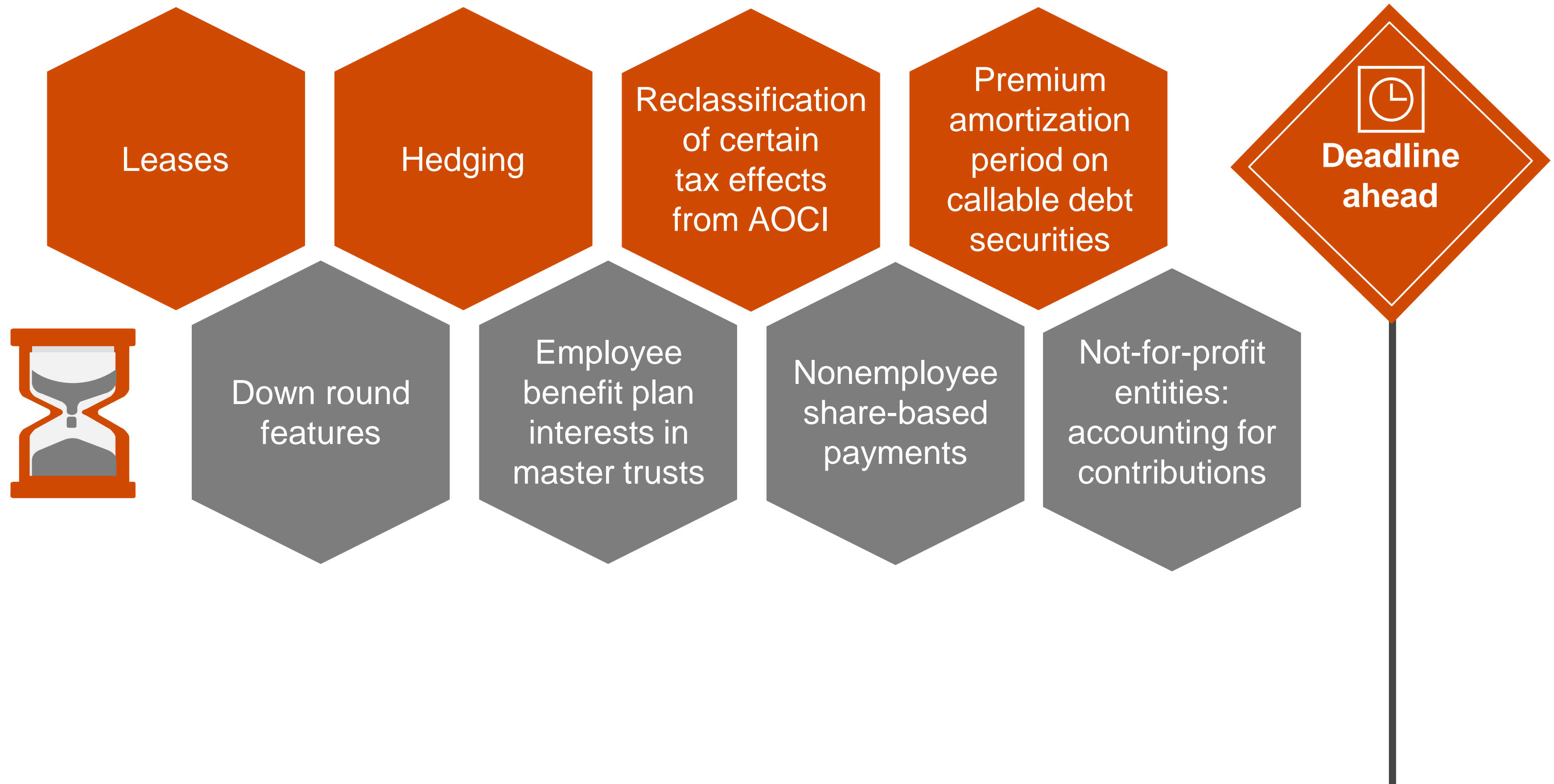
Accounting update

A summary of hot topics affecting accounting and reporting

Standards effective in 2019 for calendar year-end public business entities



Looking ahead

New Accounting Standards
Down the road

Effective in 2020

Financial instruments – impairment *

Goodwill impairment

Effective in 2021

Insurance: long-duration contracts *

* There are proposed ASU to delay the effective date of these standards for certain entities.

