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Insurance

Accounting and Financial Reporting Update

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Contents

Foreword

January 24, 2018

To our clients and colleagues in the insurance sector:

We are pleased to present the January 2018 edition of Deloitte's *Insurance — Accounting and Financial Reporting Update*. The topics discussed in this publication were selected because they may be of particular interest to insurance entities.

Some of the notable standard-setting developments that occurred since the last edition of this publication were (1) the continued deliberation of the proposed targeted improvements to the accounting for long-duration insurance contracts and (2) the issuance of targeted improvements to hedge accounting.

In this publication, the Updates to Guidance section highlights changes to accounting and reporting standards that insurance entities need to start preparing for now. The January 2018 edition also includes the following appendixes: (1) Appendix A, which lists selected ASUs that became effective for calendar year 2017; (2) Appendix B, which summarizes the current status of, and next steps for, selected active standard-setting projects of the FASB; (3) Appendix C, which lists the titles of standards and other literature referred to in this publication; and (4) Appendix D, which defines the abbreviations we used.

The annual accounting and financial reporting updates for the banking and securities, investment management, and real estate and construction sectors are available on US GAAP Plus and the Deloitte Accounting Research Tool.

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

Sincerely,

Rick Sojkowski
Insurance Industry
Professional Practice Director
Deloitte & Touche LLP

Robert Tucker
National Insurance
Professional Audit Leader
Deloitte & Touche LLP

Acknowledgments and Contact Information

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

Teri Asarito
James Barker
Mark Bolton
David Brown
Ashley Carpenter
Emily Childs
Sandy Cluzet
Mark Crowley
Amy Davidson
Jamie Davis
Geri Driscoll
David Eisenberg
Casey Fersch
David Frangione
Emily Hache
Chase Hodges
Jonathan Howard
Sandie Kim
Brittanie Lehman
Michael Lorenzo
Jake Manning
Kenjiro Matsuo
Morgan Miles
Adrian Mills
Jeanine Pagliaro
Shahid Shah
Lindsey Simpson
Curt Weller
Hayley Wilden
Andrew Winters

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

Rick Sojkowski
Insurance Industry
Professional Practice Director
+1 860 725 3094
rsojkowski@deloitte.com

Robert Tucker
National Insurance Professional
Audit Leader
+1 203 708 4888
rotucker@deloitte.com

Kenny Smith
Vice Chairman
U.S. Financial Services Leader
+1 415 783 6148
kesmith@deloitte.com

Susan Freshour
Financial Services Industry
Professional Practice Director
+1 212 436 4814
sfreshour@deloitte.com

Introduction

The past year brought many opportunities and challenges. Insurers entered 2017 on their strongest financial base in 10 years, which allowed them to focus on the development of new products and services as well as on entering into new markets. Along with these opportunities, however, there have been significant obstacles. For example, insurers continue to deal with the increasing risk of cybercrime, significant changes in consumer behavior, and a large number of weather-related catastrophes. In addition to these challenges, regulators continue to focus on standard setting that will have widespread effects on the insurance sector. Insurers need to be more nimble than ever to successfully navigate the changing marketplace.

Economic Growth

The U.S. economy experienced growth in 2017, but this did not always translate into profitability for insurers. Although the Federal Reserve increased interest rates and bond rates followed suit, margins have been shrinking, keeping yields low. In addition, while unemployment rates declined steadily in 2017, the decrease is not expected to translate into long-term growth in workers' compensation premiums since there is likely to be a continued push toward labor reduction through innovation and automation. Further, it will be harder for insurers to capitalize on the economic growth in the near and long term because of changes in consumer behavior. Younger populations are not purchasing homes, vehicles, or life insurance policies at the same rate as older generations, thus creating a need for insurers to revise their strategies for targeting those markets.

Accounting Changes

In 2017, the FASB continued to work on the proposed ASU that would change the accounting for certain long-duration insurance contracts by amending both the accounting and disclosure requirements under U.S. GAAP for insurers that issue long-duration insurance contracts. The Board believes that the proposed targeted improvements would provide more timely and useful information to users of the financial statements and would simplify certain aspects of the existing accounting model. As of the date of this publication, the Board is continuing to deliberate the proposed standard on the basis of feedback from insurance entities and users of their financial statements, and it is expected that the Board will issue a final standard in 2018.

With respect to IFRSs, the IASB issued IFRS 17 in May 2017 to help financial statement users better understand the risk exposure, profitability, and financial stability of insurance entities. This fundamental overhaul of insurance accounting under IFRSs differs significantly from current and proposed accounting guidance under U.S. GAAP, including the FASB's proposed targeted improvements (currently under revision) to the accounting for long-duration insurance contracts.

In addition, on December 22, 2017, President Trump signed into law the tax legislation commonly known as the Tax Cuts and Jobs Act[1] (the "Act"). Under ASC 740, the effects of new legislation are recognized upon enactment, which (for federal legislation) is the date the president signs a bill into law. Accordingly, recognition of the tax effects of the Act is required in the interim and annual periods that include December 22, 2017. For more information, see Deloitte's January 3, 2018 (last updated January 19, 2018),[2] and January 12, 2018, *Financial Reporting Alert* newsletters.[3]

For additional information about industry issues and trends, see Deloitte's *2018 Financial Services Outlooks*.

[1] H.R. 1/Public Law 115-97, "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."

[2] Additional updates are expected to reflect developments as they occur.

[3] On January 18, 2018, the FASB issued a proposed ASU, *Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income*. Comments on the proposal are due by February 2, 2018.

Updates to Guidance

Short-Duration Insurance Contracts

In May 2015, the FASB issued ASU 2015-09 (codified in ASC 944), which expands the breadth of disclosures entities must provide about short-duration insurance contracts issued by insurance entities.[1] The ASU focuses only on disclosures and does not change the existing U.S. GAAP accounting model for short-duration contracts. For public business entities (PBEs), the ASU became effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. For all other entities, the guidance is effective for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017.

Note that the revised disclosure requirements in ASU 2015-09 are applicable only to financial reporting under U.S. GAAP. The amendments do not affect reporting under statutory accounting principles.

Key Provisions

Under ASU 2015-09, insurance entities with short-duration insurance contracts must annually provide the following disclosures:

- "Incurred and paid claims [and allocated claim adjustment expenses (CAEs)] development information by accident year, on a net basis after risk mitigation through reinsurance, for the number of years for which claims incurred typically remain outstanding (that need not exceed 10 years, including the most recent reporting period presented in the statement of financial position). Each period presented in the disclosure about claims development that precedes the current reporting period is considered to be supplementary information." For the most recent reporting period presented, an insurer also must disclose, in the aggregate, the total net outstanding claims for all accident years not separately presented in the development tables.
- A reconciliation of the claims development disclosures "to the aggregate carrying amount of the liability for unpaid claims and [CAEs] for the most recent reporting period presented, with separate disclosure of reinsurance recoverable on unpaid claims."
- For each accident year presented in the incurred claims development table, information about (1) claim frequency (unless impracticable) and (2) the amounts of incurred-but-not-reported (IBNR) liabilities plus the expected development on reported claims.
- A description of the methods, and any significant changes to such methods, for determining (1) both IBNR and expected development on reported claims and (2) cumulative claim frequency.
- For all claims except health insurance claims, the historical average annual percentage payout of incurred claims by age, net of reinsurance, for those accident years presented in the claims development tables.

[1] The scope of the ASU is limited to insurance entities within the scope of ASC 944.

- The carrying amounts of liabilities for unpaid claims and CAEs that are presented at present value and the effects of the discounting, including (1) the aggregate discount deducted from the liabilities, (2) the amount of interest accretion recognized during each period, and (3) the line item(s) in the statement of comprehensive income in which the interest accretion is classified.[2]
- Information about any significant changes in methods and assumptions used in the computation of the liability for unpaid claims and CAEs,[3] including reasons for the changes and the impact of the changes on the most recent reporting period in the financial statements.
- The disclosures should be aggregated or disaggregated to an extent "that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have significantly different characteristics."

In addition, insurance entities are required to disclose the following in both interim and annual periods:

- The rollforward of the liability for unpaid claims and CAEs.
- Total IBNR liabilities, plus expected development on reported claims, included in the liability for unpaid claims and CAEs for health insurance claims, either as a separate disclosure or as a component of the disclosure of the rollforward of the liability, at an appropriate level of disaggregation.

Transition

Upon adoption, ASU 2015-09 must be applied retrospectively. However, certain of its requirements apply only to the current period. For example:

- Because the claims development and related tables depict cumulative experience, there is no need to provide comparative tables. In the year of adoption, an entity would provide the claims development tables, but those tables would not have to depict information about claims development for a particular category that occurred earlier than five years before the end of the year of adoption if it is impracticable to obtain the necessary information. For each subsequent year, the minimum number of years required in the claims development tables would increase by at least 1 year but need not exceed 10 years or the number of years for which claims incurred typically remain outstanding, including the most recent period presented in the statement of financial position.
- An entity would prospectively apply the requirement to disclose material changes in judgments made in calculating the liability for unpaid claims and CAEs.

Further, under ASU 2015-09, insurers are not required to provide certain transition disclosures specified in ASC 250-10. As noted in paragraph BC38 of the ASU, "the Board decided that providing the transition disclosures about (a) the method of applying the change, (b) a description of the indirect effects of a change in accounting principle, (c) the change in the interim period of the change, if issuing interim financial statements, and (d) the annual period of the change would not be applicable because the guidance in the amendments in this Update relates only to disclosures." See Deloitte's May 2015 *Insurance Spotlight* for additional information.

[2] ASU 2015-09 does not add any new requirement to discount short-duration insurance liabilities; however, the Board believes that financial statement users would find disclosure about discounted liabilities useful because existing U.S. GAAP and SEC staff guidance permit discounting of short-duration insurance contract liabilities under certain conditions.

[3] Although this disclosure under ASU 2015-09 is required only for annual periods, the ASU's Basis for Conclusions observes that ASC 270 requires disclosure in interim financial statements of the effects of a change in an accounting estimate.

Preparing for Implementation

After the issuance of ASU 2015-09, certain implementation questions arose regarding how to reflect the impact of changes in foreign currency and the acquisition and disposition of products or businesses by insurance entities in the incurred and paid claims development table disclosures required by the ASU. In meetings with the AICPA's Insurance Expert Panel (IEP) on November 1 and November 17, 2016, the SEC staff provided informal feedback on proposed alternatives related to such disclosure presentations (these alternatives had previously been submitted by the IEP). Although this guidance was directed primarily at SEC filers, entities other than PBEs that are adopting the new disclosure requirements and encountering one or more of these issues may consider this guidance helpful. See Deloitte's December 2016 *Financial Reporting Alert* for additional information.

Long-Duration Insurance Contracts

Background

In September 2016, the FASB issued a proposed ASU that would amend the accounting and disclosure model under U.S. GAAP for certain long-duration insurance contracts. The Board believes that its proposal will improve the following areas of financial reporting for long-duration insurance contracts:

- Measurement of the liability for future policy benefits related to nonparticipating traditional and limited-payment contracts.
- Measurement and presentation of market risk benefits.
- Amortization of deferred acquisition costs (DAC).
- Presentation and disclosures.

The proposed amendments would not change the scope of ASC 944. Therefore, they would not change the types of entities that are subject to the long-duration insurance contract accounting and disclosure guidance under ASC 944.

Comments on the proposal (see Deloitte's comments) were due by December 15, 2016. A public roundtable was held in April 2017, and the Board began its redeliberations in August 2017. The proposed ASU's key provisions, updated for tentative decisions made in redeliberations, are discussed below. All decisions are subject to change in future redeliberations. For additional information about the proposed ASU, see Deloitte's October 2016 *Insurance Spotlight*. Summaries of the Board's redeliberations can be found in Deloitte's August 4, 2017, and November 8, 2017, journal entries. The Board has not yet reached any tentative conclusions regarding the effective date of a final ASU.

Key Provisions

Measurement of the Liability for Future Policy Benefits Related to Nonparticipating Traditional and Limited-Payment Contracts

The proposed amendments would introduce a number of changes related to measurement of the liability for future policy benefits associated with nonparticipating traditional and limited-payment contracts. The changes would affect the frequency of updating the cash flow and discount rate assumptions, the discount rate used for measurement, and the accounting for those updates.

Under the proposed targeted improvements, an insurer would measure the liability for future policy benefits by using a discount rate that (1) is based on the yield of a current upper-medium grade (low credit risk), fixed-income instrument (which would be the equivalent of an A-rated security in today's

market) and (2) reflects the duration characteristics of the liability. In determining the rate, the insurer would "maximize the use of relevant observable inputs and minimize the use of unobservable inputs." An insurer would update its discount rate assumptions in both annual and interim reporting periods (i.e., quarterly for PBEs) and record in other comprehensive income (OCI) the impact of any change in the discount rate assumption on the measurement of the liability (i.e., by using an "immediate approach").

