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EITF Snapshot

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This *EITF Snapshot* summarizes the June 18, 2015, meeting of the Emerging Issues Task Force (EITF or "Task Force"). Initial Task Force consensuses ("consensuses-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 consensuses 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 2015 consensuses for ratification at its July 9, 2015, meeting. 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 15-A, "Application of the Normal Purchases and Normal Sales Scope Exception to Certain Electricity Contracts Within Nodal Energy Markets"

Status: Final consensus.

Affects: Entities that deliver electricity within a nodal energy market.

Background: Derivatives are measured at fair value, with changes in fair value recorded in net income. ASC 815[1] contains certain scope exceptions for contracts that otherwise meet the definition of a derivative, including the normal purchases and normal sales (NPNS) scope exception.[2]

The term "nodal energy markets" refers to an interconnected wholesale energy transmission grid administered by regional independent system operators (ISOs). The ISOs operate various "nodes" within the grid where electricity is delivered and withdrawn on the basis of market rates[3] set by the ISOs. The price differential between nodes (delivery point and withdrawal point) represents locational marginal pricing (LMP) charges. As electricity is delivered into the nodal market, the ISOs take "flash title" of the electricity and charge their counterparties the LMP charge on the basis of the market price at that node. The following example illustrates this scenario:

Example

A utility company enters into a forward purchase contract with a power-generating company for delivery of 10,000 megawatts daily over a five-year period. The power-generating company delivers the daily electricity to the utility company at Location Y.

The utility company needs the electricity at Location Z so that it can deliver electricity to its customers. The utility company sells electricity to the ISO, who takes flash title, at Location Y for $45 per megawatt-hour.

Simultaneously, the utility company purchases electricity from the ISO at Location Z for $46 per megawatt-hour so that it can deliver the electricity to its consumers, incurring an LMP charge of $1 per megawatt-hour.

[1] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

[2] For a transaction to qualify for the NPNS exception, (1) the terms of the contract must be consistent with the terms of a normal purchase or normal sale, (2) the price must be clearly and closely related to the underlying asset, and (3) physical settlement must be probable at inception and throughout the contract.

[3] Market rates are based on the economic effects of physical supply, demand, and the availability of transmission capacity (e.g., congestion).

The issue raised with the Task Force is whether the forward purchase from the power-generating company and sale to the ISO constitute net settlement of the contract, in which case the transaction would fail to qualify for the NPNS scope exception because this exception requires that physical settlement be probable.

Summary: At this meeting, the Task Force reaffirmed its consensus-for-exposure that a forward purchase or sale of electricity in which electricity must be physically delivered through a nodal energy market operated by an ISO and in which an entity incurs transmission costs on the basis of LMP charges would meet the physical-delivery requirement under the NPNS scope exception. The Task Force observed that the substance of such a transaction is that the entity physically delivers electricity to its customers. Further, the Task Force decided to clarify that transactions in which electricity is transmitted through an ISO from one jurisdiction to another, and in which LMP charges are incurred, are within the scope of this Issue and would therefore qualify for the NPNS scope exception.

Effective Date and Transition: For all entities, the final consensus will be effective upon issuance of the ASU. Entities must adopt the guidance prospectively for any qualifying new or existing contract. If the NPNS exception is elected for an existing derivative, an entity will no longer mark the derivative to market and its carrying value will be its fair value at the time of designation.

Next Steps: FASB ratification is expected at the Board's July 9, 2015, meeting, after which a final ASU will be issued.

Issue 15-C, "Employee Benefit Plan Simplifications"

Status: Final consensus.

Affects: Employee benefit plans within the scope of ASC 960, ASC 962, and ASC 965.

Background: Stakeholders have expressed an interest in narrow amendments to the accounting and disclosure requirements for employee benefit plans. Some of the requests involve the measurement of fully benefit-responsive investment contracts (FBRICs) and certain disclosure requirements for plan assets.

Under current U.S. GAAP, FBRICs are recorded at contract value but must be reconciled to fair value, if different, on the face of the plan financial statements. Stakeholders have indicated that (1) it is costly and difficult to determine the fair value of these contracts; (2) the contractual value is the amount participants will receive and therefore is more useful than fair value; and (3) the disclosure requirements in ASC 820 for FBRICs, which are generally Level 3 instruments, are often burdensome and may not be useful. Stakeholders support measuring FBRICs at contractual value and removing the requirement to reconcile contract value to fair value.