Accounting standards effective in 2019 & 2020

Non-public business entities

Effective in 2019			
Revenue	Financial Instruments – Recognition and measurement	Cash flows and restricted cash	Reclassification of certain tax effects from AOCI
Breakage for certain prepaid stored value products	Intra-entity transfers	Derecognition of non financial assets	Employee benefit plan interests in master trusts
Definition of a business	Presentation of pension costs	Service concession arrangements	

Effective in 2020		
Leases	Hedging	Down round features
Not-for-profit entities: accounting for contributions	Nonemployee share-based payments	
Premium amortization period on callable debt securities	Fair value measurement disclosure requirements	

Looking ahead – Proposed changes in effective dates

- For standards not yet effective for any entities, proposal to define effective dates as: (1) SEC filers other than smaller reporting companies (as defined by the SEC) and (2) all other entities.

	Proposed effective date SEC Filers, excluding SRCs	Proposed effective date All other entities
Financial instruments – impairment	January 1, 2020	January 1, 2023
Insurance: long-duration contracts	January 1, 2022	January 1, 2024

- As the Hedging standard was already effective for public business entities (PBEs) and the leases standard was effective for PBEs, Not for Profit conduit bond obligors and Employee benefit plans that are SEC filers, proposal to change effective dates for entities other than public business entities (2 years after PBEs)

	Effective date Public business entities (no change)	Proposed effective date All other entities
Hedging	January 1, 2019	January 1, 2021
Leases	January 1, 2019 includes certain other entities	January 1, 2021

Current technical agenda – Selected active FASB projects

Project	Impact	Status
Conceptual framework	• Focus on improving the conceptual framework to provide a better foundation for developing future accounting standards • Areas of focus include presentation, measurement and elements of the financial statements	Presentation Exposure draft redeliberations Elements & Measurement Initial deliberations
Distinguishing liabilities from equity	• Goal to reduce complexity on distinguishing liabilities from equity	Exposure draft comment period
Financial performance reporting	• Focus on the disaggregation of performance information through presentation in the statement of income or disclosure in the notes	Initial deliberations
Segment reporting	• Focus on improvements to the segment aggregation criteria and disclosures	Initial deliberations – FASB seeking public company input

Current technical agenda – Selected active FASB projects (continued)

Project	Impact	Status
Balance sheet classification of debt	• Debt is classified based on contractual terms • Classification assessment of debt is performed as of the balance sheet date	Revised exposure draft issued in September 2019
Disclosure framework	• Objective is to improve the effectiveness of footnote disclosures • Addresses Board's decision process, entities' decision process and various topic-specific disclosures	Income taxes Revised exposure draft comment period Inventory Exposure draft redeliberations Interim reporting Initial deliberations
Improving the accounting for asset acquisitions and business combinations	• Aligning the accounting for the recognition of acquired assets and businesses	Initial deliberations

Current technical agenda – Selected active FASB projects (continued)

Project	Impact	Status
Identifiable Intangible Assets and Subsequent Accounting for Goodwill	• Determining whether certain or all the elements of the PCC alternatives for goodwill and identifiable intangible assets should be extended to PBEs.	Invitation to comment – comment period
Reference Rate Reform	• Facilitating the effects on financial reporting of the market-wide migration from interbank offered rates (IBORs) to alternative reference rates	Drafting exposure draft
Effective Dates	• Establishing effective dates for major standards and whether effective dates should be different between large public companies, smaller public companies, and private companies.	Exposure draft comment period

Private company council agenda

PCC's current agenda

- **Issue No. 18-01, Practical Expedient to Measuring Grant-Date Fair Value for Equity-Classified Share-Based Payments**
  - PCC members have raised concerns that the permitted methods for valuing share-based awards are significantly more difficult to apply for private company awards, presenting unique challenges due to their ownership structure, including a lack of active market and prices for private company shares.
  - The project will consider a practical expedient to measure grant-date fair value of equity share-based payments for private companies. The practical expedient would allow private companies to use the exercise price of their equity-classified share-based awards as the current price for the purposes of determining the grant-date fair value of the awards, in certain circumstances.
  - Outreach is ongoing with preparers to determine whether such a practical expedient will impact their processes by reducing costs in determining the fair value of awards.
- Other topics
  - Implementation issues relating to ASC 606, Revenue Recognition
  - Implementation issues relating to ASC 842, Leases
  - Impact of reference rate reform on financial reporting
  - Simplifications to accounting for income taxes