An insurer would review the cash flow assumptions used to measure the liability for future policy benefits annually (at the same time each year) and update them as necessary. However, the insurer could make an entity-wide election to lock in its expense assumption(s) at contract inception (i.e., the insurer could elect to lock in the expense assumption(s) it used at inception and not update any expense assumptions for subsequent cash flow changes, although all other cash flow assumptions would need to be updated for changes at least annually regardless of the insurer's expense assumption election). In addition, more frequent updates to the cash flow assumptions (i.e., in interim periods) would be required when evidence suggests that earlier revision to the cash flow assumptions is warranted. Thus, under the proposed targeted improvements, an insurer generally would not be required to update its net premium ratio in interim periods to reflect its actual experience to date; rather, it would be required to update its net premium ratio only annually unless evidence suggests that an interim update is needed. The cash flow assumptions that an insurer uses to measure the liability for future policy benefits related to nonparticipating traditional and limited-payment contracts would not include any provision for adverse deviation. When measuring the liability, the insurer could group contracts issued within a single issue year; however, it could not group contracts from different issue years.

Updates to the cash flow assumptions would be calculated and recorded on a catch-up basis (i.e., retrospectively) in net income. An insurer would separately present the adjustment arising from those updates (referred to as the "catch-up adjustment") in the statement of operations.

Connecting the Dots

To determine the impact of the change in cash flow assumptions, an insurer would first recalculate a revised net premium ratio as of contract inception. This would be computed as the ratio of (1) the present value of the total expected benefits and expenses (excluding acquisition costs and costs required to be charged to income as incurred) to (2) the present value of total expected gross premiums. The insurer would determine the present values by using the discount rate at contract inception. Note that when the insurer computes the revised net premium ratio, it would determine its expected gross premiums as well as its expected benefits and expenses by combining its actual historical experience to date with its updated assumptions about future cash flows.

The insurer would then (1) calculate revised estimates of net premiums by applying the new net premium ratio, (2) compute an updated liability for future policy benefits as of the beginning of the reporting period, and (3) compare that updated liability (which the insurer computed by using the discount rate at contract inception) with the liability's previous carrying amount (excluding the effect of previous discount rate changes) and recognize a cumulative catch-up adjustment in current-period earnings. Thereafter, the insurer would accrue the liability for future policy benefits by using the revised net premium ratio (until the next assumption update). However, if the revised cash flow assumptions indicate that the present value of future benefits and expenses would exceed the present value of future gross premiums, the insurer would be required to recognize an immediate charge to net income for the period so that net premiums will equal gross premiums (i.e., the net premium ratio cannot exceed 100 percent). Because this proposed new model uses current assumptions and would require the shortfall to be recorded when the net premiums exceed the gross premiums, the premium deficiency test would be

eliminated for nonparticipating traditional and limited-payment insurance contracts. Experience adjustments would be recognized in the same reporting period in which they arise.

For updates to the discount rate under the immediate approach, the insurer would recognize any changes in the liability for future policy benefits arising from changes in the discount rate as an adjustment to OCI at the time the discount rate is updated (i.e., in the current period). However, the liability's interest accretion rate would remain at the discount rate that was in effect at contract issuance.

For universal life-type contracts, loss recognition testing would be retained. On the basis of the Board's redeliberations, it is expected that the concept of accruing an additional liability for contracts that result in profits followed by losses will remain.

Market Risk Benefits

The proposed amendments would introduce new accounting requirements for certain market risk benefits. In its redeliberations, the FASB tentatively decided to apply the new market risk benefit accounting model to contract features contained in both separate account and general account non-traditional products. Specifically, as memorialized in the handout for the FASB's November 1, 2017, meeting, the Board tentatively decided that an insurer should recognize a market risk benefit "for a contract feature that exposes the insurance entity to other-than-nominal capital market risk that arises from either of the following:

a. A contract feature that protects the account balance (or similar amount) from adverse capital market performance

b. A contract feature that causes variability in the account balance (or similar amount) in response to capital market volatility."

The handout also states that a contract feature would be "presumed to expose the insurance entity to other-than-nominal capital market risk if cash flows related to the contract feature vary more than an insignificant amount in response to capital market volatility, including changes in a market index or changes in the value of a reference portfolio. Capital market risk includes equity, interest rate, and foreign exchange risk."

Under the proposed targeted improvements, an insurer would also be required to:

- Initially measure a market risk benefit[4] at fair value. The insurer would recognize subsequent changes in fair value in current earnings; however, any changes in fair value attributable to changes in the instrument-specific credit risk would be recognized in OCI.
- Separately present (1) market risk benefits in the statement of financial position and (2) the change in fair value related to market risk benefits in net income (other than that portion of the fair value change attributable to changes in the instrument-specific credit risk, which would be reported in OCI).

[4] When a long-duration contract has multiple market risk benefits, an insurer would be required to bundle those benefits together into a single, compound market risk benefit.

Connecting the Dots

Because the scope of the market risk benefits accounting model was expanded in the Board's redeliberations to respond to constituent feedback, the new criteria that define when a contract feature should be accounted for as a market risk benefit did not receive the same level of public exposure as would have been received had they been included in the proposed ASU. The Board and its staff have attempted to obtain feedback on the new market risk benefit criteria by publishing them in the handout for the Board's November 1, 2017, meeting and performing direct outreach to various constituents. Insurers are advised to (1) analyze the terms of their various products, (2) assess whether those terms contain features that would be accounted for as market risk benefits under the proposed targeted improvements, and (3) provide feedback to the Board and its staff about any perceived issues with the revised criteria. It is expected that the guidance on market risk benefits will pertain to features included in universal life-type contracts (i.e., "FAS 97–type contracts").

Deferred Acquisition Costs

Although the proposed targeted improvements would not change the types of acquisition costs that qualify for capitalization, they would change the manner and timing of DAC amortization. In its redeliberations, the Board reaffirmed its goal of simplifying the accounting for DAC; however, it tentatively decided that the amortization method prescribed in the proposed ASU should be replaced by the principle that an insurer should amortize DAC on a constant basis over the insurance contract's expected life. The Board also reaffirmed that DAC should not be subject to impairment testing; rather, DAC "should be written off for actual experience in excess of expected experience, without consideration of contract profitability."[5] Thus, unexpected contract terminations would trigger a DAC write-off.

Participating Insurance Contracts

In a departure from the proposed ASU, the Board tentatively decided in its redeliberations to retain existing guidance on accounting for the liability for future policy benefits related to participating insurance contracts. However, an insurer would still apply the proposed amortization model discussed above to the DAC associated with those contracts.

Disclosures

The proposed amendments would require enhanced disclosure for both interim and annual financial statements about (1) the liability for future policy benefits and the additional liability for annuitization, death, or other insurance benefits; (2) the liability for policyholders' account balances; (3) market risk benefits; (4) DAC; (5) sales inducements; and (6) separate accounts. In addition, the proposed amendments would require insurers to disclose disaggregated tabular rollforwards of the opening to closing balance for specified accounts and provide certain other quantitative and qualitative disclosures about such measures.

[5] Quoted from the FASB staff's summary of the Board's tentative decisions as of November 1, 2017.

Transition

Upon adoption, an insurer would apply the proposed amendments related to the accounting for the liability for future policy benefits and DAC to all contracts in force on the transition date (i.e., at the beginning of the earliest period presented) by using the contracts' carrying amounts and updated future assumptions, as adjusted to remove any related amounts in accumulated other comprehensive income (AOCI) (i.e., apply a prospective transition approach). When determining the liability for future policy benefits on the transition date, the insurer would:

- Calculate the net premium ratio by comparing its estimate of (1) the present value of future benefits and expenses less the transition date carrying amount with (2) the present value of future gross premiums.
- Consider the transition date to be the contract issuance date when determining the discount rate assumption at contract inception and for subsequent adjustments.
- Adjust the opening retained earnings balance only to the extent that net premiums exceed gross premiums.

Alternatively, the insurer could elect to apply the proposed amendments retrospectively by using actual historical experience as of contract inception and record a cumulative catch-up adjustment to opening retained earnings. The Board tentatively decided that the final ASU will require an insurer to apply the same transition method to both its DAC and its liability for future policy benefits. The insurer would (1) make its transition election "at the issue-year contract aggregation level" and (2) apply that election "to all contract groups for that issue year and all subsequent issue years."[6]

The insurer would apply the proposed amendments on market risk benefits retrospectively to all prior periods and would be allowed to use hindsight, if necessary, to determine the measurement assumptions.

Next Steps

The FASB expects to issue a final ASU in 2018.

Financial Instruments

Impairment

Background

In June 2016, the FASB issued ASU 2016-13,[7] which amends the Board's guidance on the impairment of financial instruments by adding to U.S. GAAP an impairment model (known as the CECL model) that is based on expected losses rather than incurred losses. Under the new guidance, an entity recognizes its estimate of expected credit losses as an allowance, which is presented as either (1) an offset to the amortized cost basis of the related asset (for on-balance-sheet exposures) or (2) a separate liability (for off-balance-sheet exposures). That is, the expected credit losses estimated over the lifetime of a financial instrument are recognized at inception (i.e., on day 1).

[6] See footnote 5.
[7] See Deloitte's June 17, 2016, *Heads Up* for additional information about ASU 2016-13.

Transition Resource Group

In late 2015, the FASB established a credit losses TRG. Like the TRG established to discuss the new revenue recognition standard, the credit losses TRG does not issue guidance but provides feedback to the FASB on potential implementation issues. By analyzing and discussing such issues, the credit losses TRG helps the FASB determine whether it needs to take further action (e.g., by providing clarification or issuing additional guidance).

The credit losses TRG discussed the following topics related to ASU 2016-13 at its meeting on June 12, 2017:

- Determining the effective interest rate (EIR) under the CECL model:
  - *Implementation issues* — Stakeholders have questioned whether an entity that applies a discounted cash flow (DCF) method under the CECL guidance to discount the expected cash flows should use the same EIR it applied to recognize interest income in accordance with ASC 310-20.
  - *Outcome* — The TRG generally agreed that entities should be given the choice, through an accounting policy election, of whether they would like to use a prepayment-adjusted EIR when applying a DCF method under the CECL guidance. Further, entities should make this accounting policy election at the "class of financing receivable" level (as defined in the ASC master glossary). Upon making the accounting policy election, entities should update the adjusted EIR periodically to match any changes in expected prepayments.
- Scope of the guidance on purchased financial assets with credit deterioration ("PCD assets") for beneficial interests accounted for under ASC 325-40:
  - *Implementation issues* — For purchased or retained beneficial interests that are (1) within the scope of ASC 325-40 and (2) classified as available for sale or held to maturity, ASU 2016-13 provides that entities should measure an impairment allowance the same way they measure PCD assets if the beneficial interest meets the definition of a PCD asset or there is a significant difference between the contractual cash flows and expected cash flows of the beneficial interest. Stakeholders have raised implementation questions regarding the scope of the PCD asset guidance on beneficial interests in ASC 325-40. For example, they have asked about (1) the meaning of "contractual cash flows" in ASC 325-40-30-1A(a) and (2) whether prepayment expectations can be included in those contractual cash flows.
  - *Outcome* — The TRG generally agreed that if contractual cash flows of a security are not specified, an entity should look through to the contractual cash flows of the underlying assets and include an estimate of prepayments to determine whether the security should be considered a PCD asset. The consensus was that this approach would appropriately isolate credit risk. In addition, the TRG generally agreed that the initial allowance should reflect only credit-related factors and not estimated prepayments.
- Applying the transition guidance to pools of purchased credit-impaired assets under ASC 310-30:
  - *Implementation issues* — While the transition guidance in ASU 2016-13 permits entities to elect to maintain pools of loans accounted for under ASC 310-30, the ASU is unclear about the extent to which entities may continue to apply the guidance in ASC 310-30 to the pools. Stakeholders have raised implementation questions regarding application of the transition guidance for pools of purchased credit-impaired assets within the scope of ASC 310-30. For example, they have asked about (1) the level of relief the FASB intended to give entities in transition under ASC 326-10-65-1, which states that an "entity may elect to maintain pools of loans accounted for under Subtopic 310-30 at adoption," and (2) whether the election is permitted only at transition or is also permitted in subsequent periods.

  - *Outcome* — The TRG generally acknowledged that allowing companies to make a policy election to apply the transition guidance in ASC 310-30 either at adoption or at adoption and in subsequent periods would address those stakeholders' questions. That is, entities would have the choice of either maintaining their existing pools accounted for under ASC 310-30 at adoption only or doing so on an ongoing basis after adoption of the ASU.

