

# Deloitte.

## Banking & Securities Accounting and Financial Reporting Update

November 18, 2015



# Contents

---

<b>Foreword</b>	iii
<b>Acknowledgments and Contact Information</b>	iv
<b>Introduction</b>	v
<b>Updates to Guidance</b>	
Revenue Recognition	2
Accounting for Real Estate Sales Under the New Revenue Standard	5
Consolidation	7
Pushdown Accounting (ASU 2014-17 and ASU 2015-08)	12
Simplifying the Accounting for Measurement-Period Adjustments	13
Accounting Alternatives for Private Companies	14
Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) (ASU 2015-07)	16
Debt Issuance Costs	17
Repurchase Agreements	20
Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure (ASU 2014-04)	22
Accounting for Investments in Qualified Affordable Housing Projects (ASU 2014-01)	23
<b>On the Horizon</b>	
Impairment	26
Classification and Measurement	31
Hedging	33
Leases	35
Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities	37
Accounting for Identifiable Intangible Assets in a Business Combination for Public Business Entities and Not-for-Profit Entities	38
Clarifying the Definition of a Business	38
Simplifying the Accounting for Employee Share-Based Payments	39
Liabilities and Equity — Targeted Improvements	40
Simplifying the Equity Method of Accounting	41
Accounting for Interest Income Associated With the Purchase of Callable Debt Securities	42
Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (EITF Issue 15-F)	43
<b>Other Topics</b>	
Disclosure Framework	45
SEC Update	50
Other Updates	58
<b>Appendixes</b>	
Appendix A — Glossary of Standards and Other Literature	60
Appendix B — Abbreviations	63
Appendix C — Other Resources	65

# Foreword

November 18, 2015

To our clients and colleagues in the banking and securities sector:

We are pleased to announce our eighth annual accounting and financial reporting update. The topics discussed in this publication were selected because they may be of particular interest to banking and securities entities.

Some of the notable standard-setting developments that occurred during 2015 were (1) the issuance of new guidance modifying the FASB's new standard on the recognition of revenue from contracts with customers; (2) the continued work of the FASB on accounting for credit impairment, leases, and financial instruments; 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 banking and securities entities need to start preparing for now; (2) "On the Horizon," which discusses standard-setting topics that will affect banks and other financial institutions as they plan for the future; and (3) "Other Topics" that may be of interest to entities in the banking and securities sector.

The 2015 accounting and financial reporting updates for the insurance, investment management, and real estate sectors are available (or will be available soon) on [US GAAP Plus](#), Deloitte's Web site for accounting and financial reporting news.

In addition, don't miss our recently issued ninth edition of *SEC Comment Letters — Including Industry Insights — What "Edgar" Told Us*, which discusses our perspective on topics that the SEC staff has focused on in comment letters issued to registrants over the past year, including an analysis of comment letter trends in each financial services sector.

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



Kenny Smith  
Vice Chairman, U.S. Banking & Securities Sector Leader  
Deloitte LLP



Susan L. Freshour  
Financial Services Industry Professional Practice Director  
Deloitte & Touche LLP

# Acknowledgments and Contact Information

We would like to thank the following individuals for their contributions to this publication:

Teri Asarito	Mark Fischer	Adrian Mills	Inderjeet Singh
Ermir Berberi	John Franco	Emily Montgomery	Stephanie Tamulis
Mark Bolton	Rachel Grandovic	Rob Morris	PJ Theisen
Lynne Campbell	Emily Hache	Jeff Nick	Timothy Vintzel
Ashley Carpenter	Eric Hatch	Magnus Orrell	Andrew Warren
Chris Cryderman	Ben Johnson	Jeanine Pagliaro	John Wilde
Jamie Davis	Colin Kronmiller	Taylor Paul	Karen Wiltsie
Joe DiLeo	Michelle Lacey	Lauren Pesa	Andrew Winters
Christopher Donavan	Michael Lorenzo	Christine Reicheneder	
Geri Driscoll	Mat Lorie	Tom Robinson	
Trevor Farber	Stephen McKinney	Shahid Shah	

If you have any questions concerning this publication, please contact the following Deloitte industry specialists:

## **Kenny Smith**

Vice Chairman, U.S. Banking & Securities Sector Leader

+1 415 783 6148

[kesmith@deloitte.com](mailto:kesmith@deloitte.com)

## **Christopher Donovan**

Securities Industry Professional Practice Director

+1 212 436 4478

[chrdonovan@deloitte.com](mailto:chrdonovan@deloitte.com)

## **Tim Vintzel**

Securities Industry Professional Practice Director

+1 973 602 5148

[tvintzel@deloitte.com](mailto:tvintzel@deloitte.com)

## **Irv Bisnov**

Audit Industry Leader — Banking

+1 513 412 8329

[ibisnov@deloitte.com](mailto:ibisnov@deloitte.com)

## **Susan L. Freshour**

Financial Services Industry Professional Practice Director

+1 212 436 4814

[sfreshour@deloitte.com](mailto:sfreshour@deloitte.com)

## **Tom Robinson**

Banking Industry Professional Practice Director

+1 313 396 3900

[torobinson@deloitte.com](mailto:torobinson@deloitte.com)

## **Carol Larson**

Audit Industry Leader — Financial Services

+1 412 338 7210

[clarson@deloitte.com](mailto:clarson@deloitte.com)

## **Larry Rosenberg**

Audit Industry Leader — Securities

+1 212 436 4869

[lrosenberg@deloitte.com](mailto:lrosenberg@deloitte.com)

# Introduction

The economic momentum gathered by the banking and securities sector in 2013 and 2014 was slowed by market fluctuations in 2015. Uncertainties in the Federal Reserve's timing for raising interest rates contributed to this deceleration and have begun weighing on investor sentiment. Increased profitability has continued as a result of lower loan-loss provisions and a focus on cutting costs throughout all aspects of banking and securities institutions, and expenses associated with complying with new regulations will continue to put pressure on earnings.

## Economic Growth

Credit markets continue to expand as banks ease underwriting requirements. Residential, commercial, and consumer lending have continued to grow, and allowances for loan-loss provisions have dropped and remain at pre-crisis levels. Institutions with high concentrations of credits in certain industries, specifically the oil and gas industry, may face increased allowances for loan losses due to the significant challenges in these industries. The banking and securities industry continues to be affected by costs and complexities of litigation and global regulatory requirements.

## Financial Reporting Developments

In 2014, the FASB<sup>1</sup> and IASB issued new guidance on the recognition of revenue from contracts with customers ([ASU 2014-09](#)<sup>2</sup> and IFRS 15, respectively). The FASB continued to refine this guidance in 2015. In response to requests from stakeholders, as well as continued feedback from primary financial statement users and preparers, the FASB issued [ASU 2015-14](#), which defers implementation of the revenue standard by one year for all entities and permits early adoption on a limited basis. For public entities, the standard is effective for annual reporting periods beginning after December 15, 2017. For nonpublic entities, the standard is effective for annual reporting periods beginning after December 15, 2018.

The FASB is currently drafting its final standard on credit losses, which it expects to issue in the first quarter of 2016. Under this guidance, an entity would recognize as an allowance its estimate of expected credit losses (i.e., all contractual cash flows that the entity does not expect to collect). All debt instruments that are financial assets (other than those measured at fair value through net income), lease receivables, and loan commitments would be within the scope of the model, while available-for-sale (AFS) debt securities would be excluded. AFS debt securities would continue to be assessed for impairment under ASC 320 (subject to potential changes as part of the FASB's impairment project). In addition, the Board has decided to retain existing requirements related to classification and measurement of financial instruments other than equity investments. Under the FASB's tentative approach, entities will be required to carry all investments in equity securities (except investments that qualify for the equity method or for which a practicability exception to fair value measurement has been elected) at fair value through net income.

In 2015, the FASB continued to focus on a number of other miscellaneous topics, including (1) drafting a final standard on the accounting for classification and measurement of financial instruments, (2) drafting the final leases standard, and (3) making improvements to existing accounting guidance under its simplification initiative (i.e., the Board's effort to reduce the cost and complexity of current U.S. GAAP while maintaining and enhancing the usefulness of the related financial statement information).

For additional information about industry issues and trends, see Deloitte's [2015 Financial Services Industry Outlooks](#).

<sup>1</sup> For a list of abbreviations used in this publication, see [Appendix B](#).

<sup>2</sup> For the full titles of standards, topics, and regulations used in this publication, see [Appendix A](#).

# Updates to Guidance

# Revenue Recognition

## Background

In May 2014, the FASB and IASB issued their final standard on revenue recognition. The standard, issued as [ASU 2014-09](#) by the FASB and as IFRS 15 by the IASB, 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., ASC 940-605, ASC 942-605, and ASC 948-605). Financial instruments that are within the scope of other Codification topics, the recognition of interest income and dividends, and the servicing of financial assets are excluded from the ASU's scope. For additional information about ASU 2014-09 as issued, see Deloitte's May 28, 2014, [Heads Up](#) and July 2014 [Financial Services Spotlight](#).

In response to feedback received by the FASB-IASB joint transition resource group (TRG) on revenue recognition, the FASB in 2015 issued the following three proposed ASUs (currently in different stages of consideration), which would revise ASU 2014-09:<sup>1</sup>

- [Narrow-Scope Improvements and Practical Expedients](#) — The proposed guidance would (1) clarify how to assess whether collectibility is probable in certain circumstances to support the existence of a contract and the recognition of revenue, (2) add a practical expedient to ASC 606 for the presentation of sales taxes on a net basis in revenue, (3) clarify how to account for noncash consideration at contract inception and throughout the contract period, and (4) establish a practical expedient to address contract modifications upon transition. See Deloitte's October 2, 2015, [Heads Up](#) for more information.
- [Principal Versus Agent Considerations \(Reporting Revenue Gross Versus Net\)](#) — The proposal would address issues related to how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. Guidance would include (1) how to determine the unit of account, (2) whether the related indicators in ASC 606 are intended to assist in a single evaluation of control or represent an additional evaluation, and (3) how certain indicators are related to ASC 606's general control principle. The proposed ASU would also clarify 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 September 1, 2015, [Heads Up](#) for more information.
- [Identifying Performance Obligations and Licensing](#) — The amendments would clarify the guidance on an entity's identification of certain performance obligations. Proposed 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. These updates are not expected to significantly affect the banking and securities industry. In addition, the FASB directed its staff to draft a final ASU at its October 5, 2015, meeting. See Deloitte's May 13, 2015, [Heads Up](#) and October 8, 2015, [journal entry](#), respectively, for more information.



<sup>1</sup> The IASB's July 2015 [exposure draft](#) also proposes changes to IFRS 15.

## Thinking It Through

### Banking and Securities Entities

One of the major implementation challenges for banks and other financial institutions has been determining whether a transaction is within the scope of ASC 606. Such a determination requires careful consideration of the facts and circumstances and must be well documented. To date, transactions that have seemed to garner the most attention include the following:

- *Deposit-related fees and ATM usage fees* — Under current U.S. GAAP, there is no explicit industry guidance on the deposit-related fees charged to customers by banks, such as account maintenance fees (which may be charged when a customer does not keep a required minimum balance in the deposit account) and ATM usage fees. As a result, stakeholders have questioned whether such fees are within the scope of ASC 606. Two views predominate and are based on whether the arrangement is a financial liability subject to ASC 405 or a service subject to ASC 606:
  - *View A* — Because the arrangement is with a customer, the account maintenance and ATM usage fees (to the extent that the bank's ATM is accessed by an individual with an account at the bank) are charged to a customer under the terms of the deposit agreement between the customer and the financial institution. Accordingly, the arrangement creates a financial liability subject to the guidance in ASC 405. In addition, some supporters of View A believe that fees charged to individuals accessing funds from a different bank (i.e., the individual does not have a deposit account with the bank) would be within the scope of ASC 606 because the nature of this contract is to provide the service of connecting the individual with his or her bank.
  - *View B* — Providing ATM access is a distinct service provided to customers that is separate from the services provided under the depository agreements. Therefore, supporters of View B believe that ATM fees are within the scope of ASC 606 regardless of the relationship between the bank and the customer (i.e., irrespective of whether the customer holds a deposit with the bank charging the ATM fee).
- *Loan origination fees* — Many believe that loan origination fees are not within the scope of ASC 606 (much like under current U.S. GAAP). Rather, such fees are considered lending-related fees because they are related to contractual rights and obligations that are addressed in ASC 310. In addition, many believe that other lending-related fees, including interest income on receivables, rebates of accrued interest income, prepayment charges, delinquency charges (late fees), and loan commitment fees, would not be subject to ASC 606.
- *Bank-issued credit card fees and related reward programs* — Under current U.S. GAAP, credit card arrangements are typically accounted for under ASC 310. ASC 606 notes that financial instruments within the scope of other Codification topics, including ASC 310, are excluded from the scope of the new revenue standard unless those other Codification topics “do not specify how to separate and/or initially measure one or more parts of the contract.”<sup>2</sup> Stakeholders have questioned whether credit card arrangements generally — or specific features of such arrangements — are within the scope of the new revenue standard since the arrangements often involve different (1) fees (e.g., annual fees, late fees), (2) features (e.g., concierge services, rewards programs), and (3) parties to the transaction (e.g., issuer, cardholder, network, merchant, merchant acquirer). At the July 13, 2015, TRG meeting, members of the TRG agreed with the FASB staff that because the new revenue standard does not include consequential amendments to ASC 310, entities should continue to account for services exchanged for credit card fees under ASC 310 rather than ASC 606. However, there was also general agreement that, as anti-abuse measures, (1) entities should assess whether the issuance of a credit card appears incidental to the arrangement (which potentially requires the arrangement to be within the scope of ASC 606) and (2) card holder rewards programs would generally be within the scope of ASC 310 if the credit card arrangement is within the scope of ASC 310.

<sup>2</sup> See ASC 606-10-15-2 through 15-5 (paragraphs 5 through 8 of IFRS 15) for additional information.

- *Bundled arrangements* — ASC 606-10 provides certain scope exceptions for contracts with customers that are within the scope of other topics, including contracts involving financial instruments. However, ASC 606-10 also provides guidance on assessing contracts that are partially within the scope of another topic and partially within the scope of ASC 606, thus indicating that certain arrangements involving financial instruments may be at least partially subject to the new revenue recognition guidance. ASC 606-10-15-4 describes the method entities should use to separate parts of a contract into those subject to ASC 606 and those subject to other topics. This is a departure from current U.S. GAAP, under which financial institutions are not subject to the multiple-element guidance in ASC 605-25 for bundling arrangements that provide both services and financial instruments to customers. Currently, therefore, entities generally do not consider concepts such as vendor specific objective evidence (VSOE) when evaluating such contracts. Under ASC 606, entities are required to first apply the separation and measurement guidance in other Codification topics before applying the guidance in ASC 606. As a result, any discount inherent in the contract would be allocated to the part of the contract that is subject to ASC 606 since this is the last part to be separated and measured.

#### Example — Bundled Arrangements

A bank with an investment management division that sponsors a fund for which it acts as a general partner and investment manager may be partially within the scope of ASC 606 depending on the nature of the services and instruments it provides to its customers. For example, under the terms of an investment management agreement, the bank receives a management fee based on total assets managed and a performance fee based on excess returns once investors have earned a specific return rate. The bank must also hold a small equity investment in the fund. In these circumstances (and as long as the bank is not required to consolidate the fund in accordance with ASC 810), the bank would need to evaluate each involvement with the fund separately to determine which activities, if any, are within the scope of ASC 606 and other Codification topics. For instance, the equity ownership in the fund may be subject to the guidance in ASC 323 but management and performance-related fees are likely to be subject to the guidance in ASC 606.

## Broker-Dealers

While ASU 2014-09 is expected to affect broker-dealers in many ways, the treatment of revenue from financial instruments (i.e., interest and dividend income) is not likely to change because such contracts are subject to the guidance in ASC 310-940 and ASC 320-940 and are specifically outside the scope of ASC 606.

For example, ASU 2014-09 is expected to affect the treatment of commission income earned by a clearing broker-dealer, which is within the scope of ASC 606. Some of the more significant issues broker-dealers will face as they analyze contracts to determine the appropriate treatment under the new guidance are as follows:

- *Identifying performance obligations* — In step 2 of the revenue model, entities are required to identify distinct performance obligations (i.e., deliverables from which the customer can benefit either on its own or together with other resources that are readily available to the customer and separately identifiable from other items in the contract). Typical goods and services provided in contracts between a clearing broker-dealer and its customers include trade execution, clearing services, and custody services. It is unlikely that trade execution and clearing services would be separately identifiable since they are both required services for security trading. Rather, these two services are expected to be combined and identified as one performance obligation in most cases. Custody services, however, are likely to be separately identifiable since a customer can benefit from these services separately from the trade execution and clearing services. Entities would similarly need to evaluate investment research services, which are common in arrangements with broker-dealers.
- *Determining when performance obligations are satisfied* — Generally, the commissions charged by the broker-dealer to the customer upon trade execution are the only fees charged and therefore represent the transaction price for the trade execution, clearing, and custody services. Revenue recognition related to such fees would occur on the trade date since that is the date on which (1) the broker-dealer is performing the service and has a present right to payment and (2) the customer receives the benefits of the underlying security (for purchases) or is no longer subject to the risk of changes in value (for sales). Additional analysis related to determining when performance obligations are satisfied is required for contracts that are fixed in duration or contain fees specifically for custody-related services such as processing and handling of legal documents.