Further, stakeholders have expressed a desire to simplify and align the ASC 820 requirements with employee benefit plan requirements, specifically the following requirements related to the level of disaggregation of classes of assets, details about plan assets, and presentation of changes in plan assets:

- Under ASC 820, plan assets must be disaggregated on the basis of the "nature, characteristics, and risks of the asset." However, under employee benefit plan requirements, plan assets are disaggregated by general type (e.g., common stock, corporate bonds, real estate) in a manner consistent with regulatory reporting. A participant's self-directed brokerage accounts are disaggregated by general type on the basis of the participant's underlying investments.
- ASC 820 disclosures are based on the class of investment when an entity discloses the fair value hierarchy levels, types of valuation techniques used in developing the fair value, and fair value rollforward schedules of certain Level 3 investments. Under employee benefit plan accounting, individual investments that account for 5 percent or more of net assets must be listed individually.

- ASC 820 requires a rollforward of realized and unrealized gains and losses as well as sales, purchases, and transfers during the reporting period for Level 3 investments. Under the employee benefit plan requirements, an entity must disclose net appreciation or depreciation for all plan assets by general type.

Stakeholders also supported the use of a practical expedient in selecting an alternative measurement date to determine the fair value of plan assets. Stakeholders suggested that employee benefit plan accounting should align with ASU 2015-04[4] regarding sponsors of employee benefit plans.

Summary: At this meeting, the Task Force reaffirmed its consensus-for-exposure that FBRICs should be measured at contract value and removed the requirement to reconcile their contract value to fair value (if different). As a result, fair value measurement disclosure requirements related to FBRICs would be removed, including those in ASC 820, ASC 962, and ASC 965.[5] In addition, the Task Force decided to clarify that FBRICs do not need to be disaggregated by general type in the statement of net assets or the footnotes. The Task Force's decision about FBRICs would also apply to synthetic guaranteed investment contracts that meet the definition of a FBRIC. However, synthetic guaranteed investment contracts would be separately presented or disclosed in the statement of net assets or footnotes. Further, the Task Force decided that:

- Plan assets (except for FBRICs) would be disclosed by general type in a manner consistent with current plan accounting and would not need to be disaggregated in accordance with ASC 820. Participant self-directed brokerage accounts would be disclosed as one general type.
- Entities would be required to provide ASC 820 disclosures on the basis of the general type of plan assets. However, for investments in entities that are measured at net asset value by using the practical expedient and that file Form 5500[6] as direct filing entities,[7] the disclosures associated with the plan assets' significant investment strategies are no longer required. Further, plan assets that account for 5 percent or more of net assets would not be listed individually. However, entities need to consider the concentration disclosure requirements from other relevant Codification topics, such as ASC 825 and ASC 275.
- The requirement to provide net appreciation or depreciation of plan assets by general type would be removed. However, entities would present net appreciation or depreciation of plan assets in the aggregate.

In addition, the Task Force reached a final consensus that an employee benefit plan can use an alternative measurement date consisting of the closest month-end date to its fiscal year-end. (This decision is consistent with ASU 2015-04 regarding sponsors of employee benefit plans.) However, the Task Force decided that contributions, distributions, and other significant events between the alternative measurement date and the fiscal year-end will be disclosed rather than adjusted for within the financial statements.

Effective Date and Transition: The final consensus related to the measurement of FBRICs and plan asset disclosures will be effective for fiscal years beginning after December 15, 2015, and must be applied retrospectively. Early adoption is permitted.

The final consensus related to the practical expedient of an alternative measurement date for plan assets will be effective for fiscal years beginning after December 15, 2015, and must be applied prospectively. Early adoption is permitted.

Next Steps: FASB ratification is expected at the Board's July 9, 2015, meeting, after which a final ASU will be issued.

[4] FASB Accounting Standards Update No. 2015-04, *Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets*.

[5] ASC 962-325-50-3 and ASC 965-325-50-2 would be amended to remove fair value measurement disclosures for FBRICs.