- Accounting for TDRs under the CECL model:
  - *Implementation issues* — ASU 2016-13 requires an entity to forecast reasonably expected TDRs with a borrower and incorporate them into its estimate of expected credit losses. Specifically, ASC 326-20-30-6 states that an "entity shall not extend the contractual term for expected extensions, renewals, and modifications unless it has a reasonable expectation at the reporting date that it will execute a [TDR] with the borrower." Given this guidance, stakeholders have asked questions regarding the nature of TDRs that must be considered in the estimate (e.g., contractual term extensions, interest rate concessions), when and how to consider TDRs in the estimate, and whether to consider reasonably expected TDRs on a portfolio basis or at an individual-financial-asset level.
  - *Outcome* — The TRG did not agree on how to appropriately consider reasonably expected TDRs in an entity's estimate of credit losses under ASU 2016-13. As a result, the FASB staff subsequently performed additional analysis on the interaction between TDRs and expected credit losses, which was presented to the FASB at the Board's September 6, 2017, meeting. During that meeting, the FASB clarified when a creditor would recognize a TDR and how the creditor would measure the effects of the restructuring. Specifically, the FASB indicated that the ASU's guidance on TDRs was intended to accelerate the recognition of an economic concession granted in a TDR from when the TDR is executed (as required under existing U.S. GAAP) to when the TDR is reasonably expected. Consequently, the allowance for expected credit losses should include all effects of a TDR when an individual asset can be specifically identified as a reasonably expected TDR.

  In addition, the FASB acknowledged that depending on the nature of the economic concession granted in a TDR, the allowance for expected credit losses may not include the effects of the concession. For example, an entity's allowance for expected credit losses may not include the effects of the interest rate concession if the entity measures its allowance by using a principal-only loss rate approach. Because ASU 2016-13 requires an entity to include all effects of TDRs in its allowance for expected credit losses, the FASB indicated that an entity must use a DCF method if the TDR involves a concession that can only be measured under a DCF method (e.g., an interest rate or term concession).

  These clarifications are included in TRG Memo 6A, an addendum to the summary of the TRG's June 12, 2017, meeting.

- Estimating the life of a credit card receivable under the CECL model:
  - *Implementation issues* — ASU 2016-13 requires entities to determine the allowance for loan losses on financial assets on the basis of management's current estimate of expected credit losses on financial assets that exist as of the measurement date. Regardless of the method entities use to estimate expected credit losses, they must carefully consider all amounts expected to be collected (or not collected) over the life of the financial asset. Given the revolving nature of credit card lending arrangements, stakeholders have questioned how credit card issuers should determine the life of a credit card account balance to estimate expected credit losses.

In addition, under the CECL model, an allowance must not include expected losses on "unconditionally cancellable loan commitments." Because credit card lines are unconditionally cancelable, expected losses on future draws are not to be accrued before such amounts are drawn. Accordingly, some stakeholders believe that an entity should apply a customer's expected payments only to funded commitments as of the measurement date when modeling the repayment period of the measurement date receivable. That is, an entity would estimate the life of a credit card receivable without considering the impact of future draws that are unconditionally cancelable.

- *Outcome* — The TRG did not agree on how to appropriately consider the application of expected principal payments received after the measurement date under ASU 2016-13. As a result, the FASB staff subsequently performed additional analysis, which was presented to the FASB at the Board's October 4, 2017, meeting. During that meeting, the FASB discussed and agreed on two potential methods that entities may use to determine estimated expected future payments on credit card receivables: (1) "[i]nclude all payments expected to be collected from the borrower" or (2) "[i]nclude only a portion of payments expected to be collected from the borrower."[8]

  The FASB discussed the flexibility that entities have under the ASU when developing appropriate methods to estimate expected credit losses. It clarified that using either method to estimate future payments is acceptable and that an entity should consistently apply the selected method to similar facts and circumstances. The FASB also acknowledged that an entity may use other methods to estimate future payments. Further, the FASB stated that the determination of the appropriate method an entity will use to estimate the amount of expected future payments is separate from the determination of how to allocate the future payments to credit card balances.

  These clarifications are included in TRG Memo 6B, an addendum to the summary of the TRG's June 12, 2017, meeting.

For more information about the topics discussed at the TRG's meeting on June 12, 2017, see TRG Memo 6 and Deloitte's June 2017 *TRG Snapshot*.

Next Steps

The FASB indicated at its October 4, 2017, meeting that no additional inquiries have been submitted to the TRG for consideration.

Other Developments

Interagency FAQs

On June 17, 2016, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency (OCC) (collectively, the "agencies") issued a joint statement summarizing key elements of ASU 2016-13 and providing initial supervisory views on measurement methods, use of vendors, portfolio segmentation, data needs, qualitative adjustments, and allowance processes. Since that time, the agencies have developed FAQs to assist institutions and examiners. The agencies plan to issue additional and updated FAQs periodically. The existing FAQs (last updated in September 2017) can be found on the OCC's Web site.

[8] Quoted from the tentative Board decisions on the FASB's Web site.

Ongoing Discussions

Industry groups, accounting firms, standard setters, and regulators are engaged in ongoing discussions of issues related to the implementation of ASU 2016-13, including (1) the identification of financial instruments that are potentially eligible for zero credit losses, (2) the determination of appropriate historical loss information for the loss reversion period (i.e., after the "reasonable and supportable" period), (3) accounting for recoveries from freestanding insurance contracts, and (4) consideration of subsequent events in the estimation of credit losses. We will continue to monitor the progress of these discussions and provide updates as appropriate.

Classification and Measurement

Background

ASU 2016-01 amends the guidance on the classification and measurement of financial instruments. The amendments contain 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).
- 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.
- Determining the valuation allowance for deferred tax assets (DTAs) related to AFS debt securities.
- Disclosure requirements for financial assets and financial liabilities.

For PBEs, the new standard is effective for fiscal years beginning after December 15, 2017, including interim periods therein. For all other entities, the standard is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption of certain of the standard's provisions is permitted for all entities. Non-PBEs are permitted to adopt the standard in accordance with the effective date for PBEs. For more information about ASU 2016-01, see Deloitte's January 12, 2016, *Heads Up*.

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 measurement alternative under which the equity investments would be measured at cost less impairment, if any, plus or minus observable price changes in orderly transactions. This measurement alternative would not be available to reporting entities that are investment companies or broker-dealers in securities.

An entity that has elected the measurement alternative for equity investments that do not have a readily determinable fair value is required to assess whether the equity investment is impaired by qualitatively considering the indicators described in ASC 321-10-35-3. If, on the basis of the qualitative assessment, the equity investment is impaired, an entity would be required to record an impairment equal to the amount by which the carrying value exceeds fair value. The entity should no longer evaluate whether such impairment is other than temporary.

Connecting the Dots

Under current U.S. GAAP, marketable equity securities that are not accounted for as equity method investments are classified as either (1) held for trading, with changes in fair value recognized in earnings, or (2) AFS, with changes in fair value recognized in OCI. For AFS investments, changes in fair value are accumulated in OCI and not recognized in earnings until the investment is sold or has an other-than-temporary impairment. Investments in nonmarketable equity securities other than equity method investments are measured at cost (less impairment) unless the fair value option is elected. Further, under current U.S. GAAP, insurance entities recognize in OCI changes in the fair value of nonmarketable equity securities. Under the new guidance, since equity securities can no longer be accounted for as AFS or, in accordance with the insurance-specific guidance, through OCI and will instead be recorded at fair value with changes in fair value recognized in earnings (unless the measurement alternative is elected for nonmarketable securities), entities holding such investments could see more volatility in earnings.

At the FASB's January 18, 2018, meeting, the Board tentatively decided that insurance entities applying the guidance in ASC 944-325-35-1, which is superseded by ASU 2016-01, would apply a prospective transition approach to recognize amounts currently in AOCI and that the method chosen should be applied to the entire population of equity securities without a readily determinable fair value (accounted for under ASC 944-325-35-1). The Board is expected to issue a final ASU that incorporates this tentative decision and other changes (see Proposed Amendments below) in late February 2018.

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.

Valuation Allowance on a DTA Related to an AFS Debt Security

The new guidance eliminates the diversity in practice related to the evaluation of the need for a valuation allowance for DTAs related to debt securities that are classified as AFS. Under current U.S. GAAP, entities may perform this evaluation either separately from their other DTAs or in combination with them. The new guidance clarifies that an entity should "evaluate the need for a valuation allowance on a [DTA] related to [AFS] securities in combination with the entity's other [DTAs]."

Changes to Disclosure Requirements

For non-PBEs, the amendments eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost. In addition, for such financial instruments, PBEs 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 PBE to disclose the fair value in accordance with the exit price notion in ASC 820. In addition, all entities are required to separately present in the statement of financial position or separately disclose in the notes to the financial statements 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).

Proposed Amendments

On September 27, 2017, the FASB issued a proposed ASU on technical corrections and improvements to ASU 2016-01 in response to feedback from stakeholders. Comments on the proposed ASU were due by November 13, 2017.

The proposed amendments would clarify certain aspects of ASU 2016-01 as follows:

- *Equity securities without readily determinable fair values* — The proposed ASU would clarify that an entity that elects to use the measurement alternative to measure equity securities may reverse that election and choose instead to measure those securities at fair value through an election that would apply to those securities and other securities of the same type.

  In addition, the proposed ASU would clarify the guidance in ASC 321-10-55-9 (added by ASU 2016-01), which states that when applying the measurement alternative to securities without a readily determinable fair value, an entity should make adjustments from observable transactions to reflect the current fair value of the security. Specifically, the proposed ASU would clarify that the adjustments should be made to reflect the fair value of the security as of the date on which the observable transaction took place rather than as of the current reporting date.
- *Forward contracts and purchased options* — The proposed ASU would clarify that a change in observable price or impairment of underlying securities for forward contracts and purchased options on equity securities should result in the remeasurement of the entire fair value of the forward contracts and purchased options.
- *Presentation requirements for certain liabilities measured under the fair value option* — The proposed ASU would clarify that the guidance in ASC 825-10-45-5 (added by ASU 2016-01) related to the disclosure of instrument-specific risk (see the Changes in Fair Value of a Liability Attributed to Changes in Instrument-Specific Credit Risk section above) should be applied if the fair value option was elected under either ASC 815-15 or ASC 825-10.
- *Election of fair value option to measure liabilities denominated in a foreign currency* — The proposed ASU would clarify that when an entity elects to use the fair value option to measure a financial liability denominated in a currency other than the entity's functional currency, the entity should (1) first measure the change in fair value of the liability that results from changes in instrument-specific credit risk in the currency of denomination when that change is presented separately from the total change in fair value of the financial liability and (2) then remeasure into its functional currency both components of the change in fair value of the liability by using end-of-period spot rates.
- *Transition guidance for equity securities without readily determinable fair values* — ASU 2016-01 states that the amendments related to equity securities without readily determinable fair values should be applied prospectively. The proposed ASU would clarify that the prospective approach in ASU 2016-01 should be applied only to equity securities without readily determinable fair values for which the measurement alternative has been elected.

Hedging

Background

On August 28, 2017, the FASB issued ASU 2017-12, which amends the hedge accounting recognition and presentation requirements in ASC 815. The Board's objectives in issuing the ASU were to (1) improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities by better aligning the entity's financial reporting for hedging relationships with those risk management activities and (2) reduce the complexity, and simplify the application, of hedge accounting by preparers.

For PBEs, the ASU is effective for fiscal years beginning after December 15, 2018, and interim periods therein. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Entities are permitted to early adopt the new guidance in any interim or annual period after issuance of the ASU. An entity that early adopts the updated guidance in an interim period should record any transition adjustments as of the beginning of the fiscal year that includes that interim period.

See Deloitte's August 30, 2017, *Heads Up* for additional information about ASU 2017-12.

Key Changes to the Hedge Accounting Model

The ASU makes a number of improvements to the hedge accounting model, including those outlined below.

Elimination of the Concept of Separately Recognizing Periodic Hedge Ineffectiveness

ASU 2017-12 eliminates the concept of separately recognizing periodic hedge ineffectiveness for cash flow and net investment hedges (however, under the mechanics of fair value hedging, economic ineffectiveness will still be reflected in current earnings for those hedges). The Board believes that requiring an entity to record the impact of both the effective and ineffective components of a hedging relationship in the same financial reporting period and in the same income statement line item[9] will make that entity's risk management activities and their effect on the financial statements more transparent to financial statement users.

Under this rationale, even a portion of the change in a hedging instrument's fair value that is excluded from a hedging relationship's effectiveness assessment is considered part of the hedging relationship and should be recognized in the same income statement line item as the earnings effect of the hedged item (other than amounts excluded from the assessment of effectiveness of net investment hedges). However, in a departure from the proposed ASU that formed the basis for the guidance in ASU 2017-12, the Board determined that presentation should not be prescribed for "missed forecasts" in cash flow hedges. Thus, an entity that ultimately determines that it is probable that a hedged forecasted transaction will not occur will not be required to record the amounts reclassified out of AOCI for that hedging relationship into earnings in the same income statement line item that would have been affected by the forecasted transaction.

Components Excluded From the Hedge Effectiveness Assessment

ASU 2017-12 continues to allow an entity to exclude the time value of options, or portions thereof, and forward points from the assessment of hedge effectiveness. The ASU also permits an entity to exclude the portion of the change in the fair value of a currency swap attributable to a cross-currency basis spread from the assessment of hedge effectiveness.

For excluded components in fair value, cash flow, and net investment hedges, the base recognition model under the ASU is an amortization approach. An entity still may elect to record changes in the fair value of the excluded component currently in earnings; however, such an election will need to be applied consistently to similar hedges.