Other broker-dealer transactions that may be affected by ASU 2014-09 and that are still under evaluation include (1) selling and distribution fees, (2) investment banking advisory fees, (3) underwriting revenues, (4) soft-dollar arrangements, (5) costs associated with underwriting and advisory services (i.e., principal vs. agent treatment), (6) volume-related discounts on trades, and (7) free trades (e.g., when a minimum number of trades are executed or in exchange for accounts opened that exceed certain dollar thresholds).

## Effective Date and Transition

In August 2015, as a result of stakeholder concerns, the FASB issued ASU 2015-14,<sup>3</sup> which delays the effective date of ASU 2014-09. Accordingly, ASU 2014-09 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.

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*), the AICPA's revenue recognition task forces (including the Brokers and Dealers in Securities Revenue Recognition Task Force), various firms, the SEC,<sup>4</sup> and the PCAOB. Preparers should continue to monitor the activities of these groups before their adoption of the new guidance.

# Accounting for Real Estate Sales Under the New Revenue Standard

## Background

ASU 2014-09 supersedes most of the current revenue recognition guidance under U.S. GAAP, including the guidance on real estate derecognition for most transactions.<sup>5</sup> While many constituents will be relieved that the ASU eliminates the current bright-line guidance under ASC 360-20 on when to derecognize real estate assets, entities may be required to reassess their historical accounting for real estate disposals.

<sup>3</sup> The IASB amended IFRS 15 a month later to delay its effective dates.

<sup>4</sup> 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.

<sup>5</sup> While the ASU eliminates the guidance in ASC 360-20 on real estate sales, until the FASB completes its leases project, entities will still need to apply ASC 360-20 to sales of real estate that are part of sales-leaseback transactions.

## Thinking It Through

Banks that foreclose on collateralized loans are currently required to apply the guidance in ASC 360-20 to evaluate when they can derecognize their “real estate owned” when they subsequently sell the foreclosed assets. ASU 2014-09 eliminates the requirements in ASC 360-20 for assessing (1) the adequacy of a buyer’s initial and continuing investments and (2) the seller’s continuing involvement with the property. When they evaluate whether they can derecognize real estate under the new standard, banks will need to assess whether it is “probable” that they will collect the consideration to which they will be entitled in exchange for transferring the asset(s) to the customer. In addition, rather than preventing derecognition, a seller’s postsale involvement with the disposed asset may need to be accounted for as a separate performance obligation.

## Financing Arrangements (Existence of a Contract)

Under current guidance, when the seller of real estate also provides financing to the buyer, the seller must consider the buyer’s initial and continuing investments in the property to determine whether they constitute a stake sufficient to ensure that the risk of loss will motivate the buyer to honor its obligation to the seller. If the specified investment requirements are not met, the seller accounts for the sale by using the installment method, the cost recovery method, or the deposit method.

Under the ASU, several criteria must be evaluated in the determination of whether a contract exists. One particularly challenging criterion regarding the sale of real estate by a bank is that the contract must have commercial substance. In assessing whether it has satisfied this criterion, an entity should evaluate the buyer’s initial and continuing involvement in the property. Although the ASU does not retain the specific initial and continuing investment thresholds under current GAAP related to the performance of this evaluation, some factors to consider may include the loan-to-value ratio and whether the property will be used as the buyer’s primary residence. Collectibility of the sales price also affects the evaluation of whether a contract “exists.” That is, the ASU requires an entity to determine whether collectibility is probable for a contract to exist (the “collectibility threshold”).

## Thinking It Through

The collectibility threshold applies to the amount to which the entity expects to be entitled, which may not be the stated transaction price (i.e., these two amounts may differ because an entity anticipates offering the customer a price concession). Accordingly, an entity should carefully assess the facts and circumstances to determine whether, on the basis of the customer’s credit risk, for example, the entity expects to grant a price concession.

If a seller determines that a contract does not exist, it would account for any amounts received as a deposit (even if such payments are nonrefundable). In addition, the seller would continually evaluate the amounts received to determine whether the arrangement subsequently qualifies as a valid contract under the ASU’s criteria. Once it becomes probable that the seller will collect the consideration to which it will be entitled, the seller would evaluate the arrangement under the derecognition criteria in the ASU. If, instead, the contract is terminated, the seller would then recognize any nonrefundable deposits received as a gain.

## Identifying and Satisfying Performance Obligations

Often, a seller remains involved with property that has been sold. Under current guidance, profit is generally deferred if a seller has continuing involvement with the sold property. Sometimes, instead of accounting for the transaction as a sale, the seller may be required to (1) apply the deposit method to the transaction or (2) account for the transaction as a financing, leasing, or profit-sharing arrangement. Current guidance focuses on whether the seller retains substantial risks or rewards of ownership as a result of its continuing involvement with the sold property.

In contrast, under the ASU, if the arrangement includes ongoing involvement with the property, the seller must evaluate each promised good or service under the contract to determine whether it represents a “separate performance obligation,” constitutes a guarantee, or prevents the transfer of control.<sup>6</sup> If a promised good or service is considered a separate performance obligation, an allocated portion of the transaction price should be recognized as revenue when (or as) the entity transfers the related good or service to the customer. Sales of real estate should be recognized when control of the asset transfers to the buyer. The ASU provides several criteria for assessing when control has transferred, most of which are generally met on the date of sale. Criteria that may require additional analysis include whether legal title has transferred and whether the customer has obtained the significant risks and rewards of ownership. In assessing whether these criteria have been satisfied, entities should consider whether the seller (1) has the option or obligation to repurchase the property, (2) guarantees a return on investment, (3) is involved in the continuing operations of the property, and (4) will participate in future operations.



## Partial Sales

Currently, entities account for the sale of real estate in the form of a financial asset by applying the real estate sales guidance in ASC 360 rather than the deconsolidation guidance in ASC 810 if the sale involves an investment that is considered in-substance real estate (e.g., an equity interest in an entity whose sole asset is a single property).

The ASU expands the concept of in-substance real estate to include all in-substance nonfinancial assets. Accordingly, an entity would apply the deconsolidation guidance in ASC 810 only when the transfer or sale of a subsidiary or business is not considered the sale of in-substance nonfinancial assets. While the ASU does not define in-substance nonfinancial assets, a transaction that historically has been outside the scope of ASC 360 may be within the scope of the ASU (rather than ASC 810) if the entity substantially comprises nonfinancial assets other than real estate and integral equipment.

For more information on the effective date and transition of ASU 2014-09, see the [Revenue Recognition](#) section.

# Consolidation

## Background

In February 2015, the FASB issued [ASU 2015-02](#), which amends the consolidation requirements in ASC 810. The amendments could significantly change a financial institution’s consolidation conclusions. Specifically, the amended guidance will affect an entity’s evaluation of whether (1) the fees it receives from managing a fund or asset-backed financing structure should result in the consolidation of the entity, (2) limited partnerships and similar entities should be consolidated, and (3) variable interests held by the reporting entity’s related parties or de facto agents affect its consolidation conclusion. In addition, ASU 2015-02 eliminated the deferral under [ASU 2009-17](#) (formerly Statement 167) for investments in certain investment funds. Therefore, financial institutions, general partners, and investors in these investment funds will need to perform a drastically different consolidation evaluation.

See Deloitte’s May 26, 2015, [Heads Up](#) for additional information about ASU 2015-02.

<sup>6</sup> Certain forms of continuing involvement would not constitute a separate performance obligation. For example, an option or obligation to repurchase a property is specifically addressed by the ASU and would preclude derecognition of the property. Further, a seller obligation that qualifies as a guarantee under ASC 460 would be outside the scope of the ASU.

## Decision-Maker or Service-Provider Fee Arrangements

One of the first steps in assessing whether a reporting entity is required to consolidate a legal entity is to determine whether the reporting entity holds a variable interest in that legal entity. A financial institution's determination that its decision-making fee arrangement is not a variable interest would generally result in a conclusion that the financial institution is not required to consolidate the legal entity. In addition, it could affect whether the legal entity being evaluated is a variable interest entity (VIE). While the ASU retains the current definition of a variable interest, it modifies the criteria for determining whether a decision maker's fee is a variable interest.

Before ASU 2015-02, six criteria must have been met before a reporting entity could conclude that a decision maker's or service provider's fee does not represent a variable interest. The ASU eliminates the criteria related to subordination of the fees (ASC 810-10-55-37(b)) and significance of the fees (ASC 810-10-55-37(e) and (f)). Accordingly, after adoption of ASU 2015-02, the evaluation of whether fees paid to a decision maker represent a variable interest focuses on whether (1) the fees are commensurate ("at market") with the services provided, (2) the fee arrangement includes only customary terms and conditions, and (3) the decision maker (including certain of its related parties) has any other variable interests that would absorb more than an insignificant amount of expected losses or returns. As a result, it is expected that fewer fee arrangements would be considered variable interests under the ASU.

The determination of whether a financial institution is required to consolidate a VIE under the ASU focuses on whether the financial institution has (1) the power to direct the activities that most significantly affect the economic performance of the VIE (power condition) and (2) a potentially significant interest in the VIE (economics condition). Although the ASU does not amend the existing threshold for evaluating whether a financial institution meets the economics condition, under the new consolidation requirements, if the fees paid to a VIE's decision maker are commensurate and at market, they should not be considered in the evaluation of the decision maker's economic exposure to the VIE regardless of whether the reporting entity has other economic interests in the VIE. Under this new requirement, certain structures that were consolidated as a result of the significance of the fee arrangement would potentially need to be deconsolidated.

### Example

Bank ABC is the special servicer of a CMBS securitization trust, and in that capacity it earns a fee that fluctuates on the basis of the performance of the trust. This arrangement gives ABC an incentive to maximize performance of underlying loans. Bank ABC receives a fee from the structure that is subordinate to distributions of both principal and interest to note holders and other operating liabilities that arise during the normal course of the securitization trust's activities. The fees are market based and commensurate with the services provided. In addition, ABC owns a portion of the subordinate class of notes issued by the trust. The notes, by themselves, expose the bank to a maximum of 5 percent of the variability of the CMBS trust. The CMBS is considered a VIE on the basis of its equity structure.

#### **Before ASU 2015-02**

Because the special servicer fees are subordinate to other operating liabilities of the securitization trust, ABC has satisfied the condition in ASC 810-10-55-37(b) and, consequently, the special servicer fees would be considered a variable interest in the VIE. Bank ABC would also satisfy the economics condition (in ASC 810-10-35-38A(b)) if its interest in the subordinate class of notes of the CMBS structure in combination with its fee arrangement give it an aggregate exposure to variability in the CMBS that could potentially be significant to the VIE. In addition, because a special servicer is a management role by default (and in the absence of any kick-out rights held by a single note holder), ABC would be considered to have power over the activities significant to the economic performance of the CMBS in accordance with ASC 810-10-35-38A(a). Therefore, ABC would be required to consolidate the CMBS structure if its exposure to variability in the CMBS is potentially significant to the VIE.

#### **After Adoption of ASU 2015-02**

Because the FASB eliminated an entity's requirement to evaluate whether fees are subordinated (i.e., whether their level of priority is lower than that of other operating liabilities) in determining whether the fees represent a variable interest if the remaining criteria in ASC 810-10-55-37 are not met, the special servicer fees would not be considered a variable interest. In addition, fees that are market based and commensurate with the services provided would also not be considered in the primary-beneficiary analysis. Consequently, because ABC's interest in the subordinate class of notes would not give it a potentially significant interest in the CMBS, ABC would not be required to consolidate the CMBS.

## Thinking It Through

A manager of a CLO or CDO entity that receives a junior or subordinated fee may no longer have a variable interest in the entity if the manager does not have any other interests in the entity and the remaining criteria in ASC 810-10-55-37 are not met. Historically, the criteria related to subordination of the fees often resulted in a conclusion that the CLO or CDO manager's fee arrangement was a variable interest. In addition, excluding the fee arrangement from the evaluation of the economics condition increases the likelihood that CLOs or CDOs will be deconsolidated, particularly if a financial institution does not hold any other interests in the entity.

While fewer fee arrangements will be considered variable interests under the ASU, a financial institution should carefully evaluate whether an arrangement exposes it to risk of loss. Under the ASU, if the fee arrangement includes compensation for assuming the risk of loss in the legal entity, the arrangement would automatically be a variable interest. For example, a fee arrangement that exposes the financial institution to the underlying credit of the financial assets transferred to a securitization (the risk the trust was designed to pass on to its variable interest holders) would be considered a variable interest even if it meets all the criteria in ASC 810-10-55-37.

## Determining Whether a Limited Partnership (or Similar Entity) Is a VIE

The ASU amends the definition of a VIE for limited partnerships and similar entities. Under the ASU, a limited partnership is considered a VIE regardless of whether it has sufficient equity or meets the other requirements to qualify as a voting interest entity **unless** a single limited partner (LP) or a simple majority of all partners (including interests held by the general partner (GP) and its related parties) has substantive kick-out rights (including liquidation rights) or the LPs have participating rights. As a result of the amendments to the definition of a VIE for limited partnerships and similar entities, partnerships historically not considered VIEs will need to be evaluated under the new VIE consolidation model. Conversely, partnership arrangements that include simple-majority kick-out or participating rights (rather than single-partner rights) may no longer be VIEs.

Although the ASU may not have caused a financial institution's consolidation conclusion to change, an updated analysis on the basis of the revised guidance would be required. In addition, even if a reporting entity determines that it does not need to consolidate a VIE, it would have to provide the existing extensive disclosures for any VIEs in which it holds a variable interest.

## Determining Whether an Entity Other Than a Limited Partnership (or Similar Entity) Is a VIE

The ASU clarifies how a reporting entity should evaluate the condition in ASC 810-10-15-14(b)(1) (whether the equity holders (as a group) have power) for entities other than limited partnerships. Specifically, the ASU clarifies that in situations in which the equity holders have delegated the decision-making responsibility, and the decision maker's fee arrangement is a variable interest under ASC 810-10-55-37, the evaluation of this criteria should focus on whether the equity holders have power over the legal entity's most significant activities through their equity interests. In making this assessment, the reporting entity should consider whether the equity holders have the right to replace the decision maker. This is a significant change from the previous guidance, under which kick-out rights were only considered if they were held by a single party.

### Example

Bank ABC enters into a management agreement with Fund X (a corporation). Bank ABC manages the underlying investments and operations of the fund (i.e., directs the most significant activities of the entity) and earns a fee for its services that is customary and commensurate with market terms. As a result of ABC's other interest in X, its fee arrangement is considered a variable interest. However, the equity holders can constrain ABC's authority because they have the ability to (1) replace ABC as the fund manager, (2) approve ABC's compensation, and (3) determine X's overall investment strategy.

Under ASU 2015-02, the equity holders would have the power to direct the most significant activities of the entity, and if the legal entity does not meet any of the other conditions to be considered a VIE, it would be evaluated for consolidation under the voting interest entity model. This is a change from the previous guidance under which the ability to remove ABC as the fund manager would only be considered if that right was held by a single party.

## Who Should Consolidate?

In a manner consistent with the current guidance, a reporting entity would be considered the primary beneficiary of a VIE under the ASU (and would therefore be required to consolidate the VIE) when it has met the power and economics conditions, as described above. This would apply to all entities that are VIEs, including limited partnerships and similar entities that are VIEs. Further, as discussed above, the ASU amended the evaluation of the economics condition to exclude a financial institution's fees if the fees are commensurate and "at market."

Under the ASU, the evaluation of who controls a limited partnership that is **not** considered a VIE focuses on the kick-out, liquidation, or participating rights held by the "unrelated" LPs. That is, the analysis would concentrate on whether any of the LPs have the substantive ability to unilaterally dissolve the limited partnership or otherwise remove the GP without cause and, if so, should consolidate the partnership.

## Effects of Related Parties

The ASU significantly amends how variable interests held by a reporting entity's related parties or de facto agents affect its consolidation conclusion. Specifically, the ASU reduces the effects of interests held by a financial institution's related parties in the evaluation of (1) whether the financial institution's fee arrangement is a variable interest and (2) the financial institution's economic exposure to the VIE.

In addition, the need to perform the related-party tiebreaker test (as well as mandatory consolidation by one of the related parties) will be less frequent under the ASU than under current U.S. GAAP. If power is not considered shared among the related parties, the related-party tiebreaker test would be performed only by parties in the decision maker's related-party group that are under common control and that together possess the characteristics of a controlling financial interest. In this situation, the purpose of the test would be to determine whether the decision maker or a related party under common control of the decision maker is required to consolidate the VIE.

Finally, if neither the decision maker nor a related party under common control is required to consolidate a VIE but the related-party group (including de facto agents) possesses the characteristics of a controlling financial interest, and substantially all of the VIE's activities are conducted on behalf of a single entity in the related-party group, that entity would be the primary beneficiary of the VIE. However, this requirement would not apply in certain qualified affordable housing projects that are currently within the scope of [ASU 2014-01](#).

### Example

Bank ABX owns all of the LP interests in a partnership (that is not a LIHTC structure within the scope of ASU 2014-01). The GP, which cannot be removed without cause, manages the underlying investments and operations of the partnership and earns a fee for its services that is customary and commensurate with market terms. In addition, ABX cannot sell, transfer, or encumber its interests in the LIHTC partnership. Under ASC 810-10-25-43(d), a de facto agency relationship exists between ABX and the GP because of the transfer restrictions — therefore, the GP and ABX are considered a related-party group.