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Navigating the new landscape – Revenue from contracts with customers

Revenue recognition – Executive summary

Issued May 2014

What you need to know

- What you need to know
- The last of the anticipated amendments – a series of technical corrections – was issued by the FASB in December 2016.
- Guidance is applicable to all entities and industries
- Intent to improve consistency and comparability among companies
- Recognize revenue when or as control is transferred
- Guidance is now effective for IFRS reporters and public US GAAP reporters
- SEC comment letters to date have focused primarily on disclosures about key judgments
- Project added to EITF's agenda in June 2019 regarding accounting for modifications of licenses

Impacts

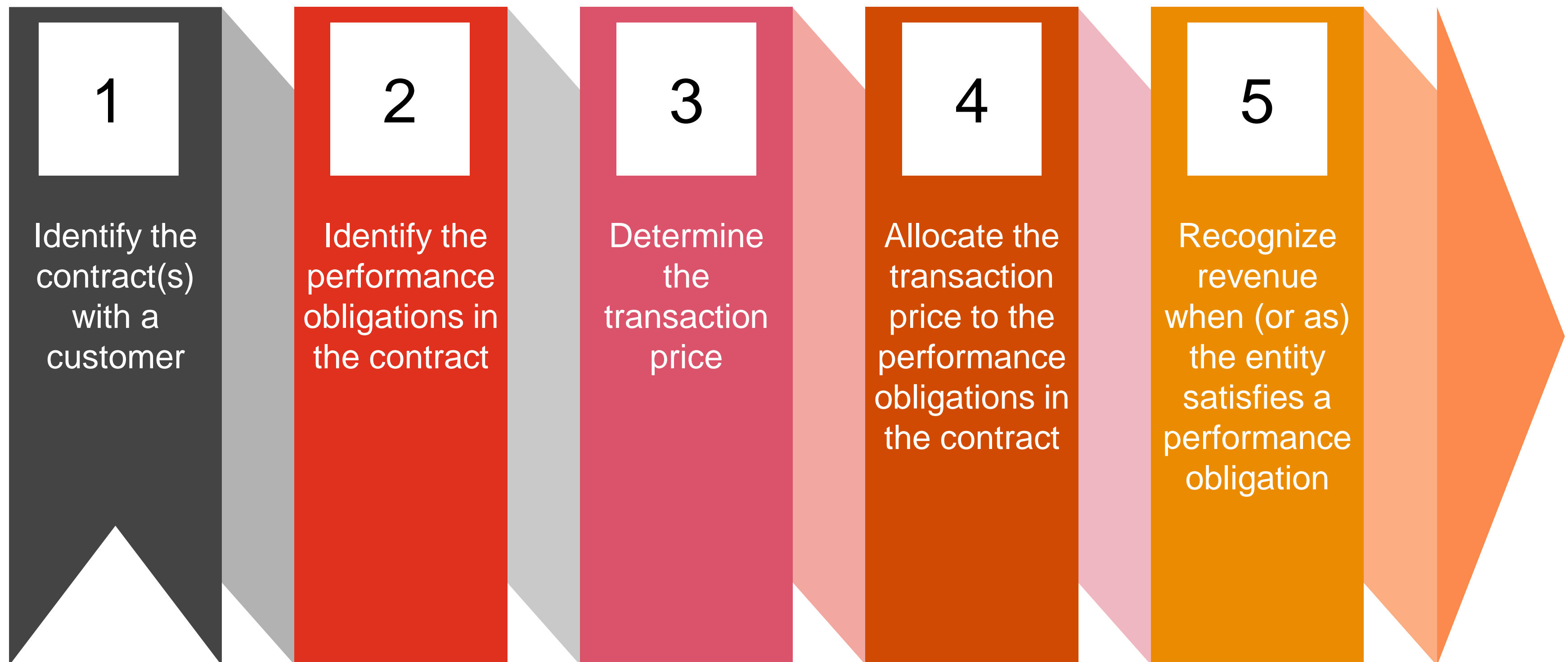
- Significant change to how many recognize revenue
- Expanded disclosure requirements