[9] Note that it is possible that changes in the fair value of the hedging instrument may be presented in more than one income statement line item if the changes in the value of the hedged item affect more than one income statement line item.

Under the ASU's amortization approach, an entity recognizes the initial value of the component that was excluded from the assessment of hedge effectiveness as an adjustment to earnings over the life of the hedging instrument by using a "systematic and rational method." In each accounting period, the entity recognizes in OCI (or, for net investment hedges, the cumulative translation adjustment (CTA) portion of OCI) any difference between (1) the change in fair value of the excluded component and (2) the amount recognized in earnings under that systematic and rational method.

Changes in the Fair Value of the Hedging Instrument and the Hedged Item

The following table summarizes the recognition and presentation requirements for the hedging instrument and the related hedged item under the updated hedge accounting and presentation model in ASU 2017-12:

	Component of Hedging Instrument *Included* in the Assessment of Hedge Effectiveness		**Component of Hedging Instrument *Excluded* From the Assessment of Hedge Effectiveness**		**Hedged Item**
	Where Fair Value Changes Are Initially Recorded	**When Hedged Item Affects Earnings**	**Systematic and Rational Amortization Method**	**Mark-to-Market Approach**	
Fair value hedge					
Recognition	Income statement	N/A	Amortization of initial value — income statement Record in OCI any difference between the change in fair value of the excluded component and amounts recognized in earnings under the systematic and rational method	Income statement	The entire change in fair value of the hedged item attributable to the hedged risk is recorded currently in income/loss and as an adjustment to the carrying amount of the hedged item
Presentation	Same income statement line item as the earnings effect of the hedged item	N/A	Same income statement line item as the earnings effect of the hedged item	Same income statement line item as the earnings effect of the hedged item	

(Table continued)

	Component of Hedging Instrument *Included* in the Assessment of Hedge Effectiveness		Component of Hedging Instrument *Excluded* From the Assessment of Hedge Effectiveness		Hedged Item
	Where Fair Value Changes Are Initially Recorded	When Hedged Item Affects Earnings	Systematic and Rational Amortization Method	Mark-to-Market Approach	
Cash flow hedge					
Recognition	OCI	Income statement	Amortization of initial value — income statement Record in OCI any difference between the change in fair value of the excluded component and amounts recognized in earnings under the systematic and rational method	Income statement	When the hedged item affects earnings, amounts will be reclassified out of AOCI and presented in the same income statement line item in which the earnings effect of the hedged item is presented
Presentation	OCI/AOCI (balance sheet)	Same income statement line item as the earnings effect of the hedged item (income statement presentation not prescribed for missed forecasts)	Same income statement line item as the earnings effect of the hedged item	Same income statement line item as the earnings effect of the hedged item	

(Table continued)

	Component of Hedging Instrument *Included* in the Assessment of Hedge Effectiveness		Component of Hedging Instrument *Excluded* From the Assessment of Hedge Effectiveness		Hedged Item
	Where Fair Value Changes Are Initially Recorded	When Hedged Item Affects Earnings	Systematic and Rational Amortization Method	Mark-to-Market Approach	
Net investment hedge					
Recognition	OCI (CTA)	Income statement	Amortization of initial value — income statement Record in OCI (CTA) any difference between the change in fair value of the excluded component and amounts recognized in earnings under the systematic and rational method	Income statement	When the hedged net investment affects earnings (i.e., upon a sale or liquidation), amounts will be reclassified out of the CTA and be presented in the same income statement line item in which the earnings effect of the net investment is presented (e.g., gain or loss on sale of investment)
Presentation	OCI/AOCI (CTA)	Same income statement line item as the earnings effect of the hedged item (e.g., gain or loss on sale of investment)	Income statement presentation not prescribed	Income statement presentation not prescribed	

Hedge Effectiveness Assessments and Documentation Requirements — Quantitative Versus Qualitative Assessments of Hedge Effectiveness

ASU 2017-12 requires an entity to perform an initial prospective quantitative hedge effectiveness assessment (by using either a dollar-offset test or a statistical method such as regression) unless the hedging relationship qualifies for application of one of the expedients that permits an assumption of perfect hedge effectiveness (e.g., the shortcut method or critical-terms-match method). An entity may complete this initial prospective assessment after hedge designation, generally until the first quarterly hedge effectiveness assessment date, by using information available at hedge inception.

Further, if (1) an entity's initial prospective quantitative hedge effectiveness assessment of a hedging relationship demonstrates that there is a highly effective offset and (2) the entity can, at hedge inception, "reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods," the entity may elect to perform subsequent retrospective and prospective effectiveness assessments qualitatively. To do so, in the hedge documentation it prepares at hedge inception, the entity must

(1) specify how it will perform the qualitative assessments and (2) document the alternative quantitative assessment method that it would use if it later concludes, on the basis of a change in the hedging relationship's facts and circumstances, that subsequent quantitative assessments will be necessary. The entity may make this election on a hedge-by-hedge basis.

After an entity makes its initial election to perform qualitative assessments, it must "verify and document whenever financial statements or earnings are reported and at least every three months that the facts and circumstances related to the hedging relationship" continue to support the entity's ability to make qualitative assessments. If the entity determines that there no longer is a sufficient basis to support continued qualitative assessments, it must assess effectiveness quantitatively by using the method that it specified in the initial hedge documentation. In future reporting periods, the entity could return to making qualitative assessments if it can support them on the basis of the same factors it had used in its original qualitative assessments.

Shortcut Method and Critical-Terms-Match Method

ASU 2017-12 retains both the shortcut method and critical-terms-match method and provides additional relief for entities applying those methods. Under the ASU, an entity that determines that a hedging relationship no longer meets the shortcut criteria can subsequently account for the hedging relationship by using a long-haul method (and avoid having to dedesignate the original hedging relationship) if the entity can show both of the following:

> a. [It] documented at hedge inception . . . which quantitative method it would use to assess hedge effectiveness and measure hedge results if the shortcut method was not or no longer is appropriate during the life of the hedging relationship.
>
> b. The hedging relationship was highly effective on a prospective and retrospective basis in achieving offsetting changes in fair value or cash flows attributable to the hedged risk for the periods in which the shortcut method criteria were not met.

If criterion (a) is not satisfied, the hedging relationship would be invalid in the period in which the shortcut method criteria were not satisfied and all subsequent periods; otherwise (if criterion (a) is met), the hedging relationship would be invalid in all periods in which criterion (b) was not satisfied.

In addition, ASU 2017-12 updates certain shortcut-method criteria to allow partial-term fair value hedges of interest rate risk to qualify for the shortcut method.

ASU 2017-12 also expands an entity's ability to apply the critical-terms-match method to cash flow hedges of groups of forecasted transactions. If all other critical-terms-match criteria are satisfied, such hedges will qualify for the critical-terms-match method "if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month."

Hedges of Interest Rate Risk

ASU 2017-12 eliminates the benchmark interest rate concept for variable-rate financial instruments but retains it for fixed-rate financial instruments. For recognized variable-rate financial instruments and forecasted issuances or purchases of variable-rate financial instruments, the ASU defines interest rate risk as "the risk of changes in the hedged item's cash flows attributable to changes in the contractually specified interest rate in the agreement." Thus, for example, in a hedge of the interest rate risk associated with variable-rate debt indexed to a specified prime rate index, an entity could hedge the variability in cash flows attributable to changes in the contractually-specified prime rate index. Fair value hedges of interest rate risk would continue to hedge the changes in fair value associated with changes in a specified benchmark interest rate. The ASU also adds the SIFMA Municipal Swap Rate to the list of permissible U.S. benchmark interest rates.

Other Targeted Improvements to Fair Value Hedges of Interest Rate Risk

ASU 2017-12 makes a number of improvements that simplify the accounting for fair value hedges of interest rate risk and make that accounting better reflect an entity's risk management activities.

Measuring Changes in the Hedged Item's Fair Value by Using Benchmark Component Cash Flows

Before the ASU, an entity had to use the total contractual coupon cash flows to determine the change in fair value of the hedged item attributable to changes in the benchmark interest rate. However, ASU 2017-12 allows an entity to calculate the change in fair value of the hedged item in a fair value hedge of interest rate risk by using either (1) the full contractual coupon cash flows or (2) the cash flows associated with the benchmark interest rate component determined at hedge inception.

An entity's ability to use only the benchmark component cash flows for measurement allows the entity to reduce the net earnings effect of its hedge accounting by eliminating recognition of any economic ineffectiveness related to credit spreads.

Measuring the Fair Value of a Prepayable Instrument

For prepayable instruments such as callable debt, ASU 2017-12 states that an entity "may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity" when it calculates the change in the fair value of the hedged item attributable to interest rate risk. That is, when adjusting the carrying amount of the hedged item, an entity would consider the same factors that it considered when assessing hedge effectiveness. Before the ASU, practice had evolved to require an entity to consider *all* factors that might lead an obligor to settle the hedged item before its scheduled maturity (e.g., changes in interest rates, credit spreads, or other factors) even if the entity had designated only interest rate risk as the risk being hedged. The ASU allows an entity to ignore factors other than changes in the benchmark interest rate that could affect the settlement decision when it assesses hedge effectiveness and makes it easier for the hedging relationship to meet the "highly effective" threshold.

For example, when an entity (1) assesses hedge effectiveness in a fair value hedge of interest rate risk of callable debt and (2) measures the change in the fair value of callable debt attributable to changes in the benchmark interest rate, it can now consider only how changes in the benchmark interest rate (and not changes in credit risk or other factors) would affect the obligor's decision to call the debt.

Partial-Term Hedges of Interest Rate Risk

ASU 2017-12 also provides relief to entities that wish to enter into fair value hedges of interest rate risk for only a portion of the term of the hedged financial instrument. Successful hedging of such partial-term exposures was typically unachievable under preadoption guidance because it was difficult to find a hedging derivative that would be highly effective at offsetting changes in the fair value of the hedged exposure as a result of the difference in timing between the hedged item's principal repayment and the maturity date of the hedging derivative.

Under the ASU, an entity may measure the change in the fair value of the hedged item attributable to changes in the benchmark interest rate by "using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable." Also, the hedged item's assumed maturity will be the date on which the last hedged cash flow is due and payable; therefore, a principal payment will be assumed to occur at the end of the specified partial term.

Last-of-Layer Method

To address constituent feedback received on the hedge accounting improvements project after the initial proposal, the FASB added to ASU 2017-12 a last-of-layer method that enables an entity to apply fair value hedging to closed portfolios of prepayable assets without having to consider prepayment risk or credit risk when measuring those assets. An entity can also apply the method to one or more beneficial interests (e.g., a mortgage-backed security) secured by a portfolio of prepayable financial instruments.

Under the last-of-layer method, an entity would designate as the hedged item in a fair value hedge of interest rate risk a stated amount of the asset or assets that the entity does not expect "to be affected by prepayments, defaults, and other factors affecting the timing and amount of cash flows" (the "last of layer"). This designation would occur in conjunction with the partial-term hedging election discussed above.

To support the designation, the initial hedge documentation should include evidence that the entity performed an analysis that supported its expectation that the hedged item (i.e., the last of layer) would be outstanding as of the assumed maturity date of the hedged item that was documented in the partial-term hedge election. That analysis should reflect the entity's current expectations about factors that can affect the timing and amount of the closed portfolio's (or, for beneficial interests, the underlying assets') cash flows (e.g., prepayments and defaults); however, the ASU allows the entity to assume that the effects of any events that occur, such as prepayments or defaults, would first apply to the portion of the closed portfolio or beneficial interests that is not part of the hedged item (last-of-layer) designation.

On each subsequent hedge effectiveness assessment date, the entity must continue to prepare and document its analysis supporting the expectation that the hedged item (i.e., the last of layer) will be outstanding on the assumed maturity date. The updated analysis should reflect the entity's current expectations about the level of prepayments, defaults, or other factors that could affect the timing and amount of cash flows, and it should use the same methods as those used at hedge inception. Also, on each reporting date, the entity will adjust the basis of the hedged item for the gain or loss on the hedged item attributable to changes in the hedged risk (i.e., interest rate risk), as it would do for any other fair value hedge.

Connecting the Dots

When an entity considers how it will allocate the basis adjustments that result from hedge accounting by using the last-of-layer method, it should factor in possible interactions with the application of other accounting requirements. For example, adjustments to the carrying value of the assets in the closed portfolio that are being hedged under the last-of-layer method might affect multiple pools of financial assets for which credit losses will be estimated on a collective basis. The identification of such pools may become an even more significant issue when an entity adopts ASU 2016-13.

