

Heads Up

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Both public and nonpublic business entities would apply the ASU by using a cumulative-effect approach to account for transactions outstanding as of the beginning of the period of adoption.

You Repo What You Sow

FASB Makes Limited Amendments to Its Repurchase Accounting Guidance

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On June 12, 2014, the FASB issued [ASU 2014-11](#),¹ which makes limited amendments to the guidance in ASC 860² on accounting for certain repurchase agreements (“repos”). The ASU (1) requires entities to account for repurchase-to-maturity transactions³ as secured borrowings (rather than as sales with forward repurchase agreements), (2) eliminates accounting guidance on linked repurchase financing transactions, and (3) expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically, repos, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings.

The ASU also amends ASC 860 to clarify that repos and securities lending transactions that do not meet all of the derecognition criteria in ASC 860-10-40-5 should be accounted for as secured borrowings. In addition, the ASU provides examples of repurchase and securities lending arrangements that illustrate whether a transferor has maintained effective control over the transferred financial assets.

Both public and nonpublic business entities would apply the ASU by using a cumulative-effect approach to account for transactions outstanding as of the beginning of the period of adoption. The ASU includes staggered effective dates for accounting and disclosure requirements that vary depending on whether the reporting entity is a public or a nonpublic business entity. See [Effective Date and Transition](#) below for more information.

This *Heads Up* summarizes the key provisions of the ASU.

Repurchase-to-Maturity Transactions

The ASU amends ASC 860 to include an exception that prohibits entities from accounting for repurchase-to-maturity transactions as sales. Specifically, ASC 860-10-40-5A (added by the ASU) states:

A repurchase-to-maturity transaction shall be accounted for as a secured borrowing as if the transferor maintains effective control (see paragraphs 860-10-40-24 through 40-24A).

¹ FASB Accounting Standards Update No. 2014-11, *Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*.

² For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte’s “Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*.”

³ The ASU defines a repurchase-to-maturity transaction as a repo that (1) settles at the maturity of the transferred financial asset and (2) does not require the transferor to reacquire the transferred financial asset.

Many stakeholders believe that accounting for a repurchase-to-maturity transaction as a secured borrowing better reflects the substance of the arrangement.

Editor’s Note: Before the ASU’s amendments, the transferor in repurchase-to-maturity transactions was typically deemed to have surrendered control since the initially transferred financial asset was never reacquired. Consequently, if the remaining conditions for derecognition in ASC 860-10-40-5 were met (i.e., legal isolation and the transferee’s right to pledge or exchange the asset), repos that settle at maturity were accounted for as a sale with a forward repurchase agreement (i.e., a derivative measured at fair value through net income, provided that the conditions in ASC 815 were met).

Although the effective-control model in ASC 860 previously distinguished between repurchases before maturity and repurchases at maturity, the FASB believes that a repurchase-to-maturity transaction is economically analogous to a collateralized financing since the transferor is exposed to both issuer-default risk and market risk during the term of the repo. In addition, as the ASU’s basis for conclusions indicates, FASB staff outreach has revealed that the transferor in a repurchase-to-maturity transaction typically recognizes (1) coupon payments associated with the transferred financial assets and (2) a financing expense on the borrowing. In light of this outreach and the inherent similarities between the risks and benefits of repurchase-before-maturity transactions and those of repurchase-to-maturity transactions, many stakeholders believe that accounting for a repurchase-to-maturity transaction as a secured borrowing better reflects the substance of the arrangement.

The ASU does not change the other criteria in ASC 860 for assessing effective control. In addition, the ASU’s basis for conclusions clarifies that (1) the repurchase-to-maturity exception should not be applied by analogy to other cash-settled repurchase agreements and (2) a repurchase-to-maturity transaction in which the underlying collateral is accounted for as held to maturity (under ASC 320) would not contradict the held-to-maturity designation of the collateral.

Repurchase Financings

The ASU eliminates the guidance on repurchase financing transactions in ASC 860-10-40-42 through 40-47 and requires the transferor and transferee to symmetrically account for the initial transfer of the financial asset as a sale (provided that derecognition conditions are met) and purchase, respectively. In addition, the ASU requires entities to evaluate and account for the repurchase component of the combined transaction in a manner similar to how they would evaluate and account for other typical repurchase agreements.

Editor’s Note: The previous guidance in ASC 860 included a rebuttable presumption that an initial transfer of a financial asset and a repurchase financing transaction that are entered into contemporaneously with, or in contemplation of, one another would be considered linked unless certain specified criteria were met. Accordingly, entities were generally required to link the initial transfer and the repurchase financing component and account for those transactions on a combined basis. Under the ASU, more repurchase financing transactions are likely to be accounted for as secured borrowings than under current guidance. Because entities will no longer be required to evaluate the presumption of linkage, implementation of the new guidance could alleviate the cost and complexity associated with performing this evaluation.