Under ASU 2015-02, because the LP does not have the ability to (1) remove the GP, (2) liquidate the partnership, or (3) participate in the decisions that most significantly affect the partnership, the partnership would be considered a VIE. In addition, although neither ABX nor the GP individually have both (1) the power to direct the activities of the VIE and (2) economic exposure that could potentially be significant to the VIE, the related-party group (including de facto agents) possesses these characteristics. Accordingly, if ABX determines that substantially all of the VIE's activities are conducted on behalf of a single entity in the related-party group, that entity would be the primary beneficiary of the VIE.

## Elimination of the ASU 2010-10 Deferral

ASU 2015-02 eliminated the deferral under [ASU 2010-10](#) for investment funds. As a result, all entities that qualified for the deferral (which applies primarily to investment companies) will need to be evaluated under an approach similar to that in ASU 2009-17. Even if the new evaluation does not result in a different consolidation conclusion, financial institutions will need to update their analysis and may be required to provide additional disclosures.

## Effective Date and Transition

For public business entities, the ASU's guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. For entities other than public business entities, the ASU's guidance is effective for annual periods beginning after December 15, 2016, and interim periods beginning after December 15, 2017. The ASU would allow early adoption for all entities but would require entities to apply the guidance as of the beginning of the annual period containing the adoption date. Modified retrospective application (including a practicability exception) would be required, with an option for full retrospective application.

### Thinking It Through

As of the date of this publication, only a few banks and other financial institutions have early adopted ASU 2015-02. While adopting the ASU has resulted in the consolidation of certain funds that previously qualified for the Statement 167 deferral, for those that have adopted the ASU it generally resulted in a significant amount of deconsolidation, primarily of previously consolidated CLOs and CDOs and limited partnerships whose agreements did not include simple majority kick-out rights.

Reporting entities that have not adopted the ASU should start considering the extent to which they may need to change their processes and controls to apply the new guidance, including those related to obtaining additional information that may have to be provided under the disclosure requirements.

## Effect of the Risk-Retention Rules on Consolidation

In October 2014, the SEC and five other federal agencies adopted a [final rule](#) that requires sponsors of securitizations, under certain conditions, to retain a portion of the credit risk associated with the assets collateralizing an asset-backed security (ABS). The retention of these interests may require reporting entities to consolidate securitization vehicles.

The type of interest retained by the sponsor (i.e., vertical, horizontal, or L-shaped) will affect the sponsor's economic exposure to the securitization structure and, accordingly, the sponsor's consolidation conclusion. If a sponsor holds the subordinate horizontal tranche of a securitization structure rather than a vertical interest (or a combination), there is greater risk that the structure would be consolidated by the sponsor under ASC 810. An entity's evaluation should take into account the sponsor's interests retained under the risk-retention requirements in addition to any other interests held by the sponsor.

See Deloitte's May 26, 2015, [Financial Services Spotlight](#) for additional information about the risk-retention requirements.

# Pushdown Accounting (ASU 2014-17 and ASU 2015-08)

## Background

In November 2014, the FASB issued [ASU 2014-17](#), which gives an acquired entity the option of applying pushdown accounting in its stand-alone financial statements upon a change-in-control event.

Before ASU 2014-17, there was limited guidance in U.S. GAAP on determining whether an acquired entity can establish a new accounting and reporting basis in its stand-alone financial statements (commonly referred to as “pushdown” accounting). ASC 805-50-599-1 through 599-41 contain pushdown accounting requirements for SEC registrants. Under this guidance, pushdown accounting is (1) prohibited when 80 percent or less of an entity’s ownership is acquired, (2) permitted when between 80 percent and 95 percent is acquired, and (3) required when 95 percent or more is acquired.

## Key Provisions of ASU 2014-17

An acquired entity that elects pushdown accounting would apply the measurement principles in ASC 805 to push down the measurement basis of its acquirer to its stand-alone financial statements. In addition, the acquired entity would be required to provide disclosures that enable “users of financial statements to evaluate the effect of pushdown accounting.”<sup>7</sup>

ASU 2014-17 also concluded that when applying pushdown accounting, an acquired entity would be:

- Prohibited from recognizing acquisition-related debt incurred by the acquirer unless the acquired entity is required to do so in accordance with applicable U.S. GAAP (e.g., because the acquired entity is legally obligated).
- Required to recognize the acquirer’s goodwill.
- Prohibited from recognizing bargain purchase gains that resulted from the change-in-control transaction or event and instead the acquiree would recognize such gains as an adjustment to equity (i.e., APIC).

The ASU also gives a subsidiary of an acquired entity the option of applying pushdown accounting to its stand-alone financial statements, even if the acquired entity (i.e., the direct subsidiary of the acquirer) elected not to apply pushdown accounting.

The ASU does not apply to common-control transfers; the guidance on accounting for transactions by entities under common control is included in ASC 805-50. A company that receives the net assets or equity interests in a common-control transfer should record those net assets or equity interests at the transferor’s carrying amounts. However, if pushdown accounting was not applied by the transferor, then the financial statements of the receiving entity would reflect the transferred net assets at the historical cost of the parent of the entities under common control, which would result in the parent’s basis being pushed down to the receiving entity.

## Conforming SEC and FASB Guidance

In a related development, the SEC has rescinded SAB Topic 5.J, which contained the SEC staff’s views on how an SEC registrant should apply pushdown accounting. Thus, all entities — regardless of whether they are SEC registrants — will now apply the guidance in ASU 2014-17.

In May 2015, the FASB issued [ASU 2015-08](#), which removes references to the SEC’s SAB Topic 5.J on pushdown accounting from ASC 805-50. The SEC’s SAB 115 had superseded the guidance in SAB Topic 5.J in connection with the FASB’s November 2014 release of ASU 2014-17. The amendments in ASU 2015-08 therefore conform the FASB’s guidance on pushdown accounting with the SEC’s.

<sup>7</sup> Entities would achieve that disclosure objective by providing the relevant disclosures required by ASC 805.

## Effective Date

The guidance in ASU 2014-17 became effective November 14, 2014. As of the effective date, an acquired entity would be permitted to elect to apply pushdown accounting arising as a result of change-in-control events occurring before the standard's effective date as long as (1) the change-in-control event is the most recent change-in-control event for the acquired entity and (2) the election is preferable. Entities would not be permitted to unwind a previous application of pushdown accounting (i.e., an acquired entity can change its election for the most recent change-in-control transaction or event from not applying pushdown accounting to applying pushdown accounting, if preferable, but not vice versa).

For more information about ASU 2014-17, see Deloitte's September 2014 *EITF Snapshot*.

# Simplifying the Accounting for Measurement-Period Adjustments

## Background

In September 2015, the FASB issued [ASU 2015-16](#), which amended the guidance in ASC 805 on the accounting for measurement-period adjustments. The ASU was issued as part of the FASB's simplification initiative in response to stakeholder feedback that restating prior periods to reflect adjustments made to provisional amounts recognized in a business combination adds cost and complexity to financial reporting but does not significantly improve the usefulness of the information provided to users.

## Key Provisions of the ASU

Under previous guidance, when an acquirer identified an adjustment to provisional amounts during the measurement period, the acquirer was required to revise comparative information for prior periods, including making any change in depreciation, amortization, or other income effects recognized in completing the initial accounting, as if the accounting for the business combination had been completed as of the acquisition date.

The ASU requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The effect on earnings of changes in depreciation or amortization, or other income effects (if any) as a result of the change to the provisional amounts, calculated as if the accounting had been completed as of the acquisition date, must be recorded in the reporting period in which the adjustment amounts are determined rather than retrospectively.

## Thinking It Through

Although the ASU changes the accounting for measurement-period adjustments, it does not change the definition of a measurement-period adjustment, which is an adjustment to the amounts provisionally recognized for the consideration transferred, the assets acquired, and the liabilities assumed as a result of "new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of those amounts as of that date." Errors, information received after the measurement period ends, or information received about events or circumstances that did not exist as of the acquisition date are not measurement-period adjustments.

## Disclosure Requirements

The ASU also requires that the acquirer present separately on the face of the income statement, or disclose in the notes, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.

## Effective Date and Transition

For public business entities, the ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The ASU must be applied prospectively to adjustments to provisional amounts that occur after the effective date. Early application is permitted for financial statements that have not been issued.



The only disclosures required at transition will be the nature of and reason for the change in accounting principle. An entity should disclose that information in the first annual period of adoption and in the interim periods within the first annual period if there is a measurement-period adjustment during the first annual period in which the changes are effective. For more information about the ASU, see Deloitte's September 30, 2015, *Heads Up*.

# Accounting Alternatives for Private Companies

## Background

The following guidance (developed in 2014 by the Private Company Council (PCC)) is effective in 2015:

- *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) existing as of the beginning of the period of adoption. The ASU is effective for annual periods beginning after December 15, 2014, and interim periods with 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.

- *Intangibles* — 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.

## Thinking It Through

Many entities in the industry will meet the definition of a public business entity and therefore are not eligible for PCC alternatives. For example, broker-dealers that are required to file financial statements with the SEC will meet the definition of a public business entity (the confidential submission of financial information to the SEC by a “material associated person” of a broker-dealer also meets the definition of a public business entity). We had historically believed that a “material associated person” of a broker-dealer would not meet the definition of a public business entity when required to confidentially submit financial statements to the SEC. In October 2015, the staff in the SEC’s Office of the Chief Accountant clarified that such an entity should be considered a public business entity. In addition, a bank that is required to make complete U.S. GAAP financial statements publicly available under banking regulations will satisfy the first component of criterion (e) and will need to further evaluate the second component of criterion (e) (i.e., whether its securities contain contractual restrictions on transfer). Application of the public business entity definition to banks was discussed in the Federal Financial Institutions Examination Council’s September 2014 [call report instructions](#).

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

In September 2015, the FASB issued for public comment a [proposed ASU](#) that would give private companies a one-time unconditional option to forgo a preferability assessment the first time they elect a PCC accounting alternative within the proposal’s scope. It would also eliminate the effective dates of PCC accounting alternatives that are within the proposal’s scope as well as extend the transition guidance in ASU 2014-02 and ASU 2014-03. The proposal’s amendments could affect all private companies within the scope of ASUs 2014-02 and 2014-03 as well as [ASU 2014-07](#) and ASU 2014-18. See Deloitte’s September 30, 2015, [Heads Up](#) for more information.

## Other Private-Company Matters

Throughout 2015, the PCC has discussed aspects of financial reporting that are complex and costly for private companies, including stock-based compensation, the application of VIE guidance to nonleasing common-control arrangements, and the balance sheet classification of debt.

At a recent meeting, the PCC agreed that it would continue to deliberate stock-based compensation and consider feedback received in connection with the FASB’s [proposed ASU](#) on employee share-based payment accounting improvements. See Deloitte’s June 12, 2015, [Heads Up](#) for more information.

The PCC also asked the FASB staff to research (1) examples that would clarify the application of VIE guidance to nonleasing common-control arrangements and (2) potential modifications to existing business scope exceptions to address application issues. The classification of debt will be discussed at a future meeting.

In addition, the PCC decided in February 2015 that it would not “amend the existing definitions of a nonpublic entity at this time. The existing definitions will remain in the FASB Codification until potentially amended at a later date by the FASB. The definition of a public business entity, [as amended by [ASU 2013-12](#)] should continue to be used for future accounting and reporting guidance.”<sup>8</sup>

## Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) (ASU 2015-07)

### Background

In May 2015, the FASB issued [ASU 2015-07](#), which is based on the final consensus reached by the EITF on Issue 14-B. Affecting entities with certain investments<sup>9</sup> for which the practical expedient<sup>10</sup> is used to measure fair value at net asset value (NAV), the ASU removes the disclosure requirement to categorize those investments within the fair value hierarchy. The ASU also amends or removes other disclosure requirements for eligible investments measured at NAV and contains consequential amendments to ASC 230-10 related to the statement of cash flows and to ASC 715-20 regarding sponsors of defined benefit plans.

### Key Provisions

Rather than categorizing within the fair value hierarchy<sup>11</sup> eligible investments that apply the NAV practical expedient, the ASU requires an entity to disclose the NAV of those investments to reconcile the fair value of the investments within the fair value hierarchy to the line item(s) presented in the statement of financial position. In addition, eligible investments that apply the NAV practical expedient no longer need to disclose the other information required by ASC 820-10-50-2, such as transfers between fair value levels, a level-three rollforward schedule, or the description of the valuation techniques for certain assets and liabilities.

### Thinking It Through

Entities must still comply with the requirements in ASC 820-10-50-6A, which include disclosing the investment’s NAV and the nature, risk, and redeemability of eligible investments that apply the NAV practical expedient in measuring fair value.

Also, in instances in which the practical expedient is used to measure fair value at NAV for all of an entity’s investments, the information required by ASC 820-10-50-6A may be disclosed in a manner that complies with the ASU’s requirement to reconcile the fair value of the investments in the disclosure to the line item(s) presented in the statement of financial position. Accordingly, an entity would not present a blank fair value hierarchy leveling tabular disclosure to meet the ASU’s reconciliation requirement.

In addition, the ASU amends the scope of the disclosure requirements in ASC 820-10-50-6A to include only investments that (1) are eligible for the practical expedient and (2) have elected to apply the practical expedient in measuring fair value at NAV. The ASU also removes the guidance in ASC 820-10-50-6A(g), under which certain disclosures were required when it was probable that an investment would be sold for an amount different from the NAV.

<sup>8</sup> See the PCC’s [overview](#) of decisions reached on PCC Issue No. 14-01.

<sup>9</sup> ASC 820-10-15-4 and 15-5 provide the requirements for an investment’s eligibility to apply the NAV per share (or its equivalent) practical expedient in measuring fair value.

<sup>10</sup> The NAV practical expedient is discussed in ASC 820-10-35-59 through 35-62.

<sup>11</sup> Under ASU 2015-07, sponsors of defined benefit plans within the scope of ASC 715-20 that elect the NAV practical expedient to measure plan investments at fair value are also no longer permitted to be categorized within the levels of the fair value hierarchy in the plan investment footnote.

## Thinking It Through

ASU 2015-07 simplifies the reporting requirements by limiting the disclosures required by ASC 820-10-50-6A to those investments measured under the NAV practical expedient (rather than all eligible investments that may apply the practical expedient).

Investment companies that meet certain criteria<sup>12</sup> may be exempt from presenting a statement of cash flows if certain conditions<sup>13</sup> are met. ASU 2015-07 amends one of those conditions to include investments that apply the NAV practical expedient that “are redeemable in the near term at all times.”

## Thinking It Through

The amendment to the exemption requirements is intended to continue to ensure that certain investment companies with liquid investments will not be required to present a statement of cash flows. Entities will need to determine whether the investments are “redeemable in the near term at all times” as of the reporting date. There is no bright-line definition of “near term.” However, by analogy to AICPA TIS 2220.25, a redemption period of 90 days or less would generally be considered near term.

## Effective Date and Transition

For public companies, the ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The effective date is deferred by one year for private companies. Early adoption is permitted. The ASU should be applied retrospectively to all periods presented.

# Debt Issuance Costs

## Background

In April 2015, the FASB issued [ASU 2015-03](#), which changes the presentation of debt issuance costs in financial statements. Under the ASU, an entity presents such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is reported as interest expense.

Under previous guidance, an entity reported debt issuance costs in the balance sheet as deferred charges (i.e., as an asset).

## Thinking It Through

Requiring presentation of debt issuance costs as a direct reduction of the related debt liability (rather than as an asset) is consistent with the presentation of debt discounts under U.S. GAAP. In addition, it converges the guidance in U.S. GAAP with that in IFRSs, under which transaction costs that are directly attributable to the issuance of a financial liability are treated as an adjustment to the initial carrying amount of the liability. It also reflects the SEC staff’s views regarding the treatment of equity issuance costs as a reduction of the gross proceeds of an equity offering. Further, it conforms U.S. GAAP to FASB Concepts Statement No. 6, which states, “Debt issue cost is not an asset for the same reason that debt discount is not — it provides no future economic benefit. Debt issue cost in effect reduces the proceeds of borrowing and increases the effective interest rate and thus may be accounted for the same as debt discount.”

<sup>12</sup> See ASC 230-10-15(b).

<sup>13</sup> See ASC 230-10-15(c).

Since the ASU's issuance, practitioners have inquired about the appropriate balance sheet presentation of costs incurred in connection with revolving-debt arrangements. At the June 18, 2015, EITF meeting, the SEC staff announced that it would "not object to an entity deferring and presenting [such] costs as an asset and subsequently amortizing the . . . costs ratably over the term of the line-of-credit arrangement." That announcement was codified in August 2015 by the issuance of ASU 2015-15.

## Key Provisions of the ASU

ASU 2015-03 specifies that "debt issuance costs related to a note shall be reported in the balance sheet as a direct deduction from the face amount of that note" and that "[a]mortization of debt issuance costs also shall be reported as interest expense." The ASU's Basis for Conclusions observes that in practice, debt issuance costs incurred before the associated funding is received (i.e., before the issuance of the debt liability) are deferred on the balance sheet until that debt liability amount is recorded.

The amendments do not affect the current guidance on the recognition and measurement of debt issuance costs. For example, the costs of issuing convertible debt would not change the calculation of the intrinsic value of an embedded conversion option that represents a beneficial conversion feature under ASC 470-20-30-13. Thus, entities may still need to track debt issuance costs separately from a debt discount.