An entity that concludes on any hedge effectiveness assessment date that it no longer expects the entire hedged last of layer to be outstanding on its assumed maturity date must, at a minimum, discontinue hedge accounting for that portion of the hedged last of layer that is not expected to be outstanding. Moreover, the entity must discontinue the entire hedging relationship on any assessment date on which it determines that the hedged last of layer currently exceeds the outstanding balance of the closed portfolio of prepayable assets or one or more beneficial interests in prepayable assets. A full or partial hedge discontinuation will also trigger the need for the entity to allocate, in a systematic and rational manner, the outstanding basis adjustment (or portion thereof) that resulted from the previous hedge accounting to the individual assets in the closed portfolio. Such allocated amounts must be amortized over a period "that is consistent with the amortization of other discounts or premiums associated with

the respective assets" under U.S. GAAP. The last-of-layer method does not, however, incorporate a tainting threshold; therefore, an entity that is required to discontinue a last-of-layer hedging relationship is not precluded from designating similar hedging relationships in the future.

Ability to Designate Components of Nonfinancial Assets as Hedged Items

Under U.S. GAAP before the adoption of ASU 2017-12, when an entity desired to cash flow hedge a risk exposure associated with a nonfinancial asset, it could designate as the hedged risk only the risk of changes in cash flows attributable to (1) all changes in the purchase or sales price or (2) changes in foreign exchange rates. Alternatively, for cash flow hedges of financial instruments, an entity could designate as the hedged risk either the risk of overall changes in cash flows or one or more discrete risks.

ASU 2017-12 enables an entity to designate the "risk of variability in cash flows attributable to changes in a contractually specified component" as the hedged risk in a hedge of a forecasted purchase or sale of a nonfinancial asset. The ASU defines a contractually specified component as an "index or price explicitly referenced in an agreement to purchase or sell a nonfinancial asset other than an index or price calculated or measured solely by reference to an entity's own operations." The Board believes that enabling an entity to component hedge purchases or sales of nonfinancial assets better reflects its risk management activities in its financial reporting and will allow the entity to more easily hedge cash flow variability associated with commodities received from multiple suppliers or delivered to multiple locations. The ASU also creates greater symmetry in the hedging models for financial and nonfinancial items by allowing an entity to hedge components of the total change in cash flows for both types of items.

Connecting the Dots

The Board declined to provide additional guidance in ASU 2017-12 on the nature and form of contracts that could contain a contractually specified component; however, ASC 815-20-55-26A states that the "definition of a contractually specified component is considered to be met if the component is explicitly referenced in agreements that support the price at which a nonfinancial asset will be purchased or sold."

An entity's determination of whether it may designate as the hedged risk the variability in cash flows attributable to changes in a contractually specified component for the purchase or sale of a nonfinancial asset depends on the nature of the contract, as follows:

- If the contract is a derivative in its entirety and the entity applies the normal purchases and normal sales scope exception, the entity may designate any contractually specified component in the contract as the hedged risk (failure to apply the normal purchases and normal sales scope exception precludes designation of any contractually specified component).
- If the contract is not a derivative in its entirety, the entity may designate any remaining contractually specified component in the host contract (i.e., after bifurcation of any embedded derivatives) as the hedged risk.

In addition, ASU 2017-12 permits an entity to designate a hedge of a contractually specified component (1) for a period that extends beyond the contractual term or (2) when a contract does not yet exist to sell or purchase the nonfinancial asset if the criteria specified above will be met in a future contract and all the other cash flow hedging requirements are met. When the entity executes the contract, it will reassess the criteria specified above to determine whether the contractually specified component continues to qualify for designation as the hedged risk. If, at the time the contract is executed, there is a change in the contractually specified component (e.g., the hedge documentation specified a commodity grade different from that in the executed contract), the entity will not be required to automatically

dedesignate the hedging relationship; however, the entity must demonstrate that the hedging relationship continues to be highly effective at achieving offsetting cash flows attributable to the revised hedged risk to justify continuation of hedge accounting.

Connecting the Dots

The amendments in ASU 2017-12 do not limit this guidance on changes in the designated hedged risk to hedges of nonfinancial items. Therefore, for example, an entity also would be permitted to continue applying hedge accounting to a cash flow hedge of a financial item if (1) the designated hedged risk changes during the life of the hedging relationship (e.g., if the interest rate index referenced in the final transaction differs from that specified in the hedge documentation for the forecasted transaction) and (2) the entity can conclude that the hedging instrument is still highly effective at achieving offsetting cash flows attributable to the revised hedged risk.

Disclosure Requirements

ASU 2017-12 updates certain illustrative disclosure examples in ASC 815. Also, to align the disclosure requirements with the updates to the hedge accounting model, the ASU removes the requirement for entities to disclose amounts of hedge ineffectiveness. In addition, an entity must now provide tabular disclosures about:

- Both (1) the total amounts reported in the statement of financial performance for each income and expense line item that is affected by fair value or cash flow hedging and (2) the effects of hedging on those line items.
- The carrying amounts and cumulative basis adjustments of items designated and qualifying as hedged items in fair value hedges. As part of such disclosures, an entity also must provide details about hedging relationships designated under the last-of-layer method, including (1) the closed portfolio's (beneficial interest's) amortized cost basis, (2) the designated last-of-layer amounts, and (3) the related basis adjustment for the last of layer.

These disclosures are required for every annual and interim reporting period for which a statement of financial position and statement of financial performance are presented.

Transition

Entities will adopt the guidance in ASU 2017-12 by applying a modified retrospective approach to existing hedging relationships[10] as of the adoption date. Under this approach, entities with cash flow or net investment hedges will make (1) a cumulative-effect adjustment to AOCI so that the adjusted amount represents the cumulative change in the hedging instruments' fair value since hedge inception (less any amounts that should have been recognized in earnings under the new accounting model) and (2) a corresponding adjustment to opening retained earnings as of the most recent period presented on the date of adoption.

In all interim periods and fiscal years ending after the date of adoption, entities should prospectively (1) present the entire change in the fair value of a hedging instrument in the same income statement line item(s) as the earnings effect of the hedged item when that hedged item affects earnings (other than amounts excluded from the assessment of net investment hedge effectiveness, for which the ASU does not prescribe presentation) and provide the amended disclosures required by the new guidance.

[10] This refers to hedging relationships in which "the hedging instrument has not expired, been sold, terminated, or exercised" and that have not been dedesignated by the entity as of the date of adoption.

In addition, ASU 2017-12 allows entities to make certain one-time transition elections. See Deloitte's August 30, 2017, *Heads Up* for a detailed discussion of the one-time transition elections provided by ASU 2017-12 and the deadlines for making such elections.

Connecting the Dots

An entity that is considering early adoption of the ASU's provisions should ensure that it has appropriate financial reporting internal controls in place to ensure compliance with the ASU's accounting and disclosure requirements. The entity also should give appropriate advance consideration to determining which transition elections it wishes to make since those elections must be made within a specified time after adoption. Also, ASC 815's general requirement for an entity to assess effectiveness for similar hedges in a similar manner, including the identification of excluded components, will apply to hedging relationships entered into after adoption; therefore, it will be important for the entity to determine its desired future methods for assessing the effectiveness of its hedging relationships when it adopts the ASU.

Receivables — Nonrefundable Fees and Other Costs

Background and Key Provisions of ASU 2017-08

In March 2017, the FASB issued ASU 2017-08, which amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date.

Under the current guidance in ASC 310-20, entities generally amortize the premium on a callable debt security as an adjustment of yield over the contractual life (to maturity date) of the instrument. Accordingly, entities do not consider early payment of principal, and any unamortized premium is recorded as a loss in earnings upon the debtor's exercise of a call on a purchased callable debt security held at a premium.

The amendments will require entities to amortize the premium on certain purchased callable debt securities to the earliest call date regardless of how the premium is generated (e.g., DAC) and cumulative fair value hedge adjustments that increase the amortized cost basis of a callable security above par value). Therefore, entities will no longer recognize a loss in earnings upon the debtor's exercise of a call on a purchased callable debt security held at a premium.

Connecting the Dots

Under ASU 2017-08, if an entity amortizes a premium to a call price greater than the par value of the debt security (e.g., because the debt security is callable at a premium to par on the earliest call date) and the debt security is not called on the earliest call date, the entity should reset the yield by using the payment terms of the debt security. If the security contains additional future call dates, the entity should consider whether the amortized cost basis exceeds the amount repayable by the issuer on the next call date. If the entity determines that the amortized cost basis does exceed the amount repayable, it should amortize the excess to the next call date.

Scope

Purchased callable debt securities within the scope of ASU 2017-08 are those that contain explicit, noncontingent call features that are exercisable at fixed prices and on preset dates. Because the ASU does not affect an entity's ability to elect to estimate prepayments under ASC 310-20-35-26, the amended guidance will not affect an entity that (1) applies ASC 310-20-35-26 to purchased callable debt securities and (2) estimates prepayments under the interest method.

Further, ASU 2017-08 does not apply to any of the following:

- Loans and other financing receivables that do not meet the definition of a debt security.
- Purchased debt securities held at a discount; the discount continues to be amortized as an adjustment of yield over the contractual life (to maturity) of the instrument.
- Purchased debt securities held at a premium and for which the call date or call price is not known in advance, including debt securities with a prepayment feature whose prepayment date is not preset (i.e., immediately prepayable instruments). As a result, the following purchased debt securities held at a premium are not within the ASU's scope:
  - Debt securities callable at fair value.
  - Debt securities callable at an amount that includes a make-whole provision that is based on the present value of future interest payments.
  - Asset-backed debt securities, including mortgage-backed securities, in which early repayment is based on the prepayment of the assets underlying the securitization as opposed to the issuer's decision to prepay the debt security itself.
- Purchased debt securities held at a premium that are contingently callable.

Effective Date and Transition

For PBEs, ASU 2017-08 is effective for fiscal years beginning after December 15, 2018, including interim periods therein. For all other entities, the standard is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early application is permitted for all entities, including adoption in an interim period. If an entity early adopts ASU 2017-08 in an interim period, any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period.

To apply the ASU, entities must use a modified retrospective approach and recognize the cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Entities are also required to provide disclosures about a change in accounting principle in the period of adoption.

Leases

Background

In February 2016, the FASB issued ASU 2016-02 (codified in ASC 842), its new standard on accounting for leases. As discussed in last year's publication, the primary objective of issuing the new leases standard was to address the off-balance-sheet treatment of lessees' operating leases. The standard's lessee model requires a lessee to adopt a right-of-use (ROU) asset approach that brings substantially all leases, with the exception of short-term leases[11] (i.e., those with a lease term of less than 12 months), on the balance sheet. Under this approach, the 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).

The development of the new leases standard began as a convergence project between the FASB and the IASB. Although the project was a convergence effort and the boards conducted joint deliberations, there are several notable differences between the boards' respective leases standards.[12] One of the more

[11] Assuming that the lessee has made an accounting policy election not to account for short-term leases on the balance sheet.
[12] The IASB issued IFRS 16, *Leases*, in January 2016.

significant differences is related to the classification of a lease. Under the FASB's standard, an entity may classify a lease as either an operating lease or a finance lease. Under the IASB's standard, however, an entity would classify all leases as finance leases.

Connecting the Dots

ASU 2016-02 defines a lease as a "contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration." While this definition may seem straightforward, judgment is crucial to identifying a complete population of leases. At first glance, a contract may not seem to meet a conventional understanding of a lease (e.g., a lease of a specific building).

However, entities should evaluate their contracts and determine whether those contracts in their entirety or in part convey the right to use property, plant, or equipment. Because most leases will be recognized "on balance sheet" under ASU 2016-02, the financial statement implications of erroneously not identifying a lease in, for example, a service contract are far more significant than under ASC 840.

Lease and Nonlease Components

Lessees and lessors are required to separate lease components and nonlease components (e.g., any services provided) in an arrangement and allocate the total transaction price to the individual components. Lessors would perform the allocation in accordance with the guidance in the new revenue recognition standard, and lessees would do so on a relative stand-alone price basis (by using observable stand-alone prices or, if the prices are not observable, estimated stand-alone prices). However, ASU 2016-02 states that as "a practical expedient, a lessee may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component." At the FASB's November 29, 2017, meeting, the Board tentatively decided to amend certain aspects of its new leasing standard to clarify that lessors may also elect not to separate lease and nonlease components when certain conditions are met.[13] For further discussion of the tentative changes, see Deloitte's December 5, 2017, *Heads Up*. However, a lessor would need to consider presentation and disclosure requirements under other U.S. GAAP, as applicable (e.g., ASU 2014-09).

Connecting the Dots

Transfer of a Separate Good or Service

If an amount is identified as a lease component, the amount is included in the measurement of the ROU asset and liability. When evaluating whether an activity should be a separate nonlease component, an entity should consider whether the activity transfers a separate good or service to the lessee. For example, maintenance services (including common area maintenance services) and utilities paid by the lessor but consumed by the lessee would be separate nonlease components because the lessee would have been required to otherwise contract for these services separately. However, payments for property taxes or insurance would most likely be considered a part of the lease component because they do not transfer a separate good or service to the lessee.

[13] This tentative decision was included in a proposed ASU, *Leases (Topic 842): Targeted Improvements*, that the FASB issued on January 5, 2018. Comments on the proposal are due by February 5, 2018.