Effective Control

If an entity determines that it does not maintain effective control over the transferred financial asset, it would still need to meet the remaining derecognition criteria (i.e., legal isolation under ASC 860-10-40-5(a) and the right to pledge or exchange under ASC 860-10-40-5(b)) to qualify for sale accounting. The ASU clarifies that agreements to repurchase financial assets that meet either (1) the effective-control criteria or (2) the repurchase-to-maturity exception need not be assessed under the remaining derecognition criteria and should be accounted for as secured borrowings.

The ASU introduces new disclosure requirements related to (1) certain transfers of financial assets accounted for as sales and (2) collateral supporting repos, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings.

Editor’s Note: The determination of whether a transfer of financial assets should be accounted for as a sale or as a secured borrowing depends on whether the transfer meets the criteria in ASC 860-10-40-5. Paragraph BC4 of the ASU’s basis for conclusions explains that under ASC 860-10-40-5, a transfer of a financial asset is accounted for as a sale only if all of the following conditions are met:

- a. The transferred assets have been isolated from the transferor, even in bankruptcy.
- b. The transferee has the right to pledge or exchange the transferred assets.
- c. The transferor does not maintain effective control.

Further, ASC 860-10-40-24 states that a transferor maintains effective control over the transferred assets only if all of the following conditions are met:

- a. The financial assets to be repurchased or redeemed are the same or substantially the same as those transferred. . . .
- c. The agreement is to repurchase or redeem the financial assets before maturity,⁽⁴⁾ at a fixed or determinable price.
- d. The agreement is entered into contemporaneously with, or in contemplation of, the transfer.

ASC 860-10-55-51B (added by the ASU) provides examples of repurchase and securities lending arrangements (including fair value forward repurchase agreements and cash-settled repurchase agreements) that illustrate whether the transferor has maintained effective control over the transferred financial assets. When entities perform the ASC 860 derecognition analysis for repos, the first two criteria in ASC 860-10-40-5 may be met since most repos are structured to give the transferee legal title to the transferred financial asset for the duration of the agreement. Therefore, the sale-or-borrowing analysis often hinges on the effective-control criterion outlined in ASC 860-10-40-5.

Disclosure Requirements

The ASU introduces new disclosure requirements related to (1) certain transfers of financial assets accounted for as sales and (2) collateral supporting repos, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings.

Certain Transfers Accounted for as Sales

The ASU requires additional disclosures about transactions accounted for as sales that meet both of the following conditions:

- a. A transfer of financial assets to a transferee
- b. An agreement entered into in contemplation of the initial transfer . . . that results in the transferor retaining substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction.

ASC 860-20-50-4B (added by the ASU) clarifies that this disclosure requirement applies to the following types of transactions:

- a. Transfers of financial assets with an agreement to repurchase the transferred financial asset (or a substantially-the-same financial asset) before maturity at a fixed or determinable price that will be settled in a form other than the return of the transferred financial asset (for example, the transaction is cash-settled)
- b. Transfers of financial assets with an agreement that requires that the transferor retain substantially all of the exposure to the economic return on the transferred financial asset (for example, a sale with a total return swap).

⁴ As discussed in [Repurchase-to-Maturity Transactions](#) above, ASC 860-10-40-5A prohibits entities from accounting for repurchase-to-maturity transactions as sales.

The disclosure requirement of ASC 860-20-50-4D does not apply to dollar-roll transactions that qualify for sale accounting.

ASC 860-20-50-4C (added by the ASU) further clarifies that the ASU excludes from the scope of this disclosure requirement (1) dollar-roll transactions that qualify for sale accounting and (2) transactions described in ASC 860-20-50-2 that are subject to the disclosure requirements of ASC 860-20-50-3 and 50-4 (i.e., securitizations, asset-backed financing arrangements, and similar transfers that meet certain criteria).

For outstanding transactions as of the reporting date that fall within the scope of this disclosure requirement, ASC 860-20-50-4D (added by the ASU) requires an entity to disclose the following:

- a. The carrying amount of assets derecognized as of the date of derecognition:
 1. If the amounts that have been derecognized have changed significantly from the amounts that have been derecognized in prior periods or are not representative of the activity throughout the period, a discussion of the reasons for the change shall be disclosed.
- b. The amount of gross cash proceeds received by the transferor for the assets derecognized as of the date of derecognition.
- c. Information about the transferor's ongoing exposure to the economic return on the transferred financial assets:
 1. As of the reporting date, the fair value of assets derecognized by the transferor.
 2. Amounts reported in the statement of financial position arising from the transaction (for example, the carrying value or fair value of forward repurchase agreements or swap contracts). To the extent that those amounts are captured in the derivative disclosures presented in accordance with paragraph 815-10-50-4B, an entity shall provide a cross-reference to the appropriate line item in that disclosure.
 3. A description of the arrangements that result in the transferor retaining substantially all of the exposure to the economic return on the transferred financial assets and the risks related to those arrangements.

The ASU requires entities to disclose this information by type of transaction (e.g., repo, securities lending arrangement, or sale and total return swap). For an example of how an entity would present the disclosures, see [Appendix A](#) of this *Heads Up*.