### Thinking It Through

Before adopting ASU 2015-03, an entity may have remeasured debt issuance costs into its functional currency by using historical exchange rates because (1) it presented debt issuance costs in the balance sheet as deferred charges under ASC 835-30 and (2) ASC 830-10-45-18(i) requires that deferred charges be treated as a nonmonetary balance sheet item that is remeasured by using historical rates.

Upon adopting ASU 2015-03, however, an entity presents debt issuance costs (other than costs related to line-of-credit or revolving-debt arrangements) in the balance sheet as a direct deduction from the related debt liability (in accordance with ASC 835-30-45-1A, as amended by ASU 2015-03) rather than as a deferred charge. The remeasurement of the carrying amount of the debt liability into the entity's functional currency, therefore, reflects any deduction related to debt issuance costs. Under ASC 830-10-45-17, monetary liabilities (including the carrying amount of a monetary debt liability that has been adjusted for debt issuance costs) are remeasured into the entity's functional currency by using current exchange rates.

Notwithstanding the Board's stated intention of not changing the recognition and measurement guidance on debt issuance costs, an entity that presented debt issuance costs (other than issuance costs associated with line-of-credit or revolving debt arrangements) as deferred charges and treated such costs as a nonmonetary item under ASC 830-10 before adopting ASU 2015-03 would need to (1) retrospectively adjust, upon transition to ASU 2015-03, its accounting for debt issuance costs under ASC 830-10 in accordance with ASC 835-30-65-1(c) and (2) perform remeasurement as of each subsequent reporting period by using current exchange rates.

## Effective Date and Transition

For public business entities, the guidance in ASU 2015-03 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. For entities other than public business entities, the guidance is effective for fiscal years beginning after December 15, 2015, and interim periods beginning after December 15, 2016. Early adoption is allowed for all entities for financial statements that have not been previously issued. Entities would apply the new guidance retrospectively to all prior periods (i.e., the balance sheet for each period is adjusted).

The ASU requires an entity to “disclose in the first fiscal year after the entity’s adoption date, and in the interim periods within the first fiscal year, the following:

1. The nature of and reason for the change in accounting principle
2. The transition method
3. A description of the prior-period information that has been retrospectively adjusted
4. The effect of the change on the financial statement line item (that is, the debt issuance cost asset and the debt liability).”

### Thinking It Through

In developing ASU 2015-03, the FASB considered but ultimately decided against providing guidance on the balance sheet presentation of (1) debt issuance costs incurred before a debt liability is recognized (e.g., before the debt proceeds are received) and (2) costs associated with revolving-debt arrangements. In our discussions with the FASB staff, the staff confirmed that the ASU does not address the presentation of issuance costs associated with revolving-debt arrangements. Accordingly, an entity should elect an accounting policy for the presentation of such costs. As noted above, the SEC staff confirmed on June 18, 2015, that the ASU does not address issuance costs associated with revolving-debt arrangements and announced that it would “not object to an entity deferring and presenting [such] costs as an asset and subsequently amortizing the . . . costs ratably over the term of the line-of-credit arrangement.”

If an entity adopts the method outlined by the SEC staff on June 18, 2015, as its accounting policy, it would present remaining unamortized debt issuance costs associated with a line-of-credit or revolving-debt arrangement as an asset even if the entity currently has a recognized debt liability for amounts outstanding under the arrangement. Further, such costs are amortized over the life of the arrangement even if the entity repays previously drawn amounts.

While the SEC staff’s announcement (codified by ASU 2015-15) clarifies that revolving-debt arrangements are outside the scope of ASU 2015-03, it does not address whether the ASU’s presentation approach is an acceptable accounting policy for such arrangements and, if so, how an entity should implement such an approach. Under the ASU, an entity would deduct debt issuance costs from the related debt liability. But it is unclear how the entity would present any remaining unamortized debt issuance costs if it repaid the amounts outstanding under the revolving-debt arrangement and still had an option to make new borrowings under the same arrangement. In this case, there would no longer be a liability with which to associate the costs. It is also unclear how the entity would present any remaining unamortized costs if the costs exceeded the amount currently outstanding under the revolving-debt arrangement.

Given the implementation questions associated with application of the ASU’s presentation approach to revolving-debt arrangements, as well as questions about the acceptability of such application, we expect that many, if not most, entities will elect to apply the accounting policy outlined by the SEC staff at the June 18, 2015, EITF meeting. Under that policy, an entity presents remaining unamortized debt issuance costs associated with a revolving-debt arrangement as an asset even if the entity currently has a recognized debt liability for amounts outstanding under the arrangement. Further, such costs are amortized over the life of the arrangement even if the entity repays previously drawn amounts.

# Repurchase Agreements

## Background

In June 2014, the FASB issued [ASU 2014-11](#), which makes limited amendments to the guidance in ASC 860 on accounting for certain repurchase agreements (“repos”). The ASU (1) requires entities to account for repurchase-to-maturity transactions as secured borrowings, (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) that are accounted for as secured borrowings.

## Repurchase Agreements That Settle at Maturity

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).

The ASU does not change the other criteria in ASC 860 for assessing effective control; however, it clarifies 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’s Basis for Conclusions clarifies that the repurchase-to-maturity exception should not be applied by analogy to “similar transactions that are settled in cash before the maturity of the transferred financial asset.”

## 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.

## Thinking It Through

The ASU could significantly affect the financial reporting of entities with repurchase financing and repurchase-to-maturity arrangements. Upon adoption of the ASU, entities with outstanding arrangements that were previously derecognized would need to recognize and account for them as secured borrowings. In addition, certain regulated entities (e.g., banks and broker-dealers) would need to assess the ASU’s effect on their compliance with regulatory and capital requirements.

## Disclosure Requirements

The ASU contains new disclosure requirements related to certain transfers of financial assets that are accounted for as sales and collateral supporting repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings.

For certain transfers accounted for as sales, the transferor would need to disclose the following by type of transactions:

- The carrying amount of assets derecognized as of the date of derecognition.
- The amount of gross proceeds received by the transferor at the time of derecognition for the assets derecognized.

- Information about the transferor’s ongoing exposure to the economic return on the transferred financial assets.
- Amounts arising from the transaction that are reported in the statement of financial position, such as those represented by derivative contracts.

The ASU specifically excludes from the scope of this disclosure requirement (1) dollar-roll transactions that qualify for sale accounting and (2) certain other transactions that are subject to the disclosure requirements of ASC 860-20-50-3 and 50-4.

For repos, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings, ASC 860-30-50-7 requires the following disclosures:

- “A disaggregation of the gross obligation by the class of collateral pledged.”
- “The remaining contractual tenor of the agreements.”
- “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.”

In addition, entities are required to reconcile the gross obligation of these arrangements to the gross liabilities of repos and securities lending transactions included in the offsetting disclosure of assets and liabilities under ASC 210-20-50-3(a) before offsetting adjustments. Any difference would be presented as a reconciling item.

### Thinking It Through

Because the definition of a repo in ASC 210-20 applies only to securities whereas its definition in ASC 860 was amended to apply more broadly to all financial assets (e.g., loans, securities), reconciling differences can arise between the offsetting disclosures required under ASC 210-20-50-3(a) and the disclosures under ASC 860-30-50-7.

In addition, an entity that engages in these transactions should consider the extent to which it may have to change its systems and controls to identify information not previously captured by its accounting or operations systems and to ensure that the information reported is accurate and complete. For example, the entity may need to reconfigure its systems to appropriately track certain transfers of financial assets that qualify for sale accounting so that it can provide the information required under the ASU.

### Transition and Effective Date

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

For public business entities, the accounting changes in the ASU are effective for the first interim or annual period beginning after December 15, 2014. For all other entities, the accounting changes are effective for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. Early application for a public business entity is prohibited; however, all other entities may elect to apply the requirements for interim periods beginning after December 15, 2014.

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 repos, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings 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.

See Deloitte’s June 19, 2014, *Heads Up* for more information.

# Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure (ASU 2014-04)



## Background

In January 2014, the FASB issued [ASU 2014-04](#), which affects entities that originate mortgage loans collateralized by residential real estate. Specifically, the ASU amends ASC 310 to clarify when an entity is considered to have obtained physical possession (from an in-substance possession or foreclosure) of a residential real estate property collateralizing a mortgage loan and, therefore, when the loan should be reclassified as other real estate owned (OREO). ASU 2014-04 also introduces new disclosure requirements about nonperforming mortgage loans that are in the process of foreclosure.

ASU 2014-04 was effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities that are not public business entities, the guidance in the ASU was effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early adoption was permitted for all entities.

## Key Provisions

ASU 2014-04 requires an entity to reclassify nonperforming mortgage loans collateralized by residential real estate as OREO when either (1) the creditor obtains legal title to the residential real estate property or (2) the borrower satisfies the loan by conveying all interest in the real estate property to the creditor through completion of a deed in lieu of foreclosure or through a similar legal agreement. Under ASU 2014-04, a deed in lieu of foreclosure or similar legal agreement is completed when both the borrower and creditor satisfy the agreed-upon terms and conditions.

In addition, ASU 2014-04 clarifies that an entity would meet the “legal title” condition even if the borrower has redemption rights that give the borrower a legal right for a period after foreclosure to reclaim the real estate property by paying certain amounts specified by law.

## Disclosure Requirements

ASU 2014-04 also requires an entity to disclose the following at each interim and annual period:

- The carrying amount of foreclosed residential real estate property held by the creditor as a result of obtaining physical possession in accordance with the ASU.
- The recorded investment in mortgage loans collateralized by residential real estate property for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction.

## Thinking It Through

Since many reporting entities were already applying the ASU’s presentation guidance, the most significant change resulting from this guidance is likely to be the requirement that reporting entities disclose additional information about foreclosed properties and properties pending foreclosure. Reporting entities should assess whether they have the necessary data and controls to comply with the requirement to disclose this information.

# Accounting for Investments in Qualified Affordable Housing Projects (ASU 2014-01)

## Background

In January 2014, the FASB issued [ASU 2014-01](#), which amended the criteria that an entity must meet to qualify for an alternative method of accounting for low income housing tax credit (LIHTC) investments (an alternative to equity method accounting that would otherwise be applicable). The ASU also replaced the previous alternative accounting method — the effective-yield method — with the proportional amortization method and introduced new disclosures that all entities must provide about their LIHTC investments.

ASU 2014-01 was effective for public business entities for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2014. For entities that are not public business entities, the guidance was effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early adoption was permitted for all entities.

## Scope

Before the issuance of ASU 2014-01, few entities were able to apply the effective-yield method of accounting to their LIHTC investments because of the restrictive nature of the previous scope requirements. ASU 2014-01 amended the scope requirements so that more LIHTC investments will qualify for an alternative method of accounting. Specifically, ASU 2014-01 eliminated the requirement that the tax credits be “guaranteed by a creditworthy entity” and also allowed entities to consider both the tax credits and other tax benefits (e.g., depreciation expense) when determining whether the projected yield of the investment is positive.

As a result of these and other changes to the scope requirements, more LIHTC investments qualify for the alternative method of accounting.

## New Alternative Approach

While ASU 2014-01 replaced the effective-yield method with the proportional amortization method, the new approach retains the effective-yield method’s presentation guidance, under which an entity presents the amortization of the LIHTC investment as “a component of income tax expense (benefit).”

Under the proportional amortization method, an entity amortizes the initial carrying amount of the LIHTC investment “in proportion to the tax credits and other tax benefits allocated to the investor.” Specifically, the amortization amount for each period would be equal to the product of (1) the initial carrying amount of the investment and (2) the “percentage of actual tax credits and other tax benefits allocated to the investor in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the investor over the life of the investment.”

The proportional amortization approach also requires entities to test their LIHTC investments for impairment “when events or changes in circumstances indicate that it is more likely than not that the carrying amount of the investment will not be realized.” If the investment is impaired, an impairment loss would be recognized equal to the amount by which the carrying amount of the investment exceeds its fair value.

## New Disclosures

ASU 2014-01 also introduces new disclosure requirements for all entities that hold LIHTC investments, irrespective of whether they have elected to apply the proportional amortization approach. The objective of these new disclosure requirements is to help financial statement users understand the “nature of [the entity’s] investments in qualified affordable housing projects” and “the effect of the measurement of its investments in qualified affordable housing projects and the related tax credits on its financial position and results of operations.”

### Thinking It Through

While the intent of the ASU is to expand the use of the alternative measurement model for LIHTC investments, a reporting entity must use judgment in determining whether it can apply the new guidance. For example, a reporting entity that has the ability to exercise significant influence over the LIHTC partnership would not be permitted to apply the method. Given the elimination of the bright-line thresholds, determining whether a LIHTC investor has significant influence will be based on the specific facts and circumstances of each investment and will require an evaluation of the rights granted to the LIHTC investor by the underlying contractual agreements.

Similarly, reporting entities may need to engage tax specialists in assessing the propriety of recognizing deferred tax assets or deferred tax liabilities as a result of applying the proportional amortization approach.





# Impairment

## Background

The FASB spent much of 2015 drafting its final guidance on impairment. It also formed a TRG on impairment, comprising financial statement preparers, auditors, and banking regulators. FASB board members attend the TRG's meetings, and representatives from the SEC and PCAOB are also invited to observe.

The objective of the impairment TRG is to help the FASB resolve issues related to implementation of the standard both before and after the new guidance is issued. At a private session with the TRG, the FASB recently sought feedback on a staff draft of the final guidance. It is unclear whether the FASB will seek additional feedback from the TRG at other such sessions before the standard is issued.

## Project Overview

The amendments will introduce the current expected credit loss (CECL) model, which is a new impairment model<sup>1</sup> based on expected losses rather than incurred losses. Under the CECL model, an entity would recognize as an allowance its estimate of the contractual cash flows not *expected* to be collected. The FASB believes that the CECL model will result in more timely recognition of credit losses and will reduce the complexity of U.S. GAAP by decreasing the number of credit impairment models used to account for debt instruments.<sup>2</sup>

Under the existing impairment models (often referred to as incurred loss models), an impairment allowance is recognized only after a loss event (e.g., default) has occurred or its occurrence is probable. In assessing whether to recognize an impairment allowance, an entity may only consider current conditions and past events; it may not consider forward-looking information.



## The CECL Model

### Scope

The CECL model will apply to most<sup>3</sup> debt instruments (other than those measured at fair value through net income (FVTNI)), trade receivables, lease receivables, reinsurance receivables that result from insurance transactions, financial guarantee contracts,<sup>4</sup> and loan commitments. However, AFS debt securities will be excluded from the model's scope and will continue to be assessed for impairment under ASC 320 (the FASB has proposed limited changes 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 an impairment allowance equal to the current estimate of expected credit losses (i.e., all contractual cash flows that the entity does not expect to collect) 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.

<sup>1</sup> Although impairment began as a joint FASB and IASB project, constituent feedback on the boards' "dual-measurement" approach led the FASB to develop its own impairment model. The IASB, however, continued to develop the dual-measurement approach and issued final impairment guidance based on it as part of the July 2014 amendments to IFRS 9. For more information about the IASB's impairment model, see Deloitte's August 8, 2014, [Heads Up](#).

<sup>2</sup> Note that the proposed CECL model would replace or amend several existing U.S. GAAP impairment models. See [Appendix B](#) of Deloitte's March 13, 2015, [Heads Up](#), for a tabular summary of those models.

<sup>3</sup> The CECL model would not apply to the following debt instruments:

- 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.

<sup>4</sup> The CECL model would not apply to financial guarantee contracts that are accounted for as insurance or measured at FVTNI.

## 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 (HTM) debt securities). However, an “entity would not be required to recognize a loss on a financial asset in which the risk of nonpayment is greater than zero [but] the amount of loss would be zero.”<sup>5</sup> U.S. Treasury securities and certain highly rated debt securities may be assets the FASB contemplated when it allowed an entity to recognize zero credit losses on an asset, but the Board decided not to specify the exact types of assets. Nevertheless, the requirement to measure expected credit losses on financial assets whose risk of loss is low is likely to result in additional costs and complexity.

## Measurement of Expected Credit Losses

Under the amendments, an entity’s estimate of expected credit losses represents all contractual cash flows that the entity does not expect to collect over the contractual life of the financial asset. When determining the contractual life of a financial asset, the entity would consider expected prepayments but would not be allowed to consider expected extensions unless it “reasonably expects that it will execute a troubled debt restructuring with the borrower.”<sup>6</sup>

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

## Thinking It Through

Measuring expected credit losses will most likely be a significant challenge for all entities, particularly financial institutions. Entities may also incur one-time or recurring costs associated with implementing the CECL model, such as those related to system changes, data collection, and using forward-looking information to estimate expected credit losses over the contractual life of an asset.

## Unit of Account

The CECL model does not prescribe a unit of account (e.g., an individual asset or a group of financial assets) in the measurement of expected credit losses. However, an entity would be required to evaluate financial assets within the scope of the model on a collective (i.e., pool) basis when similar risk characteristics are shared. If a financial asset does not share similar risk characteristics with the entity’s other financial assets, the entity would evaluate the financial asset individually. If the financial asset is individually evaluated for expected credit losses, the entity would not be allowed to ignore available external information such as credit ratings and other credit loss statistics.

<sup>5</sup> Quoted text is from the FASB’s [summary](#) of tentative Board decisions reached at the joint meeting of the FASB and IASB on September 17, 2013.

<sup>6</sup> Quoted text is from the FASB’s [summary](#) of tentative Board decisions reached at its September 3, 2014, meeting.