Looking forward

- US GAAP: Effective for nonpublic companies for annual periods beginning after December 15, 2018

How does it work

Five key steps



Annual disclosure requirements

1. Disaggregation of revenue
2. Contract balances and significant changes
3. Information about performance obligations
4. Remaining performance obligations
5. Significant judgments
6. Costs to obtain or fulfill a contract
7. Practical expedients

Nonpublic companies can exclude certain disclosures

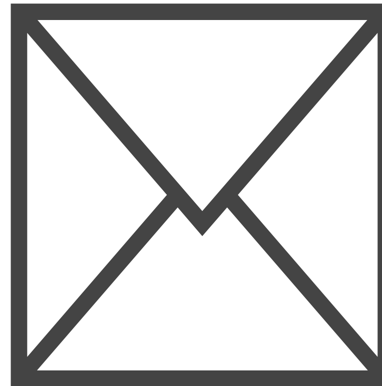
All disclosures required in 10-Qs in year of adoption

SEC comment letters – Early trends

Topics addressed in SEC comment letters to date include:

- Performance obligations
- Variable consideration
- Recognizing revenue
- Gross versus net presentation
- Disaggregated revenue disclosures

You have mail!



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Navigating the new landscape – Leases

Leases – Executive summary

Issued February 2016

What you need to know

- Virtually all leases on balance sheet
- Renewal options will be included when a significant economic incentive to exercise exists
- FASB and IASB diverged on lessee pattern of income statement recognition
  - FASB similar to today – operating lease expense on a straight-line basis
  - IASB all financing, therefore front loaded expense
- Lessors in a sales-type or direct financing lease derecognize the underlying asset and recognize a lease receivable and unguaranteed residual asset

Impacts

- Balance sheet will be grossed up for lessees
- Financial metrics and debt covenants may be impacted
- Leases may be embedded in other contracts and will now be on balance sheet

Looking forward

- Effective 2019 for calendar year-end public business entities (including interim periods – Q1 2019)
- Effective CY 2020 for calendar year-end non-public entities*

* In July 2019, the FASB voted to propose an additional one-year delay for non-public entities. Stay tuned for developments.

Effective date and transition

Adoption

- Effective January 1, 2019 for calendar-year public companies
- Other entities have an additional year for annual filings*
- Early adoption is permitted

Transition

- Two transition alternatives
- May apply hindsight to existing leases to determine lease term and asset impairment
- Change in classification (between operating and capital/finance)