Certain Transfers Accounted for as Secured Borrowings

To enhance the transparency of collateral supporting repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings, ASC 860-30-50-7 (added by the ASU) requires entities to disclose the following:

- a. A disaggregation of the gross obligation [arising] by the class of collateral pledged. An entity shall determine the appropriate level of disaggregation and classes to be presented on the basis of the nature, characteristics, and risks of the collateral pledged.
- b. The remaining contractual maturity of the repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions. . . .
- c. A discussion of the potential risks associated with the agreements and related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

For an example of how an entity would present this information, see [Appendix B](#) of this *Heads Up*.

Effective Date and Transition

The ASU prescribes effective dates for the accounting changes and the disclosure guidance, respectively. These dates vary depending on whether the reporting entity is a public or a nonpublic business entity.

For public business entities, the accounting changes are effective for the first interim or annual period beginning after December 15, 2014. For all other entities, the accounting guidance is effective for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. Early adoption is not permitted for public

business entities; however, all other entities may elect to early adopt the accounting guidance for interim periods beginning after December 15, 2014. All entities would apply the new accounting guidance by making a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption.

Public business entities would apply the disclosure requirements related to certain transactions accounted for as a sale to interim and annual periods beginning after December 15, 2014. Such entities would apply the disclosure requirements related to repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowing to annual periods beginning after December 15, 2014, and to interim periods beginning after March 15, 2015. For all other entities, the disclosure requirements are effective for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. Entities are not required to present comparative disclosures before the effective date.

Appendix A — Required Disclosures About Certain Transfers Accounted for as Sales

The example below, which is reproduced from the ASU,⁵ illustrates how an entity would present information about transfers accounted for as sales, such as transactions involving repos, a sale with a total return swap, or securities lending.

Transfer of Financial Assets Accounted for as Sales

(Dollars in millions) Type of transaction	At the Date of Derecognition for Transactions Outstanding		At the Reporting Date		
	Carrying Amount Derecognized	Gross Cash Proceeds Received for Assets Derecognized	Fair Value of Transferred Assets	Gross Derivative Assets Recorded ^{(a) (b)}	Gross Derivative Liabilities Recorded ^{(a) (b)}
Repurchase agreements	\$ XX	\$ XX	\$ XX	\$ XX	\$ XX
Sale and a total return swap	XX	XX	XX	XX	XX
Securities lending	XX	XX	XX	XX	XX
Total	\$ XX	\$ XX	\$ XX	\$ XX	\$ XX

(a) Balances are presented on a gross basis, before the application of counterparty and cash collateral offsetting.
(b) \$XX of gross derivative assets and \$XX of gross derivative liabilities are included as interest rate contracts in footnote X on derivative disclosures. \$XX of gross derivative assets and \$XX of gross derivative liabilities are included as credit risk contracts in footnote X on derivative disclosures.

⁵ ASC 860-20-55-108 (added by the ASU).

Appendix B — Required Disclosures About Certain Transfers Accounted for as Secured Borrowings

The example below, which is reproduced from the ASU,⁶ illustrates how an entity would present information about collateral supporting repos, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings.

Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions Accounted for as Secured Borrowings

20XX					
(Dollars in millions)	Remaining Contractual Maturity of the Agreements				Total
	Overnight and Continuous	Up to 30 Days	30–90 Days	Greater Than 90 Days	
Repurchase agreements and repurchase-to-maturity transactions					
U.S. Treasury and agency securities	\$ XXX	\$ XXX	\$ XXX	\$ XXX	\$ XXX
State and municipal securities	XXX	XXX	XXX	XXX	XXX
Asset-backed securities	XXX	XXX	XXX	XXX	XXX
Corporate securities	XXX	XXX	XXX	XXX	XXX
Equity securities	XXX	XXX	XXX	XXX	XXX
Non-U.S. sovereign debt	XXX	XXX	XXX	XXX	XXX
Loans	XXX	XXX	XXX	XXX	XXX
Other	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
Total	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
Securities lending transactions					
U.S. Treasury and agency securities	XXX	XXX	XXX	XXX	XXX
State and municipal securities	XXX	XXX	XXX	XXX	XXX
Corporate securities	XXX	XXX	XXX	XXX	XXX
Equity securities	XXX	XXX	XXX	XXX	XXX
Non-U.S. sovereign debt	XXX	XXX	XXX	XXX	XXX
Loans	XXX	XXX	XXX	XXX	XXX
Other	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
Total	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
Total borrowings	<u>\$ XXX</u>	<u>\$ XXX</u>	<u>\$ XXX</u>	<u>\$ XXX</u>	<u>\$ XXX</u>
Gross amount of recognized liabilities for repurchase agreements and securities lending in footnote X					<u>\$ XXX</u>
Amounts related to agreements not included in offsetting disclosure in footnote X					<u>\$ XXX</u>

⁶ ASC 860-30-55-4 (added by the ASU).

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