## Thinking It Through

Under the new guidance, an entity will be required to collectively measure expected credit losses on financial assets that share similar risk characteristics (including HTM securities). While the concept of pooling and collective evaluation currently exists in U.S. GAAP for certain loans, the FASB has not specifically defined “similar risk characteristics.” As a result, it remains to be seen whether the FASB expects an aggregation based on “similar risk characteristics” to be consistent with the existing practice of pooling purchased credit-impaired (PCI) assets on the basis of “common risk characteristics.” Entities may need to make changes to systems and processes to capture loss data at more granular levels depending on the expectations of market participants such as standard setters, regulators, and auditors.

## AFS Debt Securities

The impairment of AFS debt securities will continue to be accounted for under ASC 320. However, the amendments revise that guidance by:

- Limiting the credit losses recognized to the difference between the security’s amortized cost and its fair value.
- Requiring an entity to use an allowance approach (vs. permanently writing down the security’s cost basis).
- Removing the requirement that an entity must consider the length of time fair value has been less than amortized cost when assessing whether a security is other-than-temporarily impaired.
- Removing the requirement that an entity must consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists.

## Thinking It Through

The Board did not revise (1) step 1 of the existing other-than-temporary impairment model (i.e., an “investment is impaired if the fair value of the investment is less than its cost”) or (2) the requirement under ASC 320 that entities recognize the impairment amount only related to credit in net income and the noncredit impairment amount in OCI. However, entities would use an allowance approach when recognizing credit losses (as opposed to a permanent write-down of the AFS security’s cost basis). As a result, in both of the following instances, an entity would reverse credit losses through current-period earnings on an AFS debt security:

- If the fair value of the debt security exceeds its amortized cost in a period after a credit loss had been recognized through earnings (because fair value was less than amortized cost), the entity would reverse the *entire* credit loss previously recognized and recognize a corresponding adjustment to its allowance for credit losses.
- If the fair value of the debt security does not exceed its amortized cost in a period after a credit loss had been recognized through earnings (because fair value was less than amortized cost) but the credit quality of the debt security improves in the current period, the entity would reverse the credit loss previously recognized only in an amount that would reflect the improved credit quality of the debt security.

These revisions to the impairment model in ASC 320 could result in earlier recognition of impairment.

## PCI Assets

PCI assets are acquired financial assets for which there has been a “more than insignificant” deterioration in credit quality since origination. An entity will measure expected credit losses for these assets the same way it measures expected credit losses for originated and purchased non-credit-impaired assets.

Upon acquiring a PCI asset, the entity would recognize as its allowance for expected credit losses the amount of contractual cash flows not expected to be collected as an adjustment that increases the cost basis of the asset (the “gross-up” approach). After initial recognition of the PCI 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. Consequently, any subsequent changes to the entity’s estimate of expected credit losses — whether unfavorable or favorable — would be recorded as impairment expense (or reduction of expense) during the period of change. Interest income recognition would be based on the purchase price plus the initial allowance accreting to the contractual cash flows.

### Thinking It Through

Under the current accounting for PCI assets, an entity recognizes unfavorable changes in cash flows as an immediate credit impairment but treats favorable changes in cash flows that are in excess of the allowance as prospective yield adjustments. The CECL model’s approach to PCI assets eliminates this asymmetrical treatment in cash flow changes. However, in a manner consistent with current practice, the CECL model precludes an entity from recognizing as interest income the discount embedded in the purchase price that is attributable to expected credit losses as of the date of acquisition.

An acquired asset is currently considered credit-impaired when it is probable that the investor would be unable to collect all contractual cash flows as a result of deterioration in the asset’s credit quality since origination. However, as noted above, under the FASB’s tentative approach, a PCI asset is an acquired asset for which there has been a “more than insignificant” deterioration in credit quality since origination. The FASB revised the definition of a PCI asset partially in response to stakeholder feedback suggesting that if an entity were to recognize expected credit losses in its income statement upon purchase of any asset, regardless of the level of credit deterioration in the asset’s credit quality since origination, the entity would be “double-counting” expected credit losses on that asset because those losses were already contemplated in the purchase price. Although the FASB decided not to require an entity to apply the gross-up approach to all acquired assets, stakeholders are likely to support the change to the definition of a PCI asset because an entity is likely to apply the gross-up approach to more assets than it would have under the requirements in the proposed amendments. The FASB has also indicated that the final standard will include implementation guidance to help entities assess whether there has been a “more than insignificant” deterioration in a purchased asset’s credit quality since origination.

### Disclosures

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

- Credit quality.<sup>7</sup>
- Allowance for expected credit losses.
- Policy for determining write-offs.
- Past-due status.
- PCI assets.
- Collateralized financial assets.

In addition, an entity will need to disclose credit-quality indicators for each asset class, disaggregated by vintage, for a period not to exceed five years (although upon transition, the entity will be required to provide this disclosure only for the current and prior-year amortized cost balances). The disclosure will be required for annual and interim periods and would not be required for an entity’s revolving lines of credit.

<sup>7</sup> Short-term trade receivables resulting from revenue transactions within the scope of ASC 605 are excluded from these disclosure requirements.

## Transition

For most debt instruments, the amendments will require entities to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is effective (modified retrospective approach). However, instrument-specific transition provisions are provided for other-than-temporarily impaired debt securities, PCI assets, and certain beneficial interests within the scope of ASC 325-40.

## Other Significant Decisions

The new guidance will also reflect the FASB's tentative decisions related to the following:

- Practical expedients when measuring expected credit losses.
- Write-offs.
- Modifications.
- Certain beneficial interests within the scope of ASC 325-40.
- Loan commitments.
- Transition disclosures.

## Effective Date and Early Adoption

The Board tentatively decided the following:

- For public business entities that meet the definition under U.S. GAAP of an SEC filer, the final standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.
- For public business entities that do not meet the definition of an SEC filer, the final standard will be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.
- For all other entities, the final standard will be effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years beginning after December 15, 2020.

The Board also tentatively decided that public business entities that meet the definition under U.S. GAAP of an SEC filer will not be permitted to early adopt the final standard. All other entities will be permitted to early adopt the final standard, but not before an SEC filer would adopt the standard.

## Next Steps

On the basis of comments it received on the fatal-flaw draft, the FASB plans to discuss PCI assets at its November 23, 2015, meeting. In addition, the FASB may seek additional TRG feedback as it continues to draft the final guidance, which the Board expects to issue in first quarter of 2016. For a comprehensive summary of the impairment project to date, see the [project update page](#) on the FASB's Web site.

## Thinking It Through

Financial institutions currently use various methods to estimate credit losses. Some apply simple approaches that take into account average historical loss experience over a fixed time horizon. Others use more sophisticated “migration” analyses and forecast modeling techniques. Under the CECL model, for any approach that is based solely on historical loss experience, an entity would need to consider the effect of forward-looking information over the remaining contractual life of a financial asset. In addition, when an entity is “developing its estimate of expected credit losses . . . for periods beyond which the entity is able to make or obtain reasonable and supportable forecasts, [the] entity is allowed to revert to its [unadjusted] historical credit loss experience.”<sup>8</sup>

For instance, assume that an entity uses annualized loss rates to determine the amount of probable unconfirmed losses on its homogeneous pools of loans as of the reporting date. When moving to the CECL model, the entity may need to revise its allowance method by adjusting the fixed time horizon (i.e., annualized loss rates) to equal a period that represents the full contractual life of the instrument. Entities using a probability-of-default (PD) approach may need to revise their PD and loss-given-default (LGD) statistics to incorporate the notion of lifetime expected losses. Today, an entity’s PD approach might be an estimate of the probability that default will occur over a fixed assessment horizon, which is less than the full contractual life of the instrument (often one year). Similarly, an entity would need to revise its LGD statistic to incorporate the notion of lifetime expected losses (i.e., the percentage of loss over the total exposure if default were to occur during the full contractual life of the instrument).

# Classification and Measurement

## Background

The FASB is currently finalizing amendments to its guidance on the classification and measurement of financial instruments. During deliberations of its February 2013 [proposed ASU](#) (which outlined a new model that was largely converged with the IASB’s for the classification and measurement of financial instruments), the FASB decided to abandon the converged approach and retain much of the existing requirements in U.S. GAAP. However, the amendments contain significant 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).
- Impairment of equity investments measured using a practicability exception.
- 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.

At its November 11, 2015, meeting, the FASB directed the staff to draft a final standard, which is expect to be issued by the end of the year. The Board also made tentative decisions about the effective date of the upcoming standard.

For public business entities, the new standard would be effective for fiscal years beginning after December 15, 2017, including interim periods therein. For all other entities, it would be effective for fiscal years beginning after December 15, 2018, and interim periods for the following year. Early adoption of certain of the standard’s provisions would be permitted for all entities. Nonpublic business entities would be permitted to adopt the standard in accordance with the effective date for public business entities.

<sup>8</sup> Quoted text is from the FASB’s [summary](#) of tentative Board decisions reached at its August 13, 2014, meeting.

## 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 exception would not be available to reporting entities that are investment companies or broker-dealers in securities.

## Impairment Assessment of Equity Investments

The amendments will eliminate the requirement for an entity that has elected the practicability exception to assess whether the equity investment is other-than-temporarily impaired. Instead, as of each reporting period, the entity would qualitatively consider the following indicators (from ASC 825-10-35-18 in the proposed ASU) to determine whether the investment is impaired:

- a. A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
- b. A significant adverse change in the regulatory, economic, or technological environment of the investee
- c. A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
- d. A bona fide offer to purchase, an offer by the investee to sell, or a completed auction process for the same or similar investment for an amount less than the carrying amount of that investment
- e. Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.

If, on the basis of the qualitative assessment, the equity investment is impaired, the investee would be required to record an impairment equal to the amount by which the carrying value exceeds fair value. The investee would no longer be required to evaluate whether such impairment was 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 held for trading (with changes in fair value recognized in earnings) or available for sale (with changes in fair value recognized in OCI). Investments in nonmarketable equity securities that are not accounted for as equity-method investments are measured at cost (less other-than-temporary impairment). The amendments will eliminate the AFS classification category for marketable equity securities as well as the cost method of accounting for qualifying nonmarketable equity securities. As a result of these changes, banks with large portfolios of cost-method investments or equity investments classified as available for sale could experience 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).

## Hedging

### Background

As part of its project on targeted improvements to hedge accounting, the FASB held several educational sessions during 2015. Those sessions have thus far culminated in two decision-making meetings at which the FASB made a number of tentative decisions that, if ultimately adopted, would significantly modify certain aspects of the existing hedge accounting model. The Board hopes to issue a proposed ASU reflecting these tentative conclusions in the first quarter of 2016.

### Overall Hedging Model

The FASB tentatively decided to retain, for both fair value and cash flow hedges, (1) the highly effective threshold used to qualify for hedge accounting under current U.S. GAAP and (2) the current guidance allowing an entity to voluntarily dedesignate a hedging relationship. Further, under the proposal, an entity would still need specified documentation in place at hedge inception, including a description of its method for quantitatively assessing hedge effectiveness (unless the criteria for using the shortcut or critical-terms-match methods are met, obviating the need for quantitative assessments). However, an entity would not have to actually complete that initial quantitative assessment of hedge effectiveness until the end of the reporting period in which it designated the hedge (i.e., an entity could have up to three months to complete the initial quantitative assessment of effectiveness). Also under the proposal, after hedge inception, an entity would need to perform quantitative assessments of hedge effectiveness only when facts and circumstances change.

The Board also tentatively decided to eliminate the traditional concept of hedge ineffectiveness:

- For highly effective cash flow hedging relationships, the entire change in the fair value of the hedging instrument included in an entity’s hedge effectiveness assessment would initially be recorded in OCI. When the hedged item affects earnings, the amount in accumulated OCI would be reclassified to the same income statement line as the earnings effect of the hedged item. Any portion of the change in the fair value of the hedging instrument that is excluded from an entity’s hedge effectiveness assessment would be recognized immediately in earnings (but presented on the same income statement line as the earnings effect of the hedged item).
- For highly effective fair value hedging relationships, the entire change in the fair value of the hedging instrument would be recorded in earnings immediately in the same income statement line as the hedged item.
- For highly effective net investment hedging relationships, the entire change in the fair value of the hedging instrument included in an entity’s hedge effectiveness assessment would initially be recorded as part of the cumulative-translation adjustment in OCI. When the hedged item affects earnings, the amount in accumulated OCI would be reclassified to the same income statement line as the earnings effect of the hedged item. Any portion of the change in the fair value of the hedging instrument that is excluded from an entity’s hedge effectiveness assessment would be recognized immediately in earnings.

In addition, the FASB tentatively decided to require additional disclosure about (1) cumulative-basis adjustments for fair value hedges and (2) the effect of hedging on individual income statement line items. It also tentatively decided to require expanded qualitative disclosures about the quantitative goals, if any, that an entity set to achieve its hedging objectives.



## Nonfinancial Hedging Relationships

For hedges of nonfinancial items, the Board tentatively decided to change existing U.S. GAAP to permit an entity to designate as a hedged item a contractually specified component or ingredient that is linked to a contractually stated rate or index. Any cap, floor, or negative basis that is related to the pricing of a contractually specified component of a nonfinancial item would not preclude designation of that component as a hedged item — an entity would just need to consider such pricing features in its assessment of hedge effectiveness.

## Financial Hedging Relationships

For hedges of financial items, the FASB tentatively decided to (1) allow the contractually specified index rate in a variable-rate hedged item to be the designated interest rate risk (thereby relieving entities of the need to designate a benchmark interest rate for cash flow hedges of variable-rate instruments); (2) retain the existing benchmark interest rate definition for hedges of fixed-rate instruments, with minor modifications to eliminate inconsistencies; and (3) designate the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap index as a permitted benchmark interest rate.

In addition, the tentative decisions would allow an entity, for fair value hedges of interest rate risk, to:

- Consider only the effects of the designated hedged risk (e.g., interest rate risk) on a prepayment option when determining the change in the value of the debt for hedges of callable debt.
- Designate as the hedged risk only a portion of the hedged item's term (i.e., compute the change in the hedged item's fair value by using the same term as that of the hedging instrument).
- Calculate the change in the fair value of the hedged item attributable to changes in the benchmark interest rate by using either (1) total coupon cash flows or (2) only those cash flows related to the benchmark interest rate. However, an entity would be required to use total coupon cash flows when the effective interest rate of the hedged item is less than the benchmark interest rate on the date of hedge designation.

## Shortcut Method

The FASB tentatively decided to retain the shortcut method in current U.S. GAAP. However, the Board also tentatively decided to allow an entity to document at hedge inception the long-haul method it would use to measure hedge ineffectiveness if the shortcut method could not be applied. That is, if the entity later determines that continued use of the shortcut method is inappropriate, it can continue the hedging relationship by using the long-haul method designated at inception as long as the hedging relationship has been highly effective since inception.

## Next Steps

The FASB staff will (1) continue deliberations, including consideration of whether alternative hedge documentation requirements for private companies are warranted; (2) develop a staff draft reflecting the Board's decisions; (3) analyze the costs, benefits, and potential complexity of the tentative decisions; and (4) identify any issues that need to be brought back to the Board for a vote. In addition, the FASB will need to address transition and the comment period of the proposed ASU.

## Thinking It Through

When the proposal is issued, companies should carefully analyze it to assess its possible ramifications on their hedging strategies, systems, and internal controls, and they are encouraged to provide feedback on the proposed amendments to the FASB. Multinational companies should note that the FASB's proposed hedging model is likely to differ significantly from the IASB's IFRS 9 hedging model.

To follow the status of the FASB's hedging project, see the [project page](#) on Deloitte's US GAAP Plus Web site.

# Leases

## Background

The FASB has been working with the IASB for almost a decade to address concerns related to the off-balance-sheet treatment of certain lease arrangements by lessees. The boards' proposed model would require lessees to adopt a right-of-use (ROU) asset approach that would bring 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).

### Thinking It Through

The boards have spent a significant amount of time trying to define a lease arrangement to help constituents identify whether an arrangement contains a lease or represents an agreement to provide a service. The boards' revised leases ED, released by the FASB as a [proposed ASU](#) in May 2013, defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." The revised ED focuses on whether (1) the contract is based on an identified asset and (2) the lessee obtains the right to control the use of the asset for a particular period.

The definition of a lease will have a significant impact on whether an arrangement is within the scope of the new guidance. For example, under the FASB's requirements, an arrangement to provide access to "small ticket" items such as terminals, photocopiers, or computers could ultimately be considered a lease arrangement and therefore would need to be included on the financial institution's balance sheet. However, the IASB has decided to include an exemption for small ticket items in its final standard, and thus this guidance is not converged.

## Lessee Accounting

While the boards agree that a lessee should record an ROU asset and a corresponding lease liability when the lease commences, the FASB and the IASB support different approaches for the lessee's subsequent accounting. The FASB decided on a dual-model approach under which a lessee would classify a lease by using criteria that are 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.

## Lessor Accounting

In 2014, the boards discussed constituent feedback on the ED and decided not to make significant changes to the existing lessor accounting model. Rather, they agreed to adopt an approach 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). The FASB also reaffirmed its previous decision to eliminate leveraged-lease accounting. However, the Board tentatively decided to allow entities to continue to apply the current leveraged-lease guidance to leveraged-lease arrangements that exist as of the effective date of the final guidance on leases.