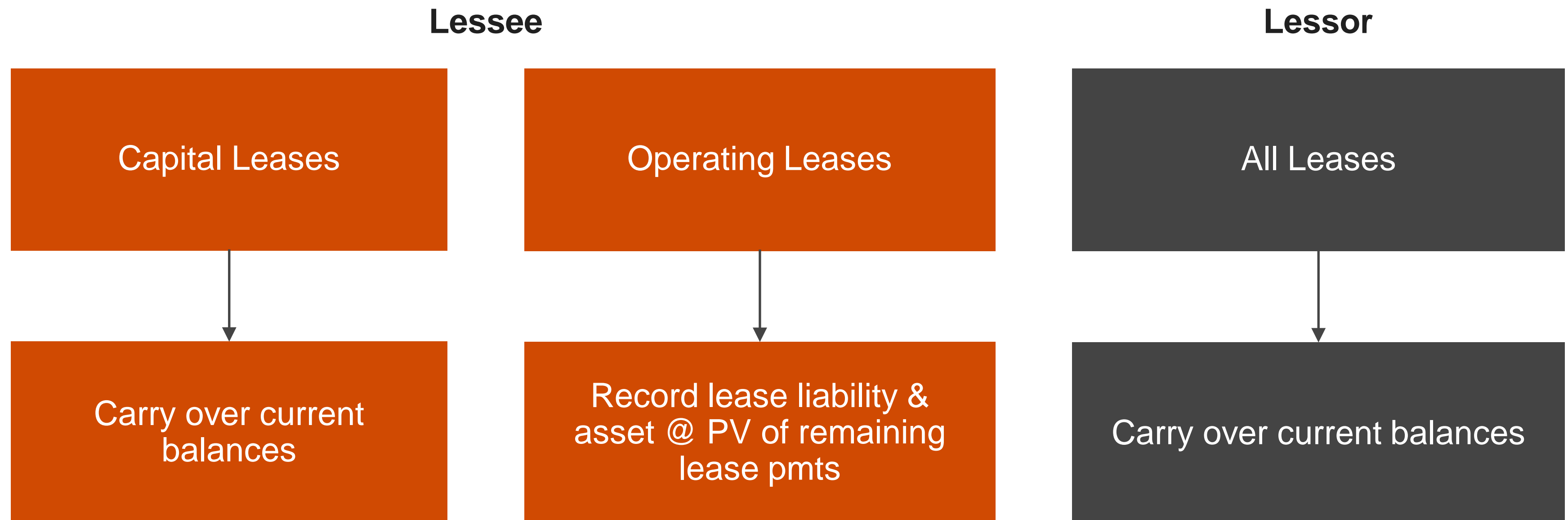
Relief package

- At adoption do not reassess:
  - Whether an arrangement is, or contains, a lease
  - Lease classification
  - Whether initial direct costs would qualify for capitalization under the new standard

* In July 2019, the FASB voted to propose an additional one-year delay for non-public entities. Stay tuned for developments.

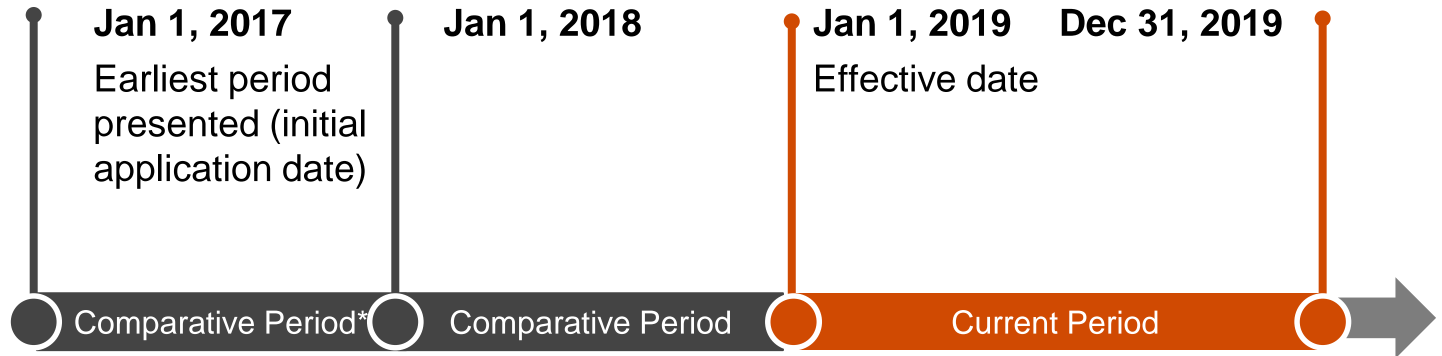
Transition

If the package of practical expedients is elected (including no reassessment of original classification), transition is generally as follows:



Optional transition method for leasing

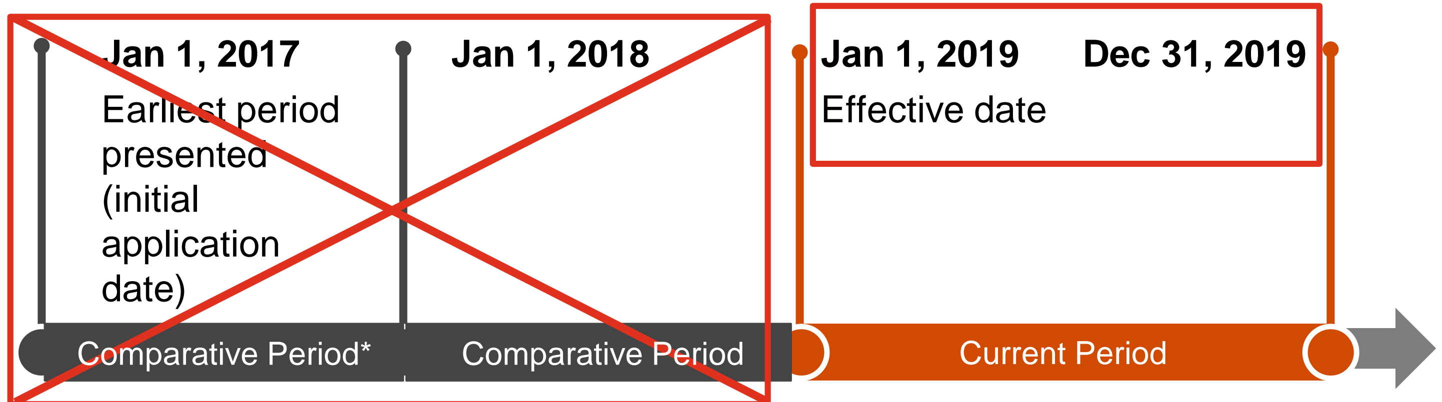
Modified Retrospective:



*Example using calendar year-end public company

OR

Alternative transition option



* Cumulative-effect adjustment to retained earnings.

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Navigating the new landscape – Financial instruments – Impairment

Impairment overview

Impacts

- Changes determination of losses from incurred loss approach to expected loss approach and replaces multiple impairment models
- Could impact regulatory capital requirements, key financial metrics
- Convergence will not be achieved
  - FASB – Single measurement lifetime losses at inception except for available-for-sale debt securities
  - IASB – Dual measurement lifetime losses upon trigger

Recognize losses on a more timely basis

Effective 2020 for calendar-year-end public companies that are SEC filers*. One additional year for other PBE's and two additional years for all other companies. Early adoption allowed for all companies

* In July 2019, the FASB proposed delaying the effective date for all entities, except SEC filers excluding SRCs to 2023 for calendar-year end entities. Stay tuned for developments.

What's in scope of CECL?

CECL applies to financial assets measured at amortized cost and certain off-balance sheet credit exposures

Scope of the standard

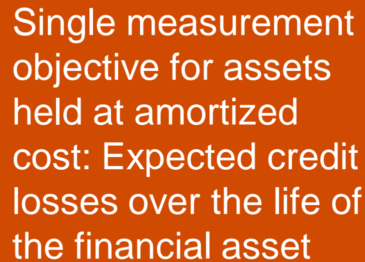
- Loans
- Held-to-maturity debt securities
- Loan commitments
- Trade receivables
- Net investments in sales-type and direct financing leases
- Reinsurance receivables
- Financial guarantees
- Purchased credit deteriorated assets recorded at amortized cost

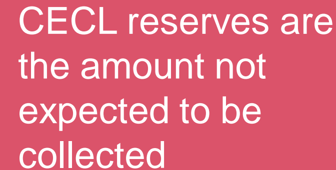
Specifically excluded

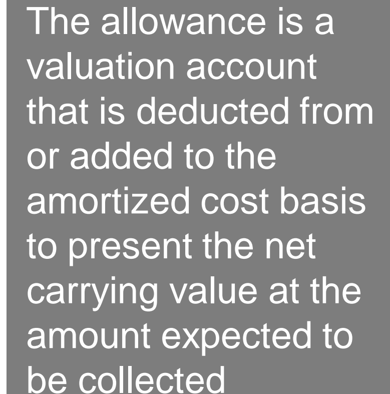
- Loan receivables held-for-sale
- Financial assets for which fair value option is elected
- Equity instruments and equity method investments
- Derivatives
- Loans and receivables between entities under common control
- Operating lease receivable

Overview of the CECL model

Current Expected Credit Loss model (CECL)