[6] Employee benefit plans use Form 5500 to satisfy their annual reporting requirements under the Employee Retirement Income Security Act, including those related to the underlying investments of the fund.

[7] Direct filing entities (DFEs) are entities that receive investments from employee benefit plans and that are required to file Form 5500 with their regulators to disclose the underlying investments of the DFEs.

Issue 15-D, "Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships"

Status: Consensus-for-exposure.

Affects: Entities with derivative contracts designated in a hedge accounting relationship.

Background: ASC 815 provides guidance on when a derivative instrument may qualify for hedge accounting. Derivative instruments that qualify for, and that are designated in, a hedging relationship may reduce volatility in an entity's earnings that can occur because of the changes in the fair value of the derivative. ASC 815 indicates that a derivative instrument must be dedesignated from a hedging relationship if (1) the derivative instrument is terminated or (2) there has been any change in the critical terms of the hedging relationship as documented at inception. The issue discussed by the Task Force is whether a derivative novation results in the dedesignation of the hedging relationship because the novation is either (1) a termination or (2) a change in a critical term of the derivative contract.

A derivative novation occurs when one party (Company A) in the contract assigns its rights and obligations to a new party (Company B), subject to the approval of the existing party (Company C). After the novation, Company C and Company B are the legal counterparties since Company A no longer has any rights or obligations under the contract. Derivative novations occur for various reasons, including business mergers with the surviving entity novated as the new counterparty, novations between legal entities of the same parent company, and regulatory requirements that result in novations to central derivative clearing counterparties. The Task Force discussed five alternatives related to whether derivative novations designated in a hedging relationship result in dedesignation of that relationship:

1. The derivative in a hedging relationship must be dedesignated because of a change in one of the parties in the related derivative contract.
2. The derivative in a hedging relationship must be dedesignated because of a change in one of the parties in the related derivative contract, unless the novation is with a central clearing counterparty as a result of laws or regulations.
3. The derivative in the hedging relationship must be dedesignated because of a change in one of the parties in the related derivative contract, unless the novation meets one of these exceptions:
    a. For contracts entered into before mandatory clearing requirements, the parties in the contract voluntarily novate the contract to a central clearing counterparty.
    b. For contracts entered into after mandatory clearing requirements, the parties agree in advance — and the hedging documentation indicates — that the contract will be novated to a central clearing counterparty with standard market terms and conventions.
    c. A counterparty that is prohibited by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 from engaging in derivative transactions novates a derivative to a consolidated affiliate that is not insured by the FDIC.
4. The derivative in the hedging relationship does not have to be dedesignated because of a change in one of the parties in the related derivative contract.
5. The derivative in the hedging relationship does not have to be dedesignated because of a change in one of the parties in the related derivative contract, provided that the creditworthiness of the new counterparty is the same as or better than that of the previous counterparty.

Summary: At this meeting, the EITF decided that a novation of a counterparty in a derivative contract does not, in itself, result in the dedesignation of the derivative from the hedge accounting relationship (the fourth alternative above). The Task Force members deliberated whether the novation of a

counterparty was, in itself, a change in critical terms. Instead, the Task Force members decided that a change in a counterparty's creditworthiness was the critical term to consider and that an entity would assess this term when evaluating hedge effectiveness in each reporting period under current U.S. GAAP. Task Force members noted that if the counterparty's creditworthiness was significantly different, the derivative hedge may not meet the highly effective hedge threshold for hedge accounting.

Effective Date and Transition: The consensus-for-exposure would be applied prospectively to derivative contracts that are novated after the guidance's effective date. However, the proposed ASU will ask stakeholders whether the Board should provide relief by allowing entities to apply a retrospective transition method to contracts that were (1) dedesignated from a hedging relationship to which the shortcut method was originally applied and then (2) designated in a hedging relationship to which the long-haul hedge effectiveness method was subsequently applied. The Task Force will discuss the effective date at a future meeting.

Next Steps: FASB ratification is expected at the Board's July 9, 2015, meeting, after which a proposed ASU will be issued for public comment.

Issue 15-E, "Contingent Put and Call Options in Debt Instruments"

Status: Consensus-for-exposure.