## Thinking It Through

The FASB had originally decided that initial direct costs associated with a sales-type lease (including those for which there is no profit margin) incurred by the lessor should be expensed. However, feedback on the proposed guidance suggested that the Board reconsider that requirement. The Board tentatively decided that initial direct costs would be deferred and recognized over the lease term if there is no selling profit or loss resulting from a sale-type lease. This approach would be consistent with how initial direct costs are recognized under current U.S. GAAP for direct financing leases.

## Next Steps

The FASB has completed its redeliberations on leases and is expected to issue a final standard in the fourth quarter of 2015 or in early 2016. The new guidance will be effective for public business entities for fiscal years beginning after December 15, 2018 (i.e., calendar periods beginning on January 1, 2019), including interim periods therein. For all other entities, the standard will be effective for annual periods beginning after December 15, 2019 (i.e., calendar periods beginning on January 1, 2020), and interim periods thereafter. Early adoption will be permitted.

## Thinking It Through

### Capital and Covenant Considerations

Companies in the banking and securities sector have expressed concerns about the capital treatment of both the ROU asset and the associated liability that would be recorded upon adoption of the proposed guidance on leases. Specifically, in the absence of clear FASB or SEC guidance, many expect regulators to view the ROU asset the same way they currently view a capital lease (i.e., not as a liquid asset). Regulators have not yet offered their views on how the ROU asset would affect a bank's common equity tier 1 capital. Constituents are therefore expecting additional clarification from the regulators to determine how the final guidance would affect a bank's net capital computations.

Similarly, regulators have not yet determined what kind of relief, if any, would be granted to broker-dealers to avoid a 100 percent capital charge (e.g., whether a 100 percent capital charge would be required in the net capital computation for a broker-dealer institution since any illiquid asset is considered "nonallowable"). Further, for broker-dealers that use an aggregate indebtedness method to compute their net capital, the recognition of a leasing liability may increase the entity's aggregate indebtedness. Therefore, a broker-dealer lessee's net capital calculation and maximum debt-to-equity ratio calculated under Rule 15c3-1 of the Exchange Act may be adversely affected as a result of adoption of the final guidance. As a result, holding companies would potentially be forced to make a significant capital contribution to broker-dealer subsidiaries to ensure sufficient capital requirements.

Finally, as a result of the balance sheet gross-up required for lessees under the proposed ASU, banking and securities lessees may need to adjust their existing loan covenants, which could trigger a broader renegotiation of the terms of, and revisions to, loan documentation.

### Operational Considerations

To implement the proposed lessee accounting requirements, banking and securities entities will have to collect and maintain data from all individual leases they are party to, including information related to real estate leases (e.g., ATM terminals and branches) and equipment leases. This data-gathering exercise may result in entity-wide operational challenges, particularly for entities with a global footprint. The new requirements could affect external as well as internal reporting information, including financial budgets and forecasts.

Entities that enter into intercompany service arrangements, which are often related to real estate, technology, or equipment, will need to determine whether these arrangements include lease components that may need to be accounted for in the separate-subsidiary financial statements. Although the FASB has tentatively decided that intercompany lease arrangements should be accounted for on the basis of their legal form (rather than their substance), the administrative burden related to inventorying such contracts may be significant.

### **Leveraged Leases**

Banks have historically invested in leveraged-lease arrangements to generate investment returns. While the FASB has tentatively decided to allow entities to continue to apply the current leveraged-lease guidance to leveraged-lease arrangements that exist as of the effective date of the final guidance, they will no longer be permitted to use this specialized accounting for new arrangements.

## Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities

### **Background**

In November 2013, the FASB endorsed a decision by the PCC to allow nonpublic business entities to amortize goodwill and perform a simplified impairment test. The Board received feedback on the PCC's decision indicating that many public business entities and not-for-profit entities had similar concerns about the cost and complexity of the annual goodwill impairment test. In response, the Board added this project to its agenda in 2014.

### **Current Status and Next Steps**

The project is currently in the initial deliberations phase. At its meeting on October 28, 2015, the FASB tentatively decided to split the project into two phases. The first phase would focus on simplifying the goodwill impairment test. In the second phase, the Board would work with the IASB to address stakeholder concerns related to the subsequent accounting for goodwill.

At the October meeting, the Board discussed how to simplify the goodwill impairment test and tentatively decided to remove step 2, thus eliminating the requirement to complete a hypothetical purchase-price allocation. The FASB also tentatively decided not to give entities the option to perform step 2 and to instead require them to adopt the simplified impairment test prospectively.

In addition, the Board discussed whether not-for-profit entities should be allowed to adopt PCC accounting alternatives. The FASB tentatively decided not to extend to not-for-profit entities the accounting alternative in [ASU 2014-02](#), which allows private entities to amortize goodwill as well as complete only step 1 of the goodwill impairment test (at the entity or reporting-unit level) upon a triggering event.

# Accounting for Identifiable Intangible Assets in a Business Combination for Public Business Entities and Not-for-Profit Entities



## Background

In November 2014, the FASB agreed to add a project to its agenda to explore potential changes to the existing model on accounting for identifiable intangible assets in a business combination for public business entities and not-for-profit entities. The Board will evaluate whether certain intangible assets should be subsumed into goodwill.

## Current Status and Next Steps

The project is currently in the initial deliberations phase. At its October 28, 2015, meeting, the Board decided to continue further research in conjunction with the IASB's project on this topic.

## Clarifying the Definition of a Business

The FASB is currently working on a project to clarify the definition of a business in ASC 805. The project comprises three phases:

- *Phase I* — Clarifying the definition of a business.
- *Phase II* — Accounting for partial sales of, and retained interests in, nonfinancial assets, and clarifying the definition of in-substance nonfinancial assets.
- *Phase III* — Minimizing certain differences between the accounting for acquisitions of assets and businesses.

At its meeting on July 10, 2015, the FASB instructed its staff to begin drafting a proposed ASU on clarifying the definition of a business. The tentative decisions reached to date in this project include:<sup>9</sup>

- To be a business, “a set of activities and assets must include inputs and one or more substantive processes that together contribute to the ability to create outputs.”
- The guidance would include a framework for determining “whether a substantive process is included in a set of acquired assets and activities.”
- The definition of a business would no longer state that “a business need not include all of the inputs and processes that the seller used in operating the business if market participants are capable of acquiring the business and continuing to produce outputs.”
- A transferred set of activities would be considered an asset (and not a business) if “substantially all the fair value of the gross assets acquired is concentrated in a single tangible or identifiable intangible asset (or group of similar tangible or identifiable intangible assets).” This decision would “(a) provide a practical way to determine when transactions are not a business that can be qualitatively assessed and (b) significantly cut out the amount of work that goes into the analysis in most cases.”

The Board noted that such clarifications are necessary not only because the current definition of a business has been interpreted very broadly and is difficult to apply but because it “is necessary to clarify the scope of sales or transfers of nonfinancial assets with noncustomers” under ASU 2014-09.

<sup>9</sup> Quoted material is from the Board's July 9, 2015, meeting [handout](#).

Further, the FASB states that “[i]f the definition of a business is clarified, the reference to in-substance nonfinancial assets may no longer be needed” but that if it is not clarified, “there will be more pressure on what an in-substance nonfinancial asset is, which will result in the need to provide additional guidance on in-substance nonfinancial assets.”

While the Board did not discuss an effective date, it decided that the proposal would be applied prospectively upon adoption and would be exposed for a 60-day comment period.

In addition, the IASB is considering adding a similar project to its agenda to reconsider the definition of a business in IFRS 3. Currently the definition of a business is converged under U.S. GAAP and IFRSs. At the time of this publication, it is not clear how the IASB’s project will affect the timing of the FASB’s proposed ASU and final standard.

### Thinking It Through

On the basis of the FASB staff’s outreach regarding the application of ASC 805’s current definition of a business, the Board determined that the concepts of “capable of providing a return” and “outputs” were being broadly interpreted in practice. Accordingly, and because it wanted start-up entities to continue to qualify as businesses under ASC 805, the Board tentatively decided to retain the notion of “capable” in the definition and instructed the staff to explore revising the definition of “outputs.”

The staff also noted that the guidance in ASC 805 does not require acquired inputs and processes to be self-sustaining (i.e., an acquirer can apply a market participant’s viewpoint in determining whether the acquired set of activities meets the definition of a business). However, ASC 805 does not provide additional guidance on how to apply a market participant’s viewpoint. As a result, the Board tentatively decided to retain the market-participant concept in the definition of a business but to ask the staff to provide clarifying guidance on how to analyze an acquisition from a market-participant perspective.

For more information, see the [project update page](#) on the FASB’s Web site.

## Simplifying the Accounting for Employee Share-Based Payments

In June 2015, the FASB issued a [proposed ASU](#) on share-based payments as part of its simplification initiative. The proposed ASU would affect several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, minimum statutory withholding requirements, classification in the statement of cash flows, and classification of awards with repurchase features. In addition, the proposed ASU contains two practical expedients for nonpublic entities under which such entities can use the simplified method to estimate the expected term of an award and make a one-time election to switch from fair value measurement to intrinsic value measurement for liability-classified awards.

The FASB received over 60 comment letters on the proposal (which were due by August 14, 2015) from various respondents, including preparers, professional and trade organizations, and accounting firms. While respondents were generally supportive of the proposed changes, a number were concerned with a key provision related to accounting for excess tax benefits and deficiencies. Specifically, the ASU proposes to eliminate the APIC pool and require entities to record all excess tax benefits and deficiencies to the income statement. While respondents generally agreed with the Board’s proposal to eliminate the APIC pool, many would prefer to record all excess tax benefits and deficiencies directly to equity.

The FASB is expected to redeliberate the proposed changes, as well as determine an effective date for the new guidance, during the fourth quarter of 2015.

For additional information about the proposed ASU, see Deloitte’s June 12, 2015, [Heads Up](#).

# Liabilities and Equity — Targeted Improvements

## Background

In November 2014, the FASB added to its agenda a project to “simplify the accounting guidance related to financial instruments with characteristics of liabilities and equity.”<sup>10</sup> The project focuses on the following:

1. Application of the indexation guidance in ASC 815-40 to “equity-linked financial instruments containing ‘down round’ features.”
2. The indefinite deferral of the liability classification guidance in ASC 480-10 on certain “mandatorily redeemable financial instruments for certain nonpublic entities and certain mandatorily redeemable noncontrolling interests.”
3. Potential improvements to the accounting guidance in ASC 815-40 on “[f]reestanding contracts indexed to, and potentially settled in, an entity’s own stock.”
4. “Improving the navigation within the Codification.”

Deliberations on the first phase of this project began at the FASB’s September 6, 2015, meeting, during which the Board discussed items (1) and (2) above.

## Down-Round Features

At its September meeting, the Board tentatively decided to create a new accounting model that would replace the existing guidance on such features in ASC 815-40.

### Thinking It Through

A down-round feature is a provision 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 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. For example, a warrant may specify that the strike price is the lower of \$5 per share or the common stock offering price in any future initial public offering of the shares. Under current U.S. GAAP, a contract that contains a down-round feature does not qualify as equity because it 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).

Unlike current U.S. GAAP, the Board’s tentative approach related to down-round features would not preclude an entity from concluding that an instrument is indexed to the entity’s own stock. For example, when an entity evaluates whether it is required to classify a freestanding warrant to acquire the entity’s common stock as a liability under ASC 815-40, the existence of the down-round feature would not affect the analysis. Similarly, a down-round feature would be excluded from the analysis of whether (1) an embedded conversion feature in a debt host contract must be bifurcated as an embedded derivative under ASC 815-15 or (2) it qualifies for the derivative accounting scope exception in ASC 815-10-15-74 for contracts indexed to an entity’s own stock and classified in stockholders’ equity.

Under the tentative approach, if a down-round feature is triggered, the accounting for it would be aligned with the classification of the related instrument. For an equity-classified instrument, the transfer of value from the entity to the holder at the time the down-round feature is triggered would result in the recognition of a dividend to the investor. If the instrument is classified as a liability, the transfer of value resulting from the down-round feature when triggered would be recognized through a charge to earnings. If the entire instrument is classified as a liability with changes in fair value charged

<sup>10</sup> Quoted text is from the [project update page](#) on the FASB’s Web site.

to earnings each reporting period, no separate adjustment would be required since the value of the down-round when triggered would inherently be captured in the periodic adjustment.

The FASB believes that existing U.S. GAAP requirements sufficiently address disclosures related to instruments with down-round features. However, the Board supported the addition of a narrow requirement for entities to disclose, in the period the down-round feature is triggered, the impact of recognizing the feature.

### Thinking It Through

Under current U.S. GAAP, the existence of a down-round feature automatically precludes the instrument being evaluated (whether freestanding or embedded) from meeting the derivative accounting scope exception in ASC 815-40-15-74. As a result of the tentative approach, there would be (1) more freestanding contracts on own equity (e.g., warrants) that meet this scope exception (and thus more contracts being included within equity rather than accounted for as derivative liabilities) and (2) fewer embedded features (e.g., equity conversation features) that meet all the criteria in ASC 815-15 for bifurcation as embedded derivatives. This will reduce earnings volatility in the issuer's financial statements since derivatives liabilities, unlike equity-classified contracts, are adjusted to their fair value each reporting period.

### Indefinite Deferrals Under ASC 480-10

The transition guidance in ASC 480-10 indefinitely defers the application of some of its requirements to 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. The Board tentatively agreed to replace the indefinite deferrals in ASC 480-10 with scope exceptions that have the same applicability. This is not intended to have any impact on accounting treatment but rather to improve navigation within the Codification.

## Simplifying the Equity Method of Accounting

In June 2015, the FASB issued a [proposed ASU](#) on equity method accounting as part of its simplification initiative. The proposal would eliminate the requirements for an investor to (1) account for basis differences related to its equity method investees and (2) retroactively account for an investment that becomes newly qualified for use of the equity method because of an increased ownership interest, as if the equity method had been applied during all previous periods in which the investment was held. Comments on the proposed ASU were due by August 4, 2015.

### Thinking It Through

The comment letters to the FASB on the proposed ASU generally supported the Board's efforts to reduce the complexity related to the equity method of accounting. Most respondents approved of the Board's proposal to eliminate retrospective application of the equity method accounting in situations in which an investment qualifies for the use of such accounting as a result of an increased level of ownership. However, concerns were raised that eliminating the requirement to account for basis differences related to an equity method investee could introduce new challenges when the investee has a single (or a predominant) asset.

For additional information about the proposed ASU, see Deloitte's June 16, 2015, [Heads Up](#) and August 4, 2015, [comment letter](#) to the FASB.

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

## Background

In March 2015, the FASB added to its agenda a project to improve interest income disclosures for purchased debt securities and loans. The objective of this project is to enhance the transparency and usefulness of the information provided in the notes to the financial statements about interest income on purchased debt securities and loans. Possible enhancements include requiring disclosure of:

- The separate components of the effective yield on purchased debt securities and loans, specifically (1) the contractual interest and (2) the accreting premium or discount.
- The outstanding amounts of principal and premiums or discounts on purchased debt securities and loans, with separate disclosure of those amounts subject to call options.

At its September 2015 meeting, the Board continued deliberating disclosures about interest income on purchased debt securities and loans and also decided to expand the scope of the project to include the amortization period used for callable debt securities. The Board tentatively decided that for purchased callable debt securities, (1) premiums would be amortized to the first call date and (2) discounts would be amortized to the maturity date. This would be a change from current practice, which requires premiums and discounts to be amortized to the maturity date in absence of the entity holding a large number of similar securities for which it has elected as an accounting policy to amortize prepayments and discounts over the expected life of the securities.

## Next Steps

The Board directed the staff to research (1) current disclosure requirements for callable debt securities and loans and (2) whether the scope of the financial instruments included in the project should be amended. At a future meeting, the staff will provide the Board with its research and proposed disclosure requirements related to interest income for purchased debt securities and loans.

## Thinking It Through

This project aims to improve the disclosures about interest income reported in the financial statements so users of the financial statements can determine how much of reported interest income is attributable to the cash paid by borrowers and how much is attributable to the amortization of premiums or discounts. In addition, in response to specific feedback, the Board plans to alter the current interest income accounting model for callable debt securities purchased at a premium because the current accounting model may result in (1) the recognition of too much interest income before prepayment of the debt instrument by the borrower and (2) the possibility of a delayed recognition of a loss for the unamortized premium.

# Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (EITF Issue 15-F)

To reduce diversity in the application ASC 230, the FASB added nine subissues related to EITF Issue 15-F to the EITF's agenda in 2015. The subissues are as follows:

- Issue 1 — Debt Prepayment or Debt Extinguishment Costs.
- Issue 2 — Settlement of Zero-Coupon Bonds.
- Issue 3 — Contingent Consideration Payments Made After a Business Combination.
- Issue 4 — Restricted Cash.
- Issue 5 — Proceeds from the Settlement of Insurance Claims.
- Issue 6 — Proceeds from the Settlement of Corporate-Owned Life Insurance Policies.
- Issue 7 — Distributions Received From Equity Method Investees.
- Issue 8 — Beneficial Interests in Securitization Transactions.
- Issue 9 — Predominant Cash Receipts and Cash Payments.

The EITF has reached a consensus-for-exposure on all of the subissues except for Issue 4 (on restricted cash) and has decided that the guidance related to those eight subissues would be applied retrospectively to all periods presented. The Task Force has also decided to incorporate an impracticability<sup>11</sup> principle into the guidance.