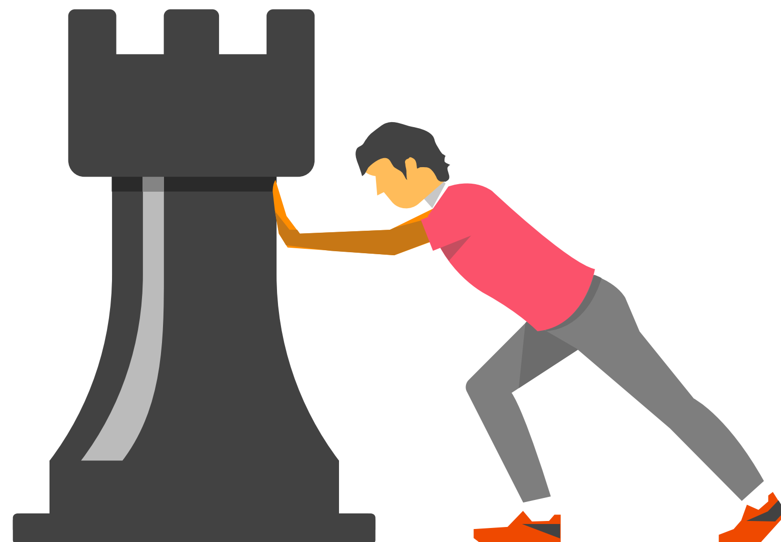


CECL measurement principles

- Financial assets within scope **must be pooled** when similar risk characteristics exist; otherwise assessed individually
- Use of a discounted cash flow model is not required
- The allowance should be generally calculated based on the amortized cost basis of the financial asset
- Consider relevant internal and external information, including:
  - Historical experience
  - Current conditions
  - Reasonable and supportable forecasts
- Future periods beyond which the entity is able to make a reasonable and supportable forecast – reversion to historical loss information

Time horizon for measurement of CECL

- Estimate of expected credit losses = amount that an entity does not expect to collect over the life of the asset
- “Life” of the asset considers
  - The contractual term
  - Expected pre-payments
  - Extension and renewals that are contractually provided and outside the lender’s control
  - Reasonably expected troubled debt restructurings
- “Life” of the asset does not consider forecasted renewals, modifications or extensions not included above
- Off-balance-sheet credit exposures:
  - Consider the period over which the commitment is legally binding
  - Do not consider obligations that are unconditionally cancellable at the lender’s discretion
- Financial guarantees will have allowances similar to an unfunded commitment



CECL – Other key considerations

- **Consideration of collateral**
  - Mitigation of credit risk
  - Measurement when foreclosure is probable
  - Collateral-dependent financial assets
  - Collateral maintenance provisions
- **Impact of “embedded” vs. freestanding credit enhancements**
- **Other allowance considerations:**
  - Trade receivables
  - Net investments in leases (capital leases)

Key differences from incurred loss models

Before	After
ASC 450 (FAS 5) for incurred losses in the loan portfolio (collectively evaluated for impairment)	• Replace incurred loss model with expected loss model • Reasonable and supportable forecasts • Reflects contractual life considering prepayments, but without consideration of renewals, extensions (except if within contract and outside the lender's control), or modifications, unless TDR is reasonably expected • Include forecasts of expected recoveries of amounts previously written off or expected to be written off. Could result in a "negative allowance"
ASC 310 (FAS 114) specific valuation allowances	• No threshold for identification of individually impaired loans • Measurement approach is similar to today if the entity elects to use a discounted cash flow modeling approach
ASC 310-40 TDRs	• Measured using the CECL model • Recognize credit losses, including certain concessions
ASC 310-30 Purchased Credit Impaired	• Purchased with more than insignificant credit deterioration (PCD) • Balance sheet "grossed up" to reflect expected loss estimate • Initial credit loss will not be recognized in income • Changes in allowance recognized in income • Follow an "accrete to contractual" interest model

Available-for-sale debt security impairment model

- Similar approach to current impairment guidance under ASC 320 with the following changes:
  - Impairment losses are accounted for as an allowance subject to future reversal upon credit improvements
  - Duration of loss is no longer a consideration in determining whether a security is impaired
  - No forecasts of future recoveries after the balance sheet date
  - No explicit requirement to evaluate the historical volatility of the fair value of a security
  - Measurement and recognition of credit losses are “capped” at the excess of amortized cost over fair value
- Measurement of credit loss based on the present value of expected cash flows (a discounted cash flow calculation is **required**)

Purchased financial assets with credit deterioration

Scope: Assets with more than insignificant deterioration in credit quality since origination

- Amortized cost basis and the allowance for credit losses “grossed up” to reflect expected loss estimate on day 1
- Initial credit loss not recognized in income
- If a discounted cash flow (DCF) model is used:
  - Step 1: Calculate the effective interest rate (EIR) by solving for the discount rate such that discounted expected cash flows equal the purchase price
  - Step 2: Calculate the initial allowance by discounting the cash flows not expected to be collected (i.e., difference between contractual and expected cash flows) by the EIR
- Loans:
  - If a non-DCF model is used, the day 1 allowance is based on “par”
- Available-for-sale debt securities:
  - A discounted cash flow approach is required at the **individual security level**
- Subsequently CECL or the available-for-sale debt securities impairment model is applied
  - Interest is recognized using an “accrete to contractual” model