Affects: Entities that invest in or issue debt instruments containing contingent put or call options.

Background: Debt instruments that contain embedded features, including contingent put and call options, are evaluated to determine whether the embedded features must be bifurcated and accounted for as derivative instruments with changes in fair value recorded through income.

The guidance on bifurcating these features is unclear because it may be interpreted as meaning that a contingent put or call option is considered clearly and closely related[8] to the host contract if *exercise* of the put or call is *only indexed to interest rates or credit risk and not some extraneous event or factor*. But the guidance also contains a four-step decision sequence related to determining whether a put or call option that accelerates the repayment of the debt contract's principal is clearly and closely related to the debt instrument. The four-step decision sequence does not require that the exercise of the contingent put or call option be indexed only to an interest rate or credit risk and not some extraneous event or factor.

The Task Force discussed whether (1) the above assessment should be limited to the four-step decision sequence or (2) an entity should apply the four-step decision sequence **and** evaluate whether the *exercise*[9] of the contingent put or call option is indexed to only an interest rate or credit risk and not some extraneous event or factor.

Summary: The Task Force decided that an entity would only apply the four-step sequence when assessing whether a contingent put or call option embedded in a debt instrument must be bifurcated as an embedded derivative and recorded at fair value through earnings. Thus, a potential embedded derivative would not fail to be clearly and closely related solely because the exercise of the contingent put or call option is indexed to an extraneous event or factor. Further, the Task Force decided that an entity may elect the fair value option for debt instruments with embedded puts and calls that, as a result of this guidance, would otherwise be separated and accounted for as a derivative contract.

[8] ASC 815-15-25-1(a) states that one of the criteria for when an embedded derivative must be separated from the host contract is that the "economic characteristics and risks of the embedded derivative are not *clearly and closely* related to the economic characteristics and risks of the host contract" (emphasis added). A put or call option that accelerates the repayment of the debt contract's principal can be clearly and closely related unless both of the following criteria are met:

- The debt involves a substantial premium or discount.
- The call (put) option is only contingently exercisable.

[9] For example, the exercise might be contingent on a change in the price of gold.

Effective Date and Transition: Entities would be required to adopt a modified retrospective transition approach, with a cumulative catch-up adjustment to opening retained earnings in the period of adoption. The Task Force will discuss the effective date at a future meeting.

Next Steps: FASB ratification is expected at the Board's July 9, 2015, meeting, after which a proposed ASU will be issued for public comment.

Issue 15-F, "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments"

Status: Tentative decisions.

Affects: Entities that prepare a statement of cash flows.

Background: ASC 230 provides some guidance on cash payments and receipts that are classified as either financing or investing activities. Cash flows associated with cash payments and receipts that do not qualify as financing or investment activities are classified in operating activities.[10] However, ASC 230 does not have consistent principles for evaluating the classification of cash payments and receipts in the statement of cash flows, which has led to diversity in practice and, in certain circumstances, financial statement restatements.

The Task Force discussed the following six issues and alternatives (quoted material is from Appendix C of the Issue Summary):

1. Debt prepayment and extinguishment costs:
   a. "Cash payments for debt prepayment or extinguishment costs should be classified as cash outflows for operating activities."
   b. "Cash payments for debt prepayment or extinguishment costs should be classified as cash outflows for financing activities."
2. Settlement of zero-coupon bonds:
   a. "At settlement, the portion of the cash payment attributable to the accreted interest should be classified as a cash outflow for operating activities and the portion of the cash payment attributable to the principal (original proceeds) should be classified as a cash outflow for financing activities."
   b. "At settlement, the entire cash payment should be classified as a cash outflow for financing activities."
3. Contingent consideration payments made after a business combination:
   a. "Cash payments made after a business combination for the settlement of a contingent consideration liability should be classified as cash outflows for investing activities."
   b. "Cash payments made after a business combination for the settlement of a contingent consideration liability should be classified as cash outflows for financing activities if the amount was not paid at the time of purchase or soon before or after the business combination occurred."