Initial Direct Costs

A lessee would include in the calculation of the ROU asset any initial direct costs related to a lease. A lessor would continue to account for initial direct costs in a manner consistent with the current requirements. However, the definition of an initial direct cost is more restrictive under the new standard and includes only those costs that are incremental to the arrangement and that the entity would not have incurred if the lease had not been obtained. The definition is consistent with how incremental costs are defined in the new revenue recognition standard (ASU 2014-09). Thus, costs such as commissions and payments made to existing tenants to obtain the lease would be considered initial direct costs. By contrast, costs such as allocated internal costs and costs to negotiate and arrange the lease agreement (e.g., professional fees such as those paid for legal and tax advice) would be excluded from the definition.

Lessee Accounting

While the boards agreed that a lessee should record an ROU asset and a corresponding lease liability when the lease commences, they supported different approaches for the lessee's subsequent accounting. The FASB chose a dual-model approach under which a lessee classifies a lease by using criteria 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.

Connecting the Dots

The leasing guidance could significantly affect insurance entities that currently account for their real estate leases as operating leases. Lessees are required to record these arrangements in their statement of financial position. The dual classification model does not drive "on" or "off" balance sheet treatment but rather the characterization of the corresponding expenses and cash flows.

Although historically, many large insurance companies may have considered leases to be immaterial in the context of their financial statements, this could change as a result of the significant differences between the measurement of operating leases under ASC 840 and the measurement of such leases under ASC 842.

Lessor Accounting

The boards considered constituent feedback and decided not to make significant changes to the existing lessor accounting model. Rather, they agreed to adopt an approach that is similar to the existing capital 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).

Connecting the Dots

Insurance companies may invest in leveraged-lease arrangements to generate investment returns. As a result of the FASB's decisions related to such arrangements, insurance companies would no longer be permitted to apply the specialized accounting for new arrangements after the adoption of the final guidance. Rather, they would be required to account for a leveraged lease as two separate arrangements.

Options in a Lease

Under legacy lease accounting guidance, entities are required to evaluate whether they expect to exercise term renewal options, purchase options, and termination options. However, conclusions about the expectation of exercising such options typically do not significantly affect the resulting accounting for the associated leases unless they result in a change in lease classification. Under the new leases standard, by contrast, conclusions about the lease term and any payments associated with the exercise of purchase or termination options can have a more significant impact on the financial statements as a result of the measurement of the lease liability on the balance sheet. If lessees are "reasonably certain" that they will exercise an option, the corresponding impact of that option is included in the measurement of the lease liability.

Connecting the Dots

Implementation of ASU 2016-02 should include thoughtful consideration of internal controls, particularly in areas that require significant judgment and involve identification of the full population of leases (including embedded leases). Entities that may have placed less importance on the review of such conclusions under legacy GAAP should ensure that appropriate processes and controls are established to support appropriate conclusions in these key areas.

Effective Date and Transition

ASU 2016-02 is effective for PBEs for annual periods beginning after December 15, 2018, including interim periods therein. For all other entities, the standard is effective for annual periods beginning after December 15, 2019, and interim periods thereafter. Early adoption is permitted.

At the FASB's November 29, 2017, meeting, the Board tentatively decided to amend ASU 2016-02 so that entities may elect not to restate their comparative periods in transition. Effectively, the proposed amendment would allow entities to change their date of initial application to the beginning of the period of adoption.[14] For more information about the proposed transition relief, see Deloitte's December 5, 2017, *Heads Up*.

Lessees and lessors are required to use a modified retrospective transition method for existing leases. Accordingly, they would apply the new accounting model for the earliest year presented in the financial statements.

For discussion of additional implementation considerations, see Deloitte's March 1, 2016, *Heads Up* (as updated on July 12, 2016), which addresses the basic technical elements of the standard, and Deloitte's April 25, 2017, *Heads Up*, which addresses FAQs about the standard.

[14] See footnote 13.

Revenue Recognition

Background

In May 2014, the FASB issued ASU 2014-09 (codified primarily in ASC 606), which 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., certain sections of ASC 360-20 and ASC 970-605). For additional information about ASU 2014-09 as issued, see Deloitte's *A Roadmap to Applying the New Revenue Recognition Standard*.

In response to concerns expressed to the FASB about applying the requirements in ASU 2014-09, the FASB in 2016 issued the following five ASUs, which amend the new revenue recognition guidance and rescind certain SEC guidance on revenue:

- *ASU 2016-08* — The ASU addresses issues related to how an entity should assess whether it is the principal or the agent in contracts involving three or more parties.
- *ASU 2016-10* — The ASU's amendments clarify the guidance on an entity's identification of certain performance obligations.
- *ASU 2016-11* — On the basis of SEC staff announcements at the March 3, 2016, meeting of the Emerging Issues Task Force (EITF), the ASU rescinds certain SEC staff guidance in the Codification upon an entity's adoption of ASU 2014-09.
- *ASU 2016-12* — The ASU provides narrow-scope improvements and practical expedients.
- *ASU 2016-20* — The ASU makes technical corrections (i.e., minor changes and improvements) to certain aspects of ASU 2014-09.

In 2017, the Board continued to issue amendments related to the new revenue recognition guidance, including those in the following ASUs:

- *ASU 2017-03* — The ASU, which amends certain SEC staff guidance in the Codification on the basis of SEC staff announcements at the EITF's meetings on September 22, 2016, and November 17, 2016, addresses the "additional qualitative disclosures" that an SEC registrant is expected to provide in applying the guidance in SAB Topic 11.M when it "cannot reasonably estimate the impact" that the adoption of ASUs 2014-09, 2016-02, and 2016-13 will have on its financial statements. At the September 22, 2016, meeting, the SEC staff indicated that when a registrant is unable to reasonably estimate the impact of adopting the new revenue, leases, or credit losses standard, the registrant should consider providing additional qualitative disclosures about the significance of the impact on its financial statements. The SEC staff would expect such disclosures to include a description of:
    - The effect of any accounting policies that the registrant expects to select upon adopting the ASU(s).
    - How such policies may differ from the registrant's current accounting policies.
    - The status of the registrant's implementation process and the nature of any significant implementation matters that have not yet been addressed.

    The SEC staff has also explained that it would expect the volume of a registrant's disclosures about the impact of adopting new standards to increase as the adoption dates approach. For more information, see Deloitte's September 2016 and November 2016 *EITF Snapshot* newsletters and its *SEC Comment Letters — Including Industry Insights*.

On numerous occasions, members of the SEC staff have emphasized the importance of providing investors with transition-period disclosures in accordance with SAB 74 (codified in SAB Topic 11.M) as the new revenue standard's mandatory effective date approaches. Such disclosures should explain not only the transition method elected but also the new revenue standard's expected impact on the financial statements.

- *ASU 2017-05* — The FASB issued the ASU in response to stakeholder feedback indicating that (1) the meaning of the term "in substance nonfinancial asset" is unclear because the Board's new revenue standard does not define it and (2) the scope of the guidance on nonfinancial assets is confusing and complex and does not specify how a partial sales transaction should be accounted for or which model entities should apply.

  As a reminder, entities will account for sales of real estate to customers under ASC 606. Entities will account for sales of real estate to noncustomers under ASC 610-20.

In addition to the above ASUs, entities should be aware of recent pronouncements and activities of the SEC staff, including the following:

- *SEC staff announcement at the July 20, 2017, EITF meeting* — The SEC staff provided significant relief to registrants that are required to include financial statements or financial information of other reporting entities in their SEC filings. Specifically, as reported in the minutes of the EITF meeting, the SEC staff announced that it would not object to elections by certain public business entities (PBEs) to use the non-PBE effective dates for the sole purpose of adopting the FASB's new standards on revenue (ASC 606) and leases (ASC 842). The staff announcement makes clear that the ability to use non-PBE effective dates for adopting the new revenue and leases standards is limited to the subset of PBEs "that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filings with the SEC" (referred to herein as "specified PBEs").

  While the staff announcement is written in the context of specified PBEs, the principal beneficiaries of the relief will be SEC filers that include financial statements or financial information prepared by specified PBEs in their own filings, for example, under the following SEC Regulation S-X rules:

  - Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired."
  - Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons."
  - Rule 3-14, "Special Instructions for Real Estate Operations to Be Acquired."
  - Rule 4-08(g), "Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons."

  See Deloitte's July 20, 2017, *Heads Up* for more information about this relief that was granted.

- *The August 18, 2017, release of SAB 116* — SAB 116 provides that SAB Topic 13 will no longer be applicable when a registrant adopts ASC 606 since ASC 606 "eliminates the need for [SAB] Topic 13." In addition, SAB 116 modifies SAB Topic 11.A to clarify that "revenues from operating-differential subsidies presented under a revenue caption should be presented separately from revenue from contracts with customers accounted for under [ASC] 606." For more information about SAB 116, see Deloitte's August 22, 2017, journal entry.

Connecting the Dots

ASU 2016-20 amends ASC 606 to clarify that all contracts within the scope of ASC 944 are excluded from the scope of ASC 606. However, certain products (or portions thereof) offered by insurance entities (e.g., administrative-services-only (ASO) or asset management services contracts) may need to be accounted for under ASC 606. This situation would occur if an insurance company's customers are offered ASO or asset management services contracts without insurance coverage. However, if those services are offered with insurance coverage, an entity will need to consider whether ASC 944 or other ASC topics contain separation or initial-measurement guidance. Accordingly, a key issue associated with an insurance entity's implementation of the new revenue standard is identifying whether a contract is partially or entirely within the scope of the new standard.

Arrangements for which stakeholders have had questions related to scope include:

- *Contracts that contain both an insurance product and services* — In current practice, property insurers and health insurers typically account for high-deductible insurance contracts that contain claim servicing as a single contract and apply the insurance accounting model in ASC 944. In addition, some insurers that write ASO contracts in combination with stop-loss insurance coverage typically do so as two separate contracts (i.e., they account for the ASO contract as a service contract and the stop loss contract as an insurance contract). Upon the adoption of ASC 606, insurers will have to deal with the same issue and determine whether all, a portion, or none of the contract is within the scope of ASC 606.

  In Chapter 14 of the 2017 AICPA Audit and Accounting Guide *Revenue Recognition*, the AICPA provided nonauthoritative accounting guidance that indicates that in such circumstances, "insurance entities should consider the economics and nature of the arrangements (including pricing interdependencies), when assessing whether contracts with the same customer (or related parties of the customer) should be combined for accounting purposes." If the insurer determines that (1) such contracts should be combined and (2) the noninsurance activities in the combined contract are "predominantly performed as part of fulfilling the insurance obligation or mitigating the insurer's insurance risk," it should account for the combined contracts as one contract under ASC 944 (i.e., ASC 606 would not apply). Otherwise, the insurer should apply the ASC 606 guidance to allocate the combined consideration received between the insurance coverage and the noninsurance performance obligations subject to ASC 606.

- *Mortgage insurance contracts* — Because ASC 944 provides a revenue recognition scope exception for mortgage guaranty insurance entities, there is currently no specific guidance on mortgage insurance contracts in the Codification. This has led to the development of industry-specific practice. As a result, while ASC 606 before its amendment by ASU 2016-20 specifically excluded insurance contracts from its scope, it was unclear whether the revenue recognition scope exception in ASC 944 would result in a requirement for mortgage insurance contracts to be accounted for under ASC 606 and therefore nullify currently accepted accounting practices. As noted in paragraphs BC13 through BC15 of ASU 2016-20, the scope exception in ASC 606 as amended by ASU 2016-20 to exclude all contracts within the scope of ASC 944 will apply to mortgage insurance contracts (i.e., mortgage insurance contracts will not be within the scope of ASC 606). Further, the Board indicates in paragraph BC15 that it does not expect the ASU's amendment to the scope exception in ASC 606 to result in a change from current accounting practice.

In addition to the issues described above, the AICPA's Insurance Entities Revenue Recognition Task Force continues to deliberate other industry-specific issues, including (1) issues related to insurance contracts within the scope of ASC 944 and (2) accounting for third-party extended warranty contracts within the scope of ASC 606.

See the revenue recognition sections of Deloitte's *Banking and Securities — Accounting and Financial Reporting Update* and its *Investment Management — Accounting and Financial Reporting Update* for considerations regarding arrangements — such as brokerage, asset management, and other third-party-provided services — that insurance entities may similarly enter into with their customers.

Effective Date and Transition

In August 2015, as a result of stakeholder concerns, the FASB issued ASU 2015-14, which delays the effective date of ASC 606. Accordingly, the new revenue standard is effective for PBEs 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 new revenue 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 involved in implementation activities related to the new standard, including the TRG (see Appendix D of Deloitte's *A Roadmap to Applying the New Revenue Recognition Standard*), the AICPA's revenue recognition task forces (e.g., the Insurance Entities Revenue Recognition Task Force, information about which is available on the AICPA's Web site), various firms, the SEC, and the PCAOB. Preparers should continue to monitor the activities of these groups before adoption of the new guidance.