Disclosure requirements

Allowance for credit loss roll forward schedule	• Disclosure of the rollforward of the allowance for credit loss on assets subject to CECL and on available-for-sale debt securities is required
Credit quality indicators	• Includes disclosure requirements for credit quality indicators (CQI) • This requirement is not applicable to short-term trade receivables • Expanded disclosures of amortized cost basis within each CQI by “vintage,” or year of asset origination • The new standard: – Exempts non-public business entities from the vintage disclosures – Provides transition relief for public business entities (PBEs) that are non-SEC filers: • On the initial date of adoption, preparers only need to disclose the most recent three years of vintage CQI data • Each fiscal year thereafter, an incremental year of vintage CQI data should be disclosed until five separate fiscal years are disclosed – Does not provide transition relief or exemptions for PBEs that are SEC-filers

Transition guidance

- Generally, a cumulative transition adjustment will be required on the date of adoption

Purchased financial assets with credit deterioration

- Current purchased credit impaired (PCI) financial assets will be classified as purchased financial assets with credit deterioration (PCD) at transition
- PCD guidance will be applied prospectively for financial assets that previously applied the PCI model
- On date of adoption, record allowance for credit loss "gross-up" to the balance sheet

Debt instruments that experienced other-than-temporary impairment

- Adopt ASU prospectively

Impacts to companies

Changes are coming

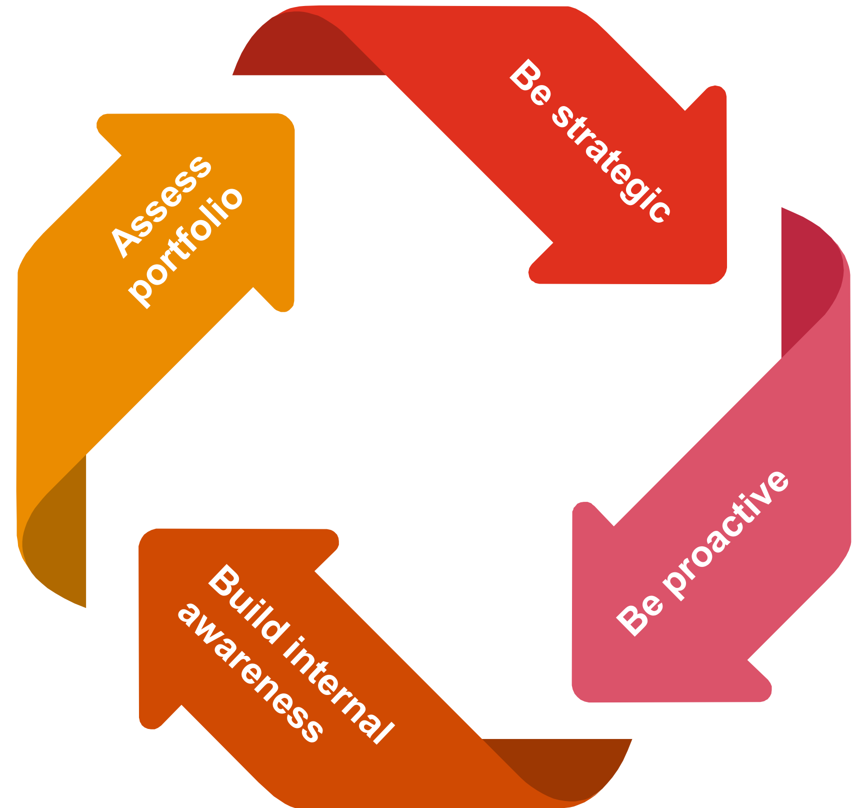
- Will significantly affect banks and other financial institutions
- Potential to affect most companies
- Models, systems, controls and processes will need to be evaluated
- Many functional areas will be affected

Actions to consider

- Monitor developments
- Identify key stakeholders
- Identify financial assets affected
- Estimate the impact
- Consider potential changes to impairment measurement, controls, and processes

CECL – Transition Resource Group

- The FASB created a transition resource group, similar to the revenue standard



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