Because Task Force members' views differ on the guidance related to restricted cash, the EITF has directed the staff to perform further research. The Task Force is expected to continue discussing restricted cash and the effective date for the guidance at a future meeting. For more information, including tentative decisions reached by the EITF as of the date of this publication, see Deloitte's November 2015 *EITF Snapshot*.



<sup>11</sup> The impracticability principle would be applied in a manner similar to ASC 250-10-45-9.

# Other Topics

# 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 “Board’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.

On February 18, 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 response to feedback from outreach activities and to maintain consistency with its proposed ASU on the omission of immaterial disclosures (see discussion in “Entity’s Decision Process” below) and with current practice, on September 24, 2015, the FASB proposed to modify the definition of materiality in Concepts Statement 8. The proposed amendment 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 are due by December 8, 2015.

### 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 included 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.

## Entity’s Decision Process

In September 2015, to reduce entities’ reluctance to omit immaterial disclosures, the FASB issued a [proposed ASU](#) 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 are due by December 8, 2015.



## Topic-Specific Disclosure Reviews

In addition to proposing amendments to guidance, the FASB staff is analyzing ways to “further promote [entities’] appropriate use of discretion” in determining proper financial statement disclosures. The Board is applying the concepts in both the entity’s and the Board’s decision process in considering “section-specific modifications.” In the second half of 2015, 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).
- ASC 330 (inventory).

Proposed changes to the disclosure requirements for fair value measurement and income taxes are discussed below.

### Fair Value Measurement — Objective for Disclosures

The FASB has tentatively decided to add to ASC 820 an objective for fair value measurement disclosures that is based on the decision questions for the Board in its proposed concepts statement. The objective could help preparers determine whether a given disclosure should be enhanced in light of the entity’s particular facts and circumstances even though the disclosure may already meet the rigid disclosure requirements. The Board stated:

The objective of the following disclosures is to provide users of financial statements with information useful in assessing the following:

- a. The different ways an entity arrives at its measures of fair value, including the 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 assets and liabilities
- d. How fair value measurements change from period to period.

In addition to establishing a disclosure objective, the Board has tentatively decided to make changes (i.e., eliminations, modifications, and additions) to the specific fair value disclosure requirements of ASC 820.

### Eliminated and Modified Disclosure Requirements

#### Policy on Timing of Transfers Between Levels and Transfers Between Levels 1 and 2

The Board tentatively decided to 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 Board made the following tentative decisions that affect disclosures about Level 3 fair value measurements:

- *Valuation process* — 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 tentatively decided 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* — 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, the Board plans to 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* — 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.
- *Level 3 rollforward* — Retain the Level 3 rollforward requirement for public business entities. For entities that are not public business entities, the Board tentatively decided to modify the Level 3 rollforward guidance 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 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 of Level 3 investments in a sentence rather than in a full rollforward as required today. A defined benefit plan sponsor would also remove the reconciliation of beginning and ending balances for plan investments categorized as Level 3 within the fair value hierarchy (i.e., the Level 3 rollforward) and would only be required to disclose transfers into and out of Level 3 and purchases of Level 3 assets in its defined benefit plan footnote (for more information about the FASB's project on reviewing defined benefit plan disclosures, see the [project page](#) on Deloitte's US GAAP Plus Web site).

## Thinking It Through

The Board discussed the results of user outreach on the Level 3 rollforward and 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.

## NAV 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.”

### 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 NAV practical expedient.

## New Disclosure Requirements — Unrealized Gains and Losses

Public business entities 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 only required for the Level 3 amounts within net income under ASC 820-10-50-2(c) and (d). This requirement would not apply to entities that are not public business entities in accordance with the private-company decision-making framework.

### Transition and Next Steps

The Board has tentatively decided that the proposed 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 is expected to issue a proposed ASU in the near term. The comment period is expected to be 75 days or until February 29, 2016, whichever is longer.

## Income Taxes

At its meeting on January 7, 2015, the FASB staff outlined potential revisions to the disclosure requirements in ASC 740 that would enhance a financial statement user’s understanding of foreign taxes. The Board’s efforts are largely driven by [findings](#) in the post-implementation review of Statement 109 that users want more information that will allow them to analyze (1) “the cash effects associated with income taxes, particularly current period taxes paid by jurisdiction (e.g., U.S. and foreign), and estimate future tax payments” and (2) “earnings determined to be indefinitely reinvested in foreign subsidiaries.”

At its October 21, 2015, meeting, the FASB discussed income tax disclosure requirements related to income taxes paid, deferred income taxes, valuation allowances, and rate reconciliation and reached the following tentative decisions, which would apply to both public and nonpublic entities:

- *Income taxes paid* — The Board would add requirements for a reporting entity to disclose (1) when a change in tax law has been enacted and it is probable that the change will affect the reporting entity in a future period and (2) the disaggregation of the income taxes paid between foreign and domestic jurisdictions.

- *Deferred income taxes* — An entity would be required to disclose the balance sheet line item(s) in which deferred taxes are presented (i.e., a mapping of total deferred taxes to the balance sheet line items in which they are reported).
- *Valuation allowances* — An entity would need to explain the “nature and amounts of the valuation allowance recorded and released during the reporting period.”<sup>1</sup>
- *Rate reconciliation* — The Board tentatively decided that:
  - Nonpublic entities would be required to present a rate reconciliation in the notes to the financial statements, as ASC 740-10-50-12 currently requires for public entities.
  - A disaggregation of a component of the rate reconciliation would be required if the individual component is greater than or equal to 5 percent of the tax at the statutory rate in a manner consistent with SEC Regulation S-X.
  - An entity would be required to disclose a qualitative description of the items that have caused a significant year-over-year change to the effective tax rate.

In addition, the Board tentatively decided to require disclosures about the (1) gross amounts and expiration dates of carryforwards recorded on a tax return, (2) tax-effected amounts and expiration dates of carryforwards that give rise to a deferred tax asset, and (3) total amount of unrecognized tax benefits that offset deferred tax assets related to carryforwards.

The Board directed its staff to begin drafting a proposed ASU for public comment that would take into account all the tentative decisions reached to date regarding income tax disclosure requirements. Such decisions include the Board’s previous tentative decisions made about disclosure requirements related to indefinitely reinvested foreign earnings and unrecognized tax benefits.



## Undistributed Foreign Earnings

On February 11, 2015, the FASB tentatively decided that entities should:

- Disclose information separately about the domestic and foreign components of income before income taxes. Further, entities should separately disclose income before income taxes of individual countries that are significant relative to total income before income taxes.<sup>2</sup>
- Disclose the domestic tax expense recognized in the period related to foreign earnings.
- Disclose unremitted foreign earnings that, during the current period, are no longer asserted to be indefinitely reinvested and an explanation of the circumstances that caused the entity to no longer assert that the earnings are indefinitely reinvested. These disclosures should be provided in the aggregate and for each country for which the amount no longer asserted to be indefinitely reinvested is significant in relation to the aggregate amount.
- Separately disclose the accumulated amount of indefinitely reinvested foreign earnings for any country that is at least 10 percent of the aggregate amount.

## Unrecognized Tax Benefits

At its [meeting](#) on August 26, 2015, the FASB tentatively decided to:

- Add a disclosure requirement in the tabular reconciliation to disaggregate settlements between cash and noncash (e.g., settlement by using existing net operating loss or tax credit carryforwards).
- Add a disclosure requirement to provide a breakdown of the amount of total unrecognized tax benefits shown in the tabular reconciliation by the respective balance-sheet lines on which such unrecognized tax benefits are recorded.

<sup>1</sup> Quoted text is from the FASB’s [summary](#) of tentative Board decisions reached at its October 21, 2015, meeting.

<sup>2</sup> In ASC 740, income before income taxes is also referred to as pretax financial income.

- Eliminate the requirement in ASC 740-10-50-15(d) for entities to provide details of 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.

Since the two new proposed disclosure requirements for unrecognized tax benefits are related to the tabular reconciliation, they will only apply to public entities.

The Board directed its staff to prepare examples of the proposed additional disclosures.

## Interim Reporting

To date, the FASB has discussed five interim reporting concepts under its proposed concepts statement. The Board generally agreed that interim financial statements should describe “differences in recognition, measurement, and presentation of line items” and should explain “how the interim period relates to the entire year.”<sup>3</sup> Two of the interim reporting concepts pertained to disclosing changes from the latest annual financial statements, and two pertained to disclosing items that are not peripheral or are “especially important.”

To determine the meaning of “especially important,” the Board will assess the interim disclosure requirements being proposed in the Board’s project on reviewing fair value measurement disclosures as well as the interim disclosure requirements related to revenue in ASC 270-10-50-1A. On the basis of this process, the FASB can assess whether entities should disclose an item or amount that has not changed but is especially important.

# 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. Key SEC rulemaking activities and other developments that have occurred since the [last edition](#) of this publication are discussed below.

## SEC Releases Cybersecurity Publications

In February 2015, the SEC issued the following two publications related to cybersecurity risks at brokerage and advisory firms:

- *Risk alert* — Summarizes the findings associated with an examination of over 100 investment advisers and broker-dealers conducted by the SEC’s Office of Compliance Inspections and Examinations (OCIE). The OCIE observed the entities’ practices related to “identifying risks related to cybersecurity; establishing cybersecurity governance, including policies, procedures, and oversight processes; protecting firm networks and information; identifying and addressing risks associated with remote access to client information and funds transfer requests; identifying and addressing risks associated with vendors and other third parties; and detecting unauthorized activity.”
- *Investor bulletin* — Provides investors with advice on how to protect their online investment accounts (e.g., selecting a strong password, two-step verification, careful use of public networks).

<sup>3</sup> Quoted text is from a [handout](#) for the Board’s January 7, 2015, meeting.

## Thinking It Through

The frequency of cyberattacks is steadily increasing. Attackers have made countless attempts to compromise companies' defenses, but it only takes a single weakness to result in a breach. Companies must accept that it is not possible to prevent all cyberattacks; however, they can significantly limit damage by quickly identifying and addressing any compromise.

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

## SEC Proposes Increased Oversight of Broker-Dealers That Engage in Off-Exchange Trading

In March 2015, the SEC issued a [proposed rule](#) that would amend Rule 15b9-1 of the Exchange Act, under which certain broker-dealers are exempted from membership in a registered national securities association. Specifically, the proposal "would narrow an exemption that currently exempts certain brokers-dealers from membership in a national securities association if they are a member of a national securities exchange, carry no customer accounts, and have annual gross income of no more than \$1,000 that is derived from securities transactions effected otherwise than on a national securities exchange of which they are a member." The purpose of the proposed amendments is to "enhance regulatory oversight of active proprietary trading firms, such as high frequency traders."

Comments on the proposed rule were due by June 1, 2015.

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

## SEC and FINRA Release Report on Examinations of Broker-Dealers' Policies Related to Senior Investors

In April 2015, the SEC and FINRA released a [report](#) on the two organizations' examinations of broker-dealers that "conduct business with senior investors [i.e., those aged 65 and older] as they prepare for and enter into retirement." The objective of the report is to "facilitate a thoughtful analysis with regard to [broker-dealers'] existing policies and procedures related to senior investors and senior-related topics and whether these policies and procedures need to be further developed or refined."

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

## SEC Publishes Examination Priorities for 2015

In January 2015, the SEC's Office of Compliance Inspections and Examinations published its [examination priorities](#) for 2015. The priorities focus on "protecting retail investors, especially those saving for or in retirement; assessing market-wide risks; and using data analytics to identify signs of potential illegal activity." The document is not necessarily comprehensive and "may be adjusted in light of market conditions, industry developments, and ongoing risk assessment activities."

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

## SEC Updates Financial Reporting Manual

In January 2015, the SEC's Division of Corporation Finance (the "Division") published an update to its [Financial Reporting Manual](#) (FRM). The changes were made in light of the FASB's November 2014 issuance of ASU 2014-17 on pushdown accounting and the related rescission of SAB Topic 5.J.

In August 2015, the Division updated paragraphs 1320.3 and 1320.4 of the FRM to clarify that “[g]enerally, the Division of Corporation Finance will not issue comments asking a delinquent registrant to file separately all of its delinquent filings if the registrant files a comprehensive annual report on Form 10-K that includes all material information that would have been included in those filings.” Previously, registrants would have sought such an accommodation in writing from the Division’s office of the chief accountant.

The updates also reiterated that a registrant’s filing of a comprehensive annual report on Form 10-K in those circumstances does not (1) absolve it of any Exchange Act liability arising from its failure to file all required reports or shield it from any related enforcement actions; (2) make it “current” for Regulation S, Rule 144, or Form S-8 filings; or (3) affect its inability to use Form S-3 until it satisfies the timely-filer requirements.

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

## **SEC Proposes Hedging Disclosure Requirements**

In February 2015, the SEC issued a [proposed rule](#) that would enhance corporate governance by requiring registrants to disclose employee and director information that may affect shareholders’ interests. Specifically, the proposal, which is being issued in response to a requirement in Section 955 of the Dodd-Frank Act, would require a registrant to disclose, in a proxy or information statement, “whether the registrant permits any employees (including officers) or directors of the registrant, or any of their designees, to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) or otherwise engage in transactions that are designed to or have the effect of hedging or offsetting any decrease in the market value of equity securities.”

Comments on the proposed rule were due by April 20, 2015.

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

## **SEC Issues Final Rule to Ease Smaller Companies’ Access to Capital**

In March 2015, the SEC issued a [final rule](#) that amends and expands Regulation A, which exempts certain offerings from registration under the Securities Act. The rule implements a mandate in Section 401 of the JOBS Act to ease smaller companies’ access to capital.

Under Regulation A before the amendments, a company could offer up to \$5 million of securities in a 12-month period and no more than \$1.5 million of those securities could be offered by the company’s securityholders. Under the new rule, a company can offer and sell up to \$50 million of securities in a 12-month period if it meets specified eligibility, disclosure, and reporting requirements. The rule creates the following two tiers of offerings under Regulation A:

- “Tier 1: annual offering limit of \$20 million, including no more than \$6 million on behalf of selling securityholders that are affiliates of the issuer.”
- “Tier 2: annual offering limit of \$50 million, including no more than \$15 million on behalf of selling securityholders that are affiliates of the issuer.”

The final rule establishes offering and reporting requirements for issuers under both tiers; however, such requirements are more extensive for Tier 2 issuers, which must provide audited financial statements in their offering documents and file annual, semiannual, and current reports with the SEC. The rule also preserves, “with some modifications, existing provisions regarding issuer eligibility, offering circular contents, testing the waters, and ‘bad actor’ disqualification.”

The final rule became effective on June 19, 2015.

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

## SEC Staff Issues Guidance on Amendments to Regulation A

In June 2015, the SEC staff issued [guidance](#) on its March 2015 amendments to Regulation A. The amendments, which were issued to implement Section 401 of the JOBS Act, exempt certain offerings from registration under the Securities Act.

Specifically, the amendments provide relief for entities that offer and sell up to \$50 million of securities in a 12-month period if they meet specified eligibility, disclosure, and reporting requirements. The amendments became effective on June 19, 2015.

The SEC staff also recently issued and revised a number of [C&DIs](#) to provide additional guidance on Regulation A. Specifically, the staff added questions 182.01 through 182.11 to the Securities Act Rules section and withdrew questions 128.01 and 128.03 from the Securities Act Forms section.

## SEC Issues Rules on Security-Based Swaps

### Registered Security-Based SDRs

In February 2015, the SEC issued two final rules (Final Rule Release Nos. [34-74244](#) and [34-74246](#)) that require registered security-based swap data repositories (SDRs) to “establish and maintain certain policies and procedures regarding how transaction data are reported and disseminated.” In addition, certain registered SDRs must “establish and maintain policies and procedures that are reasonably designed to ensure that they comply with applicable reporting obligations.”

The SEC also released a [proposed rule](#) that would “assign reporting duties for certain security-based swaps not addressed by the adopted rules, prohibit registered SDRs from charging fees to or imposing usage restrictions on the users of publicly disseminated security-based swap transaction data, and provide a compliance schedule for certain provisions of Regulation SBSR.”

The final rules became effective on May 18, 2015. Comments on the proposed rule were due by May 4, 2015.

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

### Cross-Border Security-Based Swap Transactions

In April 2015, the SEC issued a [proposed rule](#) that would “require a non-U.S. company that uses U.S. personnel to arrange, negotiate, or execute a transaction in connection with its dealing activity to include that transaction in determining whether it is required to register as a security-based swap dealer.” SEC Chairman Mary Jo White stated that “the rules will help ensure that both U.S. and non-U.S. dealers are subject to [the SEC’s] registration, reporting, public dissemination and business conduct requirements when they engage in security-based swap activity in the United States, resulting in increased transparency and enhanced stability and oversight.”

Comments on the proposed rule were due by July 13, 2015.

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



## Registration for Security-Based Swap Participants

In August 2015, the SEC issued a [final rule](#) and a [proposed rule](#) related to security-based swaps. The final rule addresses “all aspects of the registration regime for security-based swap dealers and major security-based swap participants, setting forth the extensive set of information required to be provided and kept up to date by a registrant.” The proposed rule aims to “create a process for security-based swap dealers and major security-based swap participants to apply to the Commission for permission to continue to have certain persons subject to statutory disqualifications involved in effecting their security-based swap transactions if such continuation is consistent with the public interest.”

The final rule became effective on October 13, 2015. Comments on the proposed rule were due by October 26, 2015.

