

## Heads Up

### In This Issue:

- Introduction
- Scope
- Disclosure Requirements
- Transition and Effective Date
- Appendix — Illustrative Disclosure Example

## Pulling Back the Curtain

# FASB's Proposed ASU Aims to Increase Transparency of Hybrid Financial Instruments With Embedded Derivatives

by Mark Bolton, Shahid Shah, and Chris Cryderman, Deloitte & Touche LLP

### Introduction

On February 24, 2015, the FASB issued a [proposed Accounting Standards Update](#) (ASU) that would establish new disclosure requirements for hybrid financial instruments with bifurcated embedded derivatives. This proposal stems from the Board's decision in its classification and measurement project<sup>1</sup> to retain existing U.S. GAAP guidance on the bifurcation of embedded derivatives. Although the Board chose not to amend the existing bifurcation guidance, it hopes that the proposed disclosures will address stakeholders' concerns regarding the transparency and usefulness of information about such instruments in the financial statements. In its Basis for Conclusions, the Board acknowledges that "even though the host contract and the bifurcated embedded derivative encompass one legal contract, [under existing U.S. GAAP] they often are disclosed in the footnotes as if they are two separate instruments." The proposal requires entities to disclose the link between bifurcated embedded derivatives and their host contracts so that financial statement users can "analyze the overall economics and cash flows for the entire hybrid financial instrument."

The Board decided to separately expose the proposed disclosure requirements for comment because they were not included in the 2013 proposed ASU on recognition and measurement of financial assets and financial liabilities. Comments on the proposal are due by April 30, 2015.

### Scope

The proposed ASU would apply to issuers of and investors in hybrid financial instruments with embedded derivatives for which bifurcation is required.<sup>2</sup> All entities (both public and nonpublic) would be required to provide the disclosures.

<sup>1</sup> For more information about the FASB's project on recognition and measurement of financial assets and financial liabilities, see Deloitte's February 2, 2015, [Heads Up](#).

<sup>2</sup> ASC 815-15-25-1 requires separation of an embedded derivative if all of the following conditions are met: (1) the embedded derivative is not clearly and closely related to the host contract, (2) the hybrid instrument is not remeasured at fair value, and (3) the embedded derivative on its own would meet the requirements as a derivative under ASC 815-10-15.

**Editor's Note:** The proposal's scope is limited to embedded features that must be bifurcated under ASC 815-15-25-1. Other embedded features, such as cash conversion options or beneficial conversion features, are excluded from its scope. Further, the proposal does not apply to nonfinancial hybrid instruments with bifurcated embedded derivatives; however, the proposed ASU solicits views on whether its scope should be expanded to include nonfinancial instruments.

## Disclosure Requirements

The proposal would not amend current U.S. GAAP disclosure requirements for hybrid financial instruments or bifurcated embedded derivatives, such as those in ASC 815-10-50; instead, it would require entities to link the financial instrument host contracts to the bifurcated embedded derivatives in their footnotes to the financial statements. The proposal states that for every annual and interim reporting period presented, an entity would disclose, either in a tabular or nontabular format:

- a. For each bifurcated embedded derivative:
  1. The location and fair value amounts reported in the statement of financial position
  2. The location and amounts of the gains and losses reported in the statement of financial performance.
- b. For each host contract related to each bifurcated embedded derivative above:
  1. The location in the statement of financial position, carrying amount, and measurement attribute
  2. The location and amounts reported in the statement of financial performance.

Within the disclosure, instruments may be aggregated by derivative type if all activity for the grouped bifurcated embedded derivatives and grouped related host contracts is presented in the same line items within the statements of financial position and financial performance. The appendix of this *Heads Up* contains an example, extracted from the proposed ASU, illustrating the disclosures provided in a tabular format.

## Transition and Effective Date

The proposed ASU would be applied prospectively to all hybrid financial instruments with bifurcated embedded derivatives that exist as of the beginning of the fiscal year of adoption. The Board will deliberate the effective date after considering stakeholder feedback.

## Appendix — Illustrative Disclosure Example

The following table, which has been reproduced from the ASU, is an example illustrating the disclosures provided in a tabular format:

Bifurcated Embedded Derivatives					Related Host Contracts					
Derivative Type	Balance Sheet Location	Fair Value	Location of Gain or Loss Reported in Income	Amount of Gain or Loss Reported in Income	Related Host Contract Type	Balance Sheet Location	Measurement Attribute	Carrying Amount	Location of Amount Reported in Statement of Financial Performance	Amount Reported in Statement of Financial Performance
Equity Contracts	Long-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Long-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Equity Contracts	Short-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Short-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Commodity Contracts	Long-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Long-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Interest-Rate Contracts	Securities Owned	\$XXXX	Other Income / Expense	\$YYYY	Equity Hosts	Securities Owned	Fair Value through Other Comprehensive Income	\$XXXX	Investment Income	\$YYYY

## Subscriptions

If you wish to receive *Heads Up* and other accounting publications issued by Deloitte's Accounting Standards and Communications Group, please [register](http://www.deloitte.com/us/accounting/subscriptions) at [www.deloitte.com/us/accounting/subscriptions](http://www.deloitte.com/us/accounting/subscriptions).

## *Dbriefs* for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy and tax.
- Driving enterprise value.
- Financial reporting.
- Financial reporting for taxes.
- Governance, risk, and compliance.
- Technology.
- Transactions and business events.

*Dbriefs* also provides a convenient and flexible way to earn CPE credit — right at your desk. [Subscribe](#) to *Dbriefs* to receive notifications about future webcasts at [www.deloitte.com/us/dbriefs](http://www.deloitte.com/us/dbriefs).

Registration is available for this upcoming *Dbriefs* webcast. Use the link below to register:

- [FASB's Amended Consolidation Requirements: How Could They Impact Your Firm?](#) (March 4, 3 p.m. (EST)).

## Technical Library and US GAAP Plus

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

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

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

*Heads Up* is prepared by the National Office Accounting Standards and Communications Group of Deloitte as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.