoted text is from the EITF’s May 29, 2014, [Issue Summary No. 1, Supplement No. 2](#).

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