Business Combinations

Intangibles — Goodwill and Other

Background

In January 2017, the FASB issued ASU 2017-04, which amends the guidance in ASC 350 on the accounting for goodwill impairment. The ASU was issued as part of the FASB's simplification initiative and in response to stakeholder feedback regarding the cost and complexity of the annual goodwill impairment test.

Key Provisions of the ASU

Under the current guidance in ASC 350, impairment of goodwill "exists when the carrying amount of goodwill exceeds its implied fair value." To determine the implied fair value of goodwill, an entity must "assign the fair value of a reporting unit to all of the assets and liabilities of that unit (including any

unrecognized intangible assets) as if the reporting unit had been acquired in a business combination." This process, known as step 2, is often expensive and complicated given the inability to measure goodwill directly. ASU 2017-04 seeks to simplify the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test and enabling an entity to recognize an impairment loss when the "carrying amount of a reporting unit exceeds its fair value." Any such loss will be "limited to the total amount of goodwill allocated to that reporting unit."

Connecting the Dots

ASU 2017-04 requires goodwill impairment to be measured on the basis of the fair value of a reporting unit relative to the reporting unit's carrying amount rather than on the basis of the implied amount of goodwill relative to the goodwill balance of the reporting unit. The goodwill impairment test under the ASU is therefore less precise than the test performed under current guidance. As a result of applying the new guidance, an entity may record a goodwill impairment that is entirely or partly due to a decline in the fair value of other assets that, under existing GAAP, would not be impaired or have a reduced carrying amount.

The ASU does not change the qualitative assessment;[15] however, it removes "the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test." Rather, all reporting units, including those with a zero or negative carrying amount, will apply the same impairment test.

Connecting the Dots

Under ASU 2017-04, reporting units with a zero or negative carrying value would essentially never be impaired. Accordingly, judgments related to the assignment of assets and liabilities to a reporting unit may become more relevant. The FASB considered, but ultimately rejected, prescribing additional guidance on allocating assets and liabilities to reporting units. The ASU's Basis for Conclusions states that "the amendments in this Update should not necessarily trigger changes to the composition of a reporting unit," noting that "preparers, auditors, and regulators should pay close attention to any change to a reporting unit that results in a zero or negative carrying amount, including changes made leading up to the adoption of the new guidance given the length of time until the effective dates." It further states that "the allocation of assets and liabilities to reporting units should not be viewed as an opportunity to avoid impairment charges and should only be changed if there is a change in facts and circumstances for a reporting unit."

ASU 2017-04 also:

- Clarifies the requirements for excluding and allocating foreign currency translation adjustments to reporting units related to an entity's testing of reporting units for goodwill impairment.
- Clarifies that "an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable."
- Makes minor changes to the Overview and Background sections of certain ASC subtopics and topics as part of the Board's initiative to unify and improve those sections throughout the Codification.

See Deloitte's February 1, 2017, *Heads Up* for additional information about ASU 2017-04.

[15] The optional assessment described in ASC 350-20-35-3A through 35-3G to determine whether it is more likely than not that the carrying amount of a reporting unit exceeds its fair value is commonly referred to as the qualitative assessment or step 0.

Convergence With IFRSs

The removal of step 2 from the goodwill impairment test under ASC 350 more closely aligns U.S. GAAP with IFRSs, which also prescribe a one-step goodwill impairment test. However, the impairment test required under IAS 36 is performed at the cash-generating-unit or group-of-cash-generating-units level rather than the reporting-unit level as required by U.S. GAAP. Further, IAS 36 requires an entity to compare the cash-generating unit's carrying amount with its recoverable amount, whereas ASU 2017-04 requires an entity to compare a reporting unit's carrying amount with its fair value.

Effective Date and Transition

For PBEs that are SEC filers,[16] ASU 2017-04 is effective for annual and any interim impairment tests for periods beginning after December 15, 2019. PBEs that are not SEC filers should apply the new guidance to annual and any interim impairment tests for periods beginning after December 15, 2020. For all other entities, the ASU is effective for annual and any interim impairment tests for periods beginning after December 15, 2021. Early adoption is allowed for all entities as of January 1, 2017, for annual and any interim impairment tests occurring on or after January 1, 2017.

Clarifying the Definition of a Business

Background

In January 2017, the FASB issued ASU 2017-01, which provides guidance related to the first phase of the Board's project on the definition of a business. The ASU was issued in response to concerns that the current definition of a business is too broad and that many transactions are accounted for as business combinations when they are more akin to asset acquisitions.

ASU 2017-01:

- Provides a "screen" that, if met, eliminates the need for further evaluation. Entities are required to use this screen when determining whether an integrated set of assets and activities (commonly referred to as a "set") is a business. When substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the screen is met and the set is therefore **not** a business. The objective of the screen is to reduce the number of transactions that need to be further evaluated.
- Provides that if the screen is not met, a set constitutes a business only if it includes, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs.
- Removes the evaluation of whether a market participant could replace missing elements.
- Narrows the definition of the term "output" to be consistent with how outputs are described in ASC 606.

[16] The ASC master glossary defines an "SEC filer" as follows:

> "An entity that is required to file or furnish its financial statements with either of the following:
>
> a. The Securities and Exchange Commission (SEC)
> b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.
>
> Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition."

SEC filers do not include entities that are not otherwise SEC filers whose financial statements or financial information is required to be or is included in another entity's filing with the SEC (e.g., in accordance with SEC Regulation S-X, Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons," or SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired," and SEC Regulation S-X, Rule 4-08(g), "Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons").

Connecting the Dots

ASU 2017-01 could affect the insurance industry as a result of the different accounting for business combinations and asset acquisitions. For example, acquisition costs are expensed in a business combination and capitalized in an asset acquisition. Thus, a more narrow definition of a business will result in more asset acquisitions and, therefore, more capitalized costs.

"Single Identifiable Asset" or "Group of Similar Identifiable Assets" Screen

Under ASU 2017-01, cash and cash equivalents, DTAs, and goodwill resulting from the effects of deferred tax liabilities would be excluded from the assessment of gross asset concentration when an entity applies the screen described above. If the fair value of the gross assets is not concentrated in accordance with the screen, the entity would apply the ASU's framework for evaluating whether an input and a substantive process are both present and together contribute to the ability to produce outputs.

Connecting the Dots

In the determination of gross asset concentration, neither a financial asset and a nonfinancial asset (e.g., premium deposits on insurance contracts and customer relationships) nor different major classes of financial assets (e.g., investments, cash, and accounts receivable) could be combined. Also, identifiable assets within the same major asset class that have significantly different risk characteristics could not be combined.

Input and Substantive Process Requirement

ASU 2017-01 provides a framework for determining whether a set has an input and a substantive process that collectively contribute to the ability to create outputs. When a set does not yet have outputs, the set would have a substantive process only if it has an organized workforce that has the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that, when applied to an acquired input or inputs, is critical to the ability to continue producing outputs. For a set with outputs, the ASU includes less stringent criteria for determining that the set has a substantive process. An organized workforce may represent a substantive process. However, a set may have a substantive process even without an organized workforce if an acquired process or processes contribute to the ability to continue producing outputs and cannot be replaced without significant cost, effort, or delay or are considered unique or scarce.

Definition of Outputs

Under current guidance (ASC 805-10-55-4), outputs are defined as the "result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants." ASU 2017-01 amends this definition to be the "result of inputs and processes applied to those inputs that provide goods or services to customers, investment income (such as dividends or interest), or other revenues." The revised definition of outputs aligns with the description of outputs in ASC 606 (the new revenue standard).

Effective Date and Transition

ASU 2017-01 is effective for PBEs for annual periods beginning after December 15, 2017, including interim periods within those periods. For all other entities, the ASU is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

Early application is permitted as follows:

- For transactions for which the acquisition date occurs before the issuance date or effective date of the ASU, application is permitted only when the transaction has not been reported in financial statements that have been issued or made available for issuance.
- For transactions in which a subsidiary is deconsolidated or a group of assets is derecognized that occur before the issuance date or effective date of the ASU, application is permitted only when the transaction has not been reported in financial statements that have been issued or made available for issuance.

For additional information about ASU 2017-01, see Deloitte's January 13, 2017, *Heads Up*.

Employee Share-Based Payment Accounting Improvements

In May 2017, the FASB issued ASU 2017-09, which amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification.

Background

The Board decided to change the scope of the modification guidance in ASC 718 given that ASC 718-20-20 defines a modification as a "change in **any** of the terms or conditions of a share-based payment award" (emphasis added). As a result of that broad definition, there may be diversity in practice regarding the types of changes to share-based payment awards to which an entity applies modification accounting. Accordingly, to provide clarity and reduce diversity, cost, and complexity, the FASB issued ASU 2017-09.

Examples 1 and 2 below illustrate the effects of an entity's application of modification accounting depending on whether the original awards are expected to vest.

Example 1

Entity A grants employees restricted stock units that are classified as equity and have a fair-value-based measure of $1 million on the grant date. Before the awards vest, A subsequently modifies them to provide dividend participation during the vesting period. Assume that the addition of dividend participation changes the fair-value-based measurement of the awards and that the fair-value-based measure on the modification date is $1.5 million immediately before the modification and $1.6 million immediately after it. In addition, there are no other changes to the awards (including their vesting conditions or classification). If A applies modification accounting, and the awards are expected to vest on the modification date, A would recognize incremental compensation cost of $100,000 over the remaining requisite service period (for a total of $1.1 million of compensation cost). However, if A applies modification accounting, and the awards are not expected to vest on the modification date, any compensation cost to be recognized (if the awards are subsequently expected to vest or actually do vest) will be based on the modification-date fair-value-based measure of $1.6 million.

Example 2

Entity B grants employees restricted stock units that are classified as equity and have a fair-value-based measure of $1 million on the grant date. Before the awards vest, B subsequently modifies them to add a contingent fair-value repurchase feature on the underlying shares. Assume that the addition of the repurchase feature **does not** change the fair-value-based measurement of the awards or their classification and that the fair-value-based measure on the modification date is $1.5 million (both immediately before and after the modification). In addition, there are no other changes to the awards (including their vesting conditions). If B applies modification accounting, and the awards are expected to vest on the modification date, there is no accounting consequence associated with the modification because there is no increase in the fair-value-based measurement; any compensation cost will continue to be based on the grant-date fair-value-based measure of $1 million. However, if B applies modification accounting, and the awards are not expected to vest on the modification date, any compensation cost to be recognized (if the awards are subsequently expected to vest or actually do vest) will be based on the modification-date fair-value-based measure of $1.5 million.

In accordance with the provisions of ASU 2017-09 (see discussion below), B would not apply modification accounting because the fair-value-based measurement, vesting conditions, and classification of the awards are the same immediately before and after the modification. Accordingly, irrespective of whether the awards are expected to vest on the modification date, any compensation cost recognized will continue to be based on the grant-date fair-value-based measure of $1 million.

Key Provisions of ASU 2017-09

Scope of Modification Accounting

ASU 2017-09 limits the circumstances in which an entity applies modification accounting. When an award is modified, an entity does not apply the guidance in ASC 718-20-35-3 through 35-9 if it meets all of the following criteria:

- "The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified."
- "The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified."
- "The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified."

Connecting the Dots

Upon an equity restructuring, it is not uncommon for an entity to make employees "whole" (in accordance with a preexisting nondiscretionary antidilution provision) on an intrinsic-value basis when the awards are stock options. In certain circumstances, the fair-value-based measurement of modified stock options could change as a result of the equity restructuring even if the intrinsic value remains the same. Under ASU 2017-09, an entity compares the intrinsic value before and after a modification in determining whether to apply modification accounting only "if such an alternative measurement method is used"; thus, if an entity uses a fair-value-based measure to calculate and recognize compensation cost for its share-based payment awards, it would still be required to apply modification accounting when the fair-value-based measurement has changed, even if the intrinsic value is the same immediately before and after the modification.

Clarification Related to the Fair Value Assessment

ASC 718-20-35-2A(a) states, "If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification."

Connecting the Dots

In paragraph BC16 of ASU 2017-09, the Board noted that it does not expect that an entity will always need to estimate the fair-value-based measurement of a modified award. An entity might instead be able to determine whether the modification affects any of the inputs used in the valuation technique performed for the award. For example, if an entity changes the net-settlement terms of its share-based payment arrangements related to statutory tax withholding requirements, that change is not likely to affect any inputs used in the method performed by the entity to value the awards. If none of the inputs are affected, the entity would not be required to estimate the fair-value-based measurement immediately before and after the modification (i.e., the entity could conclude that the fair-value-based measurement is the same).