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

## SEC Issues Proposed Rule on Pay Versus Performance

In April 2015, the SEC issued a [proposed rule](#) that would require public companies — except foreign private issuers, registered investment companies, and emerging growth companies — to disclose “the relationship between executive compensation actually paid and the financial performance of the registrant” in proxy or information statements in which executive compensation disclosures are required. In a [public statement](#), SEC Chairman Mary Jo White indicated that she believes that the proposed disclosure requirements would “assist shareholders in assessing a company’s executive compensation practices and policies [and] inform [them] when voting in an election of directors and in connection with a shareholder’s advisory vote on executive compensation.”

Comments on the proposed rule were due by July 6, 2015.

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

## SEC Proposes Rules for Investment Companies and Investment Advisers

In May 2015, the SEC issued two proposed rules that would “modernize and enhance” the reporting and disclosure requirements for investment companies and investment advisers. The purpose of the proposals is to improve the “quality of information available to investors” and facilitate the Commission’s collection and use of data that investment companies and investment advisers provide.

The [proposed rule](#) on investment-company reporting would require “mutual funds, ETFs and other registered investment companies” to report information in a new structured format that would be easier for the SEC and the public to analyze. Further, this proposal “would permit but not require registered investment companies to transmit periodic reports to their shareholders by making the reports accessible on a website and satisfying certain other conditions.”

The [proposed rule](#) for investment advisers would require disclosures that allow the SEC and investors to get a better picture of the advisers’ risk profiles. In addition, this proposal “would require advisers to maintain records of performance calculations and communications related to performance.”

Comments on both proposals were due by August 11, 2015.

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

## SEC and CFTC Issue Interpretation on Forward Contracts With Volumetric Optionality

In May 2015, the SEC and CFTC jointly issued an [interpretive release](#) that clarifies the CFTC’s “interpretation of when an agreement, contract, or transaction with embedded volumetric optionality would be considered a forward contract.” The interpretation is being released in response to a mandate of the Dodd-Frank Act as well as comments from market participants.

The interpretation became effective on May 18, 2015.

## SEC Proposes New Clawback Requirements

In July 2015, the SEC issued a [proposed rule](#) that would require companies to adopt “clawback” policies on executive compensation. Specifically, the proposal, which was released in response to a mandate in Section 954 of the Dodd-Frank Act, “would direct the national securities exchanges and national securities associations to establish listing standards that would require each issuer to develop and implement a policy providing for the recovery, under certain circumstances, of incentive-based compensation based on financial information required to be reported under the securities laws that is received by current or former executive officers, and require the disclosure of the policy.” This proposal marks the completion of the SEC’s issuance of proposed executive compensation rules under the Dodd-Frank Act.

Comments on the proposed rule were due by September 14, 2015.

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

## SEC Issues Final Rule on Pay Ratio Disclosure

In August 2015, the SEC issued a [final rule](#) that requires a registrant to calculate and disclose (1) the median of the annual total compensation of all of its employees (excluding its principal executive officer (PEO)), (2) the PEO’s annual total compensation, and (3) the ratio of (1) to (2). Starting with its first full fiscal year beginning on or after January 1, 2017, the registrant will include the disclosures in filings in which executive compensation information is required, such as proxy and information statements, registration statements, and annual reports. Emerging growth companies, smaller reporting companies, foreign private issuers, registered investment companies, and filers under the U.S.-Canadian Multijurisdictional Disclosure System are exempt from the rule’s requirements.

### Thinking It Through

The rulemaking associated with the new requirements has been controversial, as evidenced by the SEC’s receipt of over 287,400 comment letters on the original rule proposal and the Commission’s 3–2 split vote on the final rule. The rule contains certain accommodations to address concerns expressed by commenters about the costs of complying with the requirements.

The final rule became effective on October 19, 2015.

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

## SEC Proposes Revisions to Registration Requirements

In December 2014, the SEC issued a [proposed rule](#) that would revise the requirements in Section 12(g) of the Exchange Act related to the thresholds for registration, termination of registration, and suspension of reporting. The proposal, which was issued in response to the mandates in Titles V and VI of the JOBS Act, would:

- Amend “Exchange Act Rules 12g-1 through 4 and 12h-3 which govern the procedures relating to registration, termination of registration under Section 12(g), and suspension of reporting obligations under Section 15(d) to reflect the new thresholds established by the JOBS Act.”

- Revise “the rules so that savings and loan holding companies are treated in a similar manner to banks and bank holding companies for the purposes of registration, termination of registration, or suspension of their Exchange Act reporting obligations.”
- Apply “the definition of ‘accredited investor’ in Securities Act Rule 501(a) to determinations as to which record holders are accredited investors for purposes of Exchange Act Section 12(g)(1). The accredited investor determination would be made as of the last day of the fiscal year.”

In addition, the proposal would amend the definition of “held of record” and establish a nonexclusive safe harbor under Exchange Act Section 12(g).

Comments on the proposed rule were due by March 2, 2015.

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

## SEC and Other Organizations Publish Joint Staff Report on U.S. Treasury Market

In July 2015, the SEC and four other agencies<sup>4</sup> released a [joint staff report](#) that analyzes “the significant volatility in the U.S. Treasury market on October 15, 2014.” The report notes that the volatility included “an unusually rapid round trip in prices and deterioration in liquidity during a narrow window” and concludes that it was caused by a number of factors, such as “changes in global risk sentiment and investor positions, a decline in order book depth, and changes in order flow and liquidity provision.”

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

## SEC Conflict Minerals Rule: Federal Appellate Court Upholds Partial Stay; GAO Releases Report

In August 2015, the U.S. Court of Appeals for the District of Columbia Circuit (the “appellate court”) upheld its April 2014 ruling that parts of the SEC’s [conflict minerals rule](#) and of Section 1502 of the Dodd-Frank Act violate the First Amendment to the extent that they require issuers to disclose that their products have “not been found to be ‘DRC conflict free.’” The appellate court had agreed to review its April 2014 ruling in light of a separate case involving country-of-origin labeling of meat products.

### Thinking It Through

On April 14, 2014, the appellate court held that parts of the SEC’s conflict minerals rule and of Section 1502 of the Dodd-Frank Act violate the First Amendment and remanded the case to the district court. Later that month, the SEC staff issued guidance indicating that registrants would not be required to identify any products as having “not been found to be ‘DRC conflict free.’” or as being “DRC conflict undeterminable.” Registrants could still elect to identify products as “DRC conflict free,” but those doing so would be required to obtain an independent private-sector audit (IPSA). On May 2, 2014, the SEC issued a stay of the effective date of portions of its conflict minerals rule that the appellate court deemed unconstitutional. The SEC is currently reviewing the appellate court’s decision, and final resolution of the legal action remains uncertain. Accordingly, registrants should consult with their SEC counsel to determine whether and, if so, when an IPSA is required in light of (1) the SEC staff’s April 2014 guidance; (2) the expiration, for many registrants, of the conflict mineral rule’s temporary transition period after the 2014 calendar-year filings; and (3) the appellate court’s ruling.

<sup>4</sup> The U.S. Department of the Treasury, the Federal Reserve, the Federal Reserve Bank of New York, and the CFTC.

In addition, the GAO has released a [report](#) that analyzes the disclosures that companies provided to the SEC under the Commission's conflict minerals rule for the first time in 2014. The GAO concluded that "most companies were unable to determine the source of their conflict minerals" (i.e., whether they came from the DRC or an adjoining country). Other report findings included the following:

- Most of the companies (87 percent) that provided such disclosures were U.S.-based.
- Nearly all of them (99 percent) performed country-of-origin inquiries.
- Most companies (94 percent) indicated that they had performed due-diligence procedures related to the "source and chain of custody of conflict minerals used."

For more information about developments related to the SEC's conflict minerals rule, see Deloitte's [March 27, 2014](#); [July 21, 2014](#); and [August 25, 2015](#), *Heads Up* newsletters.

## Certain Amendments to SEC Regulation AB I Are Now Effective

In September 2014, the SEC issued a [final rule](#) governing the registration, offering process, disclosures, and reporting related to SEC-registered ABSs (collectively, "Regulation AB II"). The rule amends previously adopted rules related to such securities ("Regulation AB I"). Certain of the rule's changes, which include the following, became effective a year after the rule's issuance:

- Revisions to the registration requirements under the Securities Act, as amended, including changes to the shelf offering process and prospectus delivery requirements.
- New disclosure requirements, including requirements to disclose asset-level information in connection with certain specified asset classes.
- New requirements related to ongoing reporting under the Exchange Act, including certain amendments to Item 1122 of Regulation AB I related to compliance with applicable servicing criteria.
- Certain other changes to the current rules governing ABSs.

### Thinking It Through

Banking and securities companies should focus in particular on the final rule's amendments to Item 1122, which became effective in November 2015. Those amendments include:

- A new servicing criterion (Item 1122(d)(1)(v)) that requires a servicer to assess the mathematical accuracy of any information it aggregates.
- A new instruction (Instruction 1 to Item 1122) that requires a servicer to include in its compliance assessment a description of the scope of its servicing platform if such platform includes less than all of the transactions backed by the same asset type that it services.
- A requirement for registrants in the banking and securities industry to disclose information in the Form 10-K regarding identified instances of noncompliance with servicing criteria, including (1) the impact of such noncompliance on assets covered by the applicable Form 10-K and (2) steps taken to remedy a previously identified material instance of noncompliance.

# Other Updates

## OCC Updates Bank Accounting Advisory Series

In September 2015, the OCC issued the [annual update](#) to its Bank Accounting Advisory Series, which “expresses the office’s views on accounting topics relevant to national banks and federal savings associations.” Topics addressed in the update include acquired loans, allowances for loans and lease losses, other real estate owned, and other borrowings.

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

## IVSC Issues Engagement Paper on Review Group Report

In May 2015, the IVSC issued an [engagement paper](#) that requests feedback on a report published by the IVSC Review Group regarding the structure and future of the IVSC. The paper points out that the report concluded that, though the IVSC is the “most appropriate” organization for developing international valuation standards, reforms are necessary. The priorities of these reforms, according to the report, should include enhancing the standard setter’s “long-term viability” and improving its standards.

Comments on the engagement paper were due by September 1, 2015.

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



# Appendixes

# Appendix A — Glossary of Standards and Other Literature

The standards and literature below were cited or linked to in this publication.

## AICPA TIS

2220.25, "Impact of 'Near Term' on Classification Within Fair Value Hierarchy"

## FASB ASC References

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

## FASB Accounting Standards Updates and Other FASB Literature

See the FASB's Web site for the titles of:

- [Accounting Standards Updates](#).
- [Proposed Accounting Standards Updates](#) (exposure drafts and public comment documents).
- [Pre-Codification literature](#) (Statements, Staff Positions, EITF Issues, and Topics).
- [Concepts Statements](#).

## Government Accountability Office

Report, "SEC Conflict Minerals Rule: Initial Disclosures Indicate Most Companies Were Unable to Determine the Source of Their Conflict Minerals"

## International Valuation Standards Council Review Group

Engagement Paper, "IVSC Review Group Report"

## Office of the Comptroller of the Currency

Bank Accounting Advisory Series — September 2015

## Private Company Council Literature

PCC Issue No. 14-01, *Definition of a Public Business Entity*

## SEC Final Rules

34-75611, *Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants*

34-74835, *Pay Versus Performance*

34-74246, *Security-Based Swap Data Repository Registration, Duties, and Core Principles*

34-74244, *Regulation SBSR — Reporting and Dissemination of Security-Based Swap Information*

34-73407, *Credit Risk Retention*

34-67716, *Conflict Minerals*

33-9877, *Pay Ratio Disclosure*

33-9741, *Amendments to Regulation A*

33-9638, *Asset-Backed Securities Disclosure and Registration*

## **SEC and CFTC Interpretive Release**

34-74936, *Forward Contracts With Embedded Volumetric Optionality*

## **SEC Proposed Rules**

34-75612, *Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps*

34-74835, *Pay Versus Performance*

34-74834, *Application of Certain Title VII Requirements to 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*

34-74581, *Exemption for Certain Exchange Members*

34-74245, *Regulation SBSR — Reporting and Dissemination of Security-Based Swap Information*

33-9861, *Listing Standards for Recovery of Erroneously Awarded Compensation*

33-9776, *Investment Company Reporting Modernization*

33-9723, *Disclosure of Hedging by Employees, Officers and Directors*

33-9693, *SEC Proposal, Changes to Exchange Act Registration Requirements to Implement Title V and Title VI of the JOBS Act*

IA-4091, *Amendments to Form ADV and Investment Advisers Act Rules*

## **SEC Staff Accounting Bulletins**

SAB Topic 5.J, "New Basis of Accounting Required in Certain Circumstances" (rescinded by SAB 115)

SAB Topic 13, "Revenue Recognition"

## **SEC Office of Compliance Inspections and Examinations**

*Examination Priorities for 2015*

## **SEC Guidance**

*Amendments to Regulation A: A Small Entity Compliance Guide*

## **SEC and Financial Industry Regulatory Authority**

Joint Report, "National Senior Investor Initiative — A Coordinated Series of Examinations"

## **SEC, U.S. Department of the Treasury, Federal Reserve, the Federal Reserve Bank of New York, and the U.S. Commodity Futures Trading Commission**

Joint Staff Report, "The U.S. Treasury Market on October 15, 2014"

## **International Standards**

See Deloitte's [IAS Plus Web site](#) for the titles of:

- International Financial Reporting Standards.
- International Accounting Standards.
- [Exposure documents](#).

## Appendix B — Abbreviations

Abbreviation	Description
<b>ABS</b>	asset-backed security
<b>AFS</b>	available for sale
<b>AICPA</b>	American Institute of Certified Public Accountants
<b>APIC</b>	additional paid-in capital
<b>ASC</b>	FASB Accounting Standards Codification
<b>ASU</b>	FASB Accounting Standards Update
<b>ATM</b>	automated teller machine
<b>CDO</b>	collateralized debt obligation
<b>C&amp;DI</b>	SEC compliance and disclosure interpretation
<b>CECL</b>	current expected credit loss
<b>CFTC</b>	U.S. Commodity Futures Trading Commission
<b>CLO</b>	collateralized loan obligation
<b>CMBS</b>	commercial mortgage-backed securities
<b>DRC</b>	Democratic Republic of the Congo
<b>ED</b>	exposure draft
<b>EITF</b>	Emerging Issues Task Force
<b>ETF</b>	exchange-traded fund
<b>FASB</b>	Financial Accounting Standards Board
<b>FINRA</b>	Financial Industry Regulatory Authority
<b>FRM</b>	SEC's Financial Reporting Manual
<b>FVTNI</b>	fair value through net income
<b>GAO</b>	Government Accountability Office
<b>GP</b>	general partner
<b>HTM</b>	held to maturity
<b>IAS</b>	International Accounting Standard
<b>IASB</b>	International Accounting Standards Board
<b>IFRS</b>	International Financial Reporting Standard
<b>IPSA</b>	independent private-sector audit

Abbreviation	Description
<b>IVSC</b>	International Valuation Standards Council
<b>LGD</b>	loss given default
<b>LIHTC</b>	low income housing tax credit
<b>LP</b>	limited partner
<b>NAV</b>	net asset value
<b>OCC</b>	Office of the Comptroller of the Currency (U.S. Department of the Treasury)
<b>OCI</b>	other comprehensive income
<b>OCIE</b>	SEC's Office of Compliance Inspections and Examinations
<b>OREO</b>	other real estate owned
<b>PCAOB</b>	Public Company Accounting Oversight Board
<b>PCC</b>	Private Company Council
<b>PCI</b>	purchased credit-impaired
<b>PD</b>	probability of default
<b>PEO</b>	principal executive officer
<b>repo</b>	repurchase agreement
<b>ROU</b>	right of use
<b>SAB</b>	SEC Staff Accounting Bulletin
<b>SEC</b>	Securities and Exchange Commission
<b>SIFMA</b>	Securities Industry and Financial Markets Association
<b>TIS</b>	Technical Inquiry Service
<b>TRG</b>	FASB-IASB joint revenue recognition transition resource group
<b>U.S. GAAP</b>	United States Generally Accepted Accounting Principles
<b>VIE</b>	variable interest entity
<b>VSOE</b>	vendor specific objective evidence

The following is a list of short references for the Acts mentioned in this publication:

<b>Abbreviation</b>	<b>Act</b>
<b>Dodd-Frank Act</b>	The Dodd-Frank Wall Street Reform and Consumer Protection Act
<b>Exchange Act</b>	Securities Exchange Act of 1934
<b>JOBS Act</b>	Jumpstart Our Business Startups Act
<b>Securities Act</b>	Securities Act of 1933

# Appendix C — Other Resources

## Deloitte Publications

Register to receive other Deloitte industry-related publications by going to [www.deloitte.com/us/subscriptions](http://www.deloitte.com/us/subscriptions). Publications pertaining to your selected industry (or industries), along with any other Deloitte publications or webcast invitations you choose, will be sent to you by e-mail.

## *Dbriefs*

We also offer *Dbriefs* webcasts, which feature discussions by Deloitte professionals and industry specialists on critical issues that affect your business. Aimed at an executive-level audience, *Dbriefs* are designed to be timely, relevant, interactive, convenient, and supportive of your continuing professional education objectives. For more information about *Dbriefs*, please visit [www.deloitte.com/us/dbriefs](http://www.deloitte.com/us/dbriefs).

## 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!

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.

Copyright © 2015 Deloitte Development LLC. All rights reserved.