[10] The glossary in ASC 230 further defines operating activities as those that "involve producing and delivering goods and providing services" and cash flows that generally affect "transactions and other events that enter into the determination of net income."

c. “Cash payments made after a business combination for the settlement of a contingent consideration liability should be separated and classified as cash outflows for financing activities and operating activities. Specifically, the portion of the total cash payment not to exceed the amount of the contingent consideration liability recognized at acquisition-date fair value, including measurement period adjustments, should be classified as a cash outflow for financing activities, if the amount was not paid at the time of purchase or soon before or after the business combination occurred. Amounts paid in excess of the amount of the contingent consideration liability recognized at acquisition-date fair value, including measurement period adjustments, should be classified as a cash outflow for operating activities.”

4. Restricted cash:
   a. Classification of changes in restricted cash:
      i. “Changes of the principal balances in restricted cash that affect cash and cash equivalents should be based on the nature of the cash flows and, therefore, classified as investing activities on the statement of cash flows.”
      ii. “Changes of the principal balances in restricted cash that affect cash and cash equivalents should be classified based on the purpose of the restricted cash” (e.g., if the purpose of the activities is to settle debt, they would be financing activities).
   b. Cash payments and cash receipts that directly affect restricted cash:
      i. “Require noncash disclosures.”
      ii. “Present cash payments made directly from restricted cash and cash receipts directly deposited into restricted cash in the body of the statement of cash flows.”
5. Proceeds from the settlement of insurance claims:
   a. “Proceeds received from the settlement of insurance claims should be classified based on the insurance coverage (that is, the nature of the loss).”
   b. “Proceeds received from the settlement of insurance claims should be classified as cash inflows from operating activities.”
6. Proceeds from the settlement of corporate-owned life insurance (COLI) policies:
   a. “Cash proceeds received from the settlement of COLI policies should be classified as cash inflows from operating activities.”
   b. “Cash proceeds received from the settlement of COLI policies should be classified as cash inflows from investing activities.”
   c. “Cash proceeds received from the settlement of COLI policies should be separated and classified as cash inflows from operating and investing activities.”

Summary: The Task Force made tentative decisions about four of the six issues deliberated, which are described below. The Task Force instructed the FASB staff to perform additional research related to restricted cash and proceeds from the settlement of corporate-owned life insurance policies. The Task Force tentatively decided that:

1. All debt prepayment and extinguishment costs should be classified as financing activities (alternative (b) from above).
2. The settlement of a zero-coupon bond would be classified within operating and financing activities (alternative (a) from above). The cash payment of the accreted interest would be classified within operating activities, while the cash payment attributable to the original proceeds (i.e., the principal) would be classified within financing activities.
3. Contingent consideration payments that were not made on the acquisition date or soon before or after the business combination would be classified within operating and financing activities (alternative (c) from above). Cash payments up to the fair value amount of the contingent consideration liability, including any measurement-period adjustments, recognized as of the acquisition date would be classified within financing activities, while any excess cash payments would be classified within operating activities.

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4. The cash proceeds from the settlement of insurance claims would be based on the nature of the insurance coverage (alternative (a) from above). For example, cash proceeds from insurance claims related to a building or manufacturing equipment would be classified in investing activities, while cash proceeds from insurance claims related to inventory or business interruption insurance would be classified within operating activities.

Next Steps: At its September 17, 2015, meeting, the Task Force is expected to (1) redeliberate the cash flow classification of restricted cash and proceeds from the settlement of corporate-owned life insurance policies; (2) discuss three other cash flow issues: (a) distributions received from equity method investees, (b) beneficial interests in securitization transactions, and (c) application of the predominance principle; and (3) deliberate the transition alternatives for each issue. The Task Force will discuss the effective date at a future meeting.

Administrative Matters

At the EITF meeting, the SEC staff discussed an implementation issue related to ASU 2015-03,[11] which requires that debt costs be presented as a direct deduction from the related debt liability rather than as an asset within the statement of operations. ASU 2015-03 does not provide explicit guidance on the presentation of costs incurred in connection with an undrawn revolving line of credit. The SEC staff noted that it would "not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the revolving debt arrangement." For more information, see Deloitte's June 18, 2015, *Heads Up*.

The next EITF decision-making meeting is tentatively scheduled for September 17, 2015.

[11] FASB Accounting Standards Update No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*.

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