Examples From the ASU's Basis for Conclusions

The Basis for Conclusions of ASU 2017-09 provides examples (that "are educational in nature, are not all-inclusive, and should not be used to override the guidance in paragraph 718-20-35-2A") of (1) changes to awards for which modification accounting generally would not be required and (2) those for which it generally would be required. The following table summarizes those examples:

Examples of Changes for Which Modification Accounting *Would Not* Be Required	Examples of Changes for Which Modification Accounting *Would* Be Required
• Administrative changes, such as a change to the company name, company address, or plan name • Changes in net-settlement provisions related to tax withholdings that do not affect the classification of the award	• Repricings of stock options that result in a change in value • Changes in a service condition • Changes in a performance condition or a market condition • Changes in an award that result in a reclassification of the award (equity to liability or vice versa) • Addition of an involuntary termination provision in anticipation of a sale of a business unit that accelerates vesting of an award

Connecting the Dots

Share-based payment plans commonly contain clawback provisions that allow an entity to recoup awards upon certain contingent events (e.g., termination for cause, violation of a noncompete provision, material financial statement restatement). Under ASC 718-10-30-24, such clawback provisions are generally not reflected in estimates of the fair-value-based measure of awards. Accordingly, we believe that the addition of a clawback provision to an award would typically not result in the application of modification accounting because such clawbacks generally do not change the fair value, vesting conditions, or classification of an award.

Effective Date

For all entities, ASU 2017-09 is effective for annual reporting periods, including interim periods within those annual reporting periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period.

Transition and Related Disclosures

The amendments in ASU 2017-09 should be applied prospectively to awards modified on or after the effective date. Transition disclosures are not required, because modifications typically are not recurring events for most entities.

Restricted Cash

Background

In November 2016, the FASB issued ASU 2016-18, which amends ASC 230 to clarify guidance on the classification and presentation of restricted cash. The ASU is the result of the following consensuses reached by the EITF:

- An entity should include in its cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. The Task Force decided not to define the terms "restricted cash" and "restricted cash equivalents" but observed that an entity should continue to provide appropriate disclosures about its accounting policies pertaining to restricted cash in accordance with other GAAP. The Task Force also observed that any change in accounting policy will need to be assessed under ASC 250.
- A reconciliation between the statement of financial position and the statement of cash flows must be disclosed when the statement of financial position includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents.
- Changes in restricted cash and restricted cash equivalents that result from transfers between cash, cash equivalents, and restricted cash and restricted cash equivalents should not be presented as cash flow activities in the statement of cash flows.
- An entity with a material balance of amounts generally described as restricted cash and restricted cash equivalents must disclose information about the nature of the restrictions.

Connecting the Dots

When applying the guidance in ASU 2016-18, broker-dealers will most likely consider cash they segregate for regulatory purposes to be restricted cash.

Effective Date and Transition

For PBEs, the guidance in ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, it is effective for annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019. Early adoption is permitted. A reporting entity will apply the guidance retrospectively.

Connecting the Dots

In August 2016, the FASB issued ASU 2016-15, which amends ASC 230 to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows. The ASU adds or clarifies guidance on items such as (1) debt prepayment or debt extinguishment costs, (2) contingent consideration payments made after a business combination, and (3) distributions received from equity method investees. See Deloitte's August 30, 2016, *Heads Up* for more information.

Appendixes

Appendix A — Summary of Accounting Pronouncements Effective in 2017

The table below lists selected ASUs that became effective for calendar year 2017. (Note that it is assumed that the ASUs were not early adopted before 2017 if early adoption was permitted.)

ASU (Issuance Date)	Effective Date for PBEs	Effective Date for Non-PBEs	Early Adoption Allowed?	Deloitte Resources
ASU 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments — Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings* (January 23, 2017)	Effective upon issuance	Effective upon issuance	N/A	January 24, 2017, news article
ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting* (March 30, 2016)	Annual periods, and interim periods within those annual periods, beginning after December 15, 2016	Annual periods beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018	Yes	April 21, 2016, *Heads Up*
ASU 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments* (September 25, 2015)	Fiscal years beginning after December 15, 2015, including interim periods within those fiscal years	Fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The amendments in the ASU should be applied prospectively to adjustments to provisional amounts that occur after the effective date of the ASU.	Yes	September 30, 2015, *Heads Up*

(Table continued)

ASU (Issuance Date)	Effective Date for PBEs	Effective Date for Non-PBEs	Early Adoption Allowed?	Deloitte Resources
ASU 2015-09, *Disclosures About Short-Duration Contracts* (May 21, 2015)	Annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016	Annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017	Yes	May 2015 *Insurance Spotlight*
ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* (April 15, 2015)	Annual periods, including interim periods within those annual periods, beginning after December 15, 2015	Annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016	Yes	April 17, 2015, *Heads Up*
ASU 2015-04, *Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets* (April 15, 2015)	Fiscal years beginning after December 15, 2015, and interim periods within those fiscal years	Fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017	Yes	April 17, 2015, *Heads Up*
ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs* (April 7, 2015)	Fiscal years beginning after December 15, 2015, and interim periods within those fiscal years	Fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016	Yes	June 18, 2015, *Heads Up*
ASU 2015-02, *Amendments to the Consolidation Analysis* (February 18, 2015)	Fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015	Fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017	Yes	December 29, 2015, *Heads Up* (originally issued May 26, 2015)

(Table continued)

ASU (Issuance Date)	Effective Date for PBEs	Effective Date for Non-PBEs	Early Adoption Allowed?	Deloitte Resources
ASU 2014-16, *Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity* — a consensus of the FASB Emerging Issues Task Force (November 3, 2014)	Fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015	Fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016	Yes	September 2014 *EITF Snapshot*
ASU 2014-15, *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern* (August 27, 2014)	Annual periods ending after December 15, 2016, and interim periods thereafter	Annual periods ending after December 15, 2016, and interim periods thereafter	Yes	August 28, 2014, *Heads Up*
ASU 2014-13, *Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity* — a consensus of the FASB Emerging Issues Task Force (August 5, 2014)	Annual periods, and interim periods within those annual periods, beginning after December 15, 2015	Annual periods ending after December 15, 2016, and interim periods beginning after December 15, 2016	Yes	June 2014 *EITF Snapshot*

Appendix B — Current Status of FASB Projects

The table below summarizes the current status of, and next steps for, active standard-setting projects of the FASB (selected projects only and excluding research initiatives).

Project	Status and Next Steps	Deloitte Resources
Recognition and Measurement Projects		
Consolidation reorganization and targeted improvements	On September 20, 2017, the FASB issued a proposed ASU that would reorganize the consolidation guidance in ASC 810 by dividing it into separate subtopics for voting interest entities and variable interest entities (VIEs). The new subtopics would be included in a new topic, ASC 812, which would supersede ASC 810. Comments on the proposal were due by December 4, 2017.	November 8, 2016, and March 14, 2017, journal entries; October 5, 2017, *Heads Up*
Consolidation: targeted improvements to related-party guidance for VIEs	On June 22, 2017, the FASB published a proposed ASU under which (1) private companies "would not have to apply VIE guidance to legal entities under common control . . . if both the parent and the legal entity being evaluated for consolidation are not public business entities"; (2) "[i]ndirect interests held through related parties in common control arrangements would be considered on a proportional basis for determining whether fees paid to decision makers and service providers are variable interests"; and (3) consolidation would no longer be mandatory when "power is shared among related parties or when commonly controlled related parties, as a group, have the characteristics of a controlling financial interest but no reporting entity individually has a controlling financial interest." Comments on the proposal were due by September 5, 2017.	July 14, 2017, *Heads Up*
Distinguishing liabilities from equity	The FASB added this project to its technical agenda on September 20, 2017. The purpose of the project is to "improve understandability and reduce complexity — without sacrificing the relevance of information provided to financial statement users — with a focus on indexation and settlement (within the context of the derivative scope exception), convertible debt, disclosures, and earnings per share."	
Nonemployee share-based payment accounting improvements	On March 7, 2017, the FASB issued a proposed ASU that would simplify the accounting for share-based payments granted to nonemployees for goods and services. Under the proposal, most of the guidance on such payments would be aligned with the requirements for share-based payments granted to employees. Comments on the proposed ASU were due by June 5, 2017.	March 10, 2017, *Heads Up*

(Table continued)

Project	Status and Next Steps	Deloitte Resources
Presentation and Disclosure Projects		
Simplifying the balance sheet classification of debt	On January 10, 2017, the FASB issued a proposed ASU that would reduce the complexity of determining whether debt should be classified as current or noncurrent in a classified balance sheet. Comments on the proposal were due by May 5, 2017. On June 28, 2017, the Board discussed a summary of comments received. On September 13, 2017, the Board concluded its redeliberations and directed the staff to draft a final ASU for a vote by written ballot. The FASB expects to issue this ASU in the first quarter of 2018.	January 12, 2017, *Heads Up*; September 15, 2017, journal entry

Appendix C — Glossary of Standards and Other Literature

The following are the titles of standards and other literature mentioned in this publication:

FASB Accounting Standards Updates (ASUs)

ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

ASU 2017-09, *Compensation — Stock Compensation (Topic 718): Scope of Modification Accounting*

ASU 2017-08, *Receivables — Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*

ASU 2017-05, *Other Income — Gains and Losses From the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*

ASU 2017-04, *Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*

ASU 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments — Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings*

ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

ASU 2016-20, *Technical Corrections and Improvements to Topic 606,* Revenue From Contracts With Customers

ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* — a consensus of the FASB Emerging Issues Task Force

ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* — a consensus of the FASB Emerging Issues Task Force

ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

ASU 2016-12, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

ASU 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting*

ASU 2016-10, *Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing*

ASU 2016-09, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*

ASU 2016-08, *Revenue From Contracts With Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*

ASU 2016-02, *Leases (Topic 842)*

ASU 2016-03, *Intangibles — Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance* — a consensus of the Private Company Council

ASU 2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

ASU 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*

ASU 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*

ASU 2015-09, *Financial Services — Insurance (Topic 944): Disclosures About Short-Duration Contracts*

ASU 2015-05, *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*

ASU 2015-04, *Compensation — Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets*

ASU 2015-03, *Interest — Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*

ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*

ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-15, *Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*

ASU 2014-13, *Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*

FASB Accounting Standards Codification (ASC) Topics

ASC 230, *Statement of Cash Flows*

ASC 250, *Accounting Changes and Error Corrections*

ASC 270, *Interim Reporting*

ASC 310, *Receivables*

ASC 321, *Investments — Equity Securities*

ASC 325, *Investments — Other*

ASC 326, *Financial Instruments — Credit Losses*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 606, *Revenue From Contracts With Customers*

ASC 610, *Other Income*

ASC 718, *Compensation — Stock Compensation*

ASC 740, *Income Taxes*

ASC 805, *Business Combinations*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 825, *Financial Instruments*

ASC 840, *Leases*

ASC 842, *Leases*

ASC 944, *Financial Services — Insurance*

ASC 970, *Real Estate — General*

FASB Proposed Accounting Standards Updates

Proposed ASU 2018-210, *Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income*

Proposed ASU 2018-200, *Leases (Topic 842): Targeted Improvements*

Proposed ASU 2017-310, *Technical Corrections and Improvements to Recently Issued Standards: I. Accounting Standards Update No. 2016-01,* Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities *and II. Accounting Standards Update No. 2016-02,* Leases (Topic 842)

Proposed ASU 2017-280, *Consolidation (Topic 812): Reorganization*

Proposed ASU 2017-240, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*

Proposed ASU 2017-220, *Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

Proposed ASU 2017-200, *Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current Versus Noncurrent)*

Proposed ASU 2016-330, *Financial Services — Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*

FASB Statement of Financial Accounting Standards (Pre-Codification Literature)

Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses From the Sale of Investments*

SEC Regulation S-X

Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

Rule 3-14, "Special Instructions for Real Estate Operations to Be Acquired"

Rule 4-08, "General Notes to Financial Statements"

SEC Staff Accounting Bulletin (SAB) Topics

SAB Topic 11.A, "Operating-Differential Subsidies"

SAB Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period" (SAB 74)

SAB Topic 13, "Revenue Recognition"

SAB 116

International Standards

IFRS 17, *Insurance Contracts*

IFRS 16, *Leases*

IAS 36, *Impairment of Assets*

IAS 17, *Leases*

Appendix D — Abbreviations

Abbreviation	Description
AFS	available for sale
AICPA	American Institute of Certified Public Accountants
AOCI	accumulated other comprehensive income
ASC	FASB Accounting Standards Codification
ASO	administrative-services-only
ASU	FASB Accounting Standards Update
CAE	claim adjustment expense
CECL	current expected credit loss
CTA	cumulative translation adjustment
DAC	deferred acquisition costs
DCF	discounted cash flow
DTA	deferred tax asset
EIR	effective interest rate
EITF	FASB's Emerging Issues Task Force
FAS	FASB Statement of Financial Accounting Standards
FASB	Financial Accounting Standards Board
FAQ	frequently asked question
GAAP	generally accepted accounting principles

Abbreviation	Description
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IBNR	incurred-but-not-reported
IEP	AICPA's Insurance Expert Panel
IFRS	International Financial Reporting Standard
OCC	Office of the Comptroller of the Currency (U.S. Department of the Treasury)
OCI	other comprehensive income
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PCD asset	purchased financial asset with credit deterioration
ROU	right-of-use
SAB	SEC Staff Accounting Bulletin
SEC	U.S. Securities and Exchange Commission
SIFMA	Securities Industry and Financial Markets Association
TDR	troubled debt restructuring
TRG	transition resource group
VIE	variable interest entity