FASB Update: Recent Developments in Financial Reporting

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INTRODUCTION

• Simplification Projects
  – ASU 2015-01: Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items
  – ASU 2015-03: Simplifying the Presentation of Debt Issuance Costs
  – ASU 2015-11: Simplifying the Subsequent Measurement of Inventory
  – ASU 2015-17: Accounting for Income Taxes: Balance Sheet Classification of Deferred Taxes

• Other Projects:
  – Status of the Project on Leases
  – Status of the Projects on Financial Instruments (Classification and Measurement; Impairment)
  – Status of the Project on the Transition to the Equity Method
  – Projects related to Revenue Recognition
    • Deferral of Effective Date of ASU 2014-09
    • Continuing Issues resulting from ASU 2014-09: Revenue from Contracts with Customers
ASU 2015-01: Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items

- Current GAAP
  - Unusual in nature and infrequent in occurrence (APB 30, 1973)—disclose as a separate line item after income from continuing operations, net of tax.
  - Unusual in nature or infrequent in occurrence should be disclosed before income from continuing operations or in the notes.
  - SFAS No. 4 (1975) added gains and losses on extinguishment of debt as extraordinary items.

- Current IFRS
  - Neither the income statement nor the notes may describe any item as “extraordinary”.

- New GAAP
  - Eliminates the concept of extraordinary items—unusual and infrequent disclosed the same way as unusual or infrequent.

- Effective date:
  - Years beginning after 12/15/15.
  - Early adoption is permitted if started from the beginning of the year.
  - May be adopted prospectively or retrospectively.
ASU 2015-03: Simplifying the Presentation of Debt Issuance Costs

• Current GAAP
  – Debt issuance costs are capitalized separately from the debt (and any related discount or premium) and disclosed as an asset. Costs are amortized over the life of the debt.

• New GAAP
  – Disclose the debt issuance costs as a direct reduction of the carrying amount of the debt.
  – Amortization (using effective interest) is included in interest expense. (In substance, debt issuance costs change the effective rate.)
  – Similar to IFRS treatment.

ASU 2015-03: Simplifying the Presentation of Debt Issuance Costs

• Effective date:
  – Public business entities: Years beginning after 12/15/15 (All others, 12/15/16).
  – Early adoption is permitted for financial statements not previously issued.
  – Retrospective treatment is required in comparative statements.

ASU 2015-03: Simplifying the Presentation of Debt Issuance Costs

• ASU 2015-05: Debt issuance Costs—Line of Credit Arrangements
  – Acknowledges that the SEC will continue to permit debt issuance costs arising from LOC’s to be disclosed as assets whether funds have been borrowed or not.
  – Amortize over the term of the LOC.
  – Effective upon issuance.
ASU 2015-11: Simplifying the Subsequent Measurement of Inventory

• Current GAAP
  – Applying lower of cost or market requires comparing the historical cost of inventory with its market value. Market value is defined as replacement cost subject to a ceiling (net realizable value) and a floor (net realizable value less a normal profit).

• New GAAP
  – Lower of cost and net realizable value will compare the cost of inventory with its net realizable value. (Any inventory write-downs occurring before this ASU is first applied create a new cost basis.)
  – The new method only applies to FIFO and weighted average. For both LIFO and the retail inventory method, lower of cost or market is retained.

ASU 2015-11: Simplifying the Subsequent Measurement of Inventory

• Because of the LIFO and retail inventory exceptions, this standard is really a complication, not a simplification. There are now two “subsequent measurement of inventory” methods.

• Effective date:
  – Public entities: Years beginning after 12/15/16 (Private entities, 12/15/16 annual, 12/15/17 interim periods).
  – Early adoption is permitted if started from the beginning of the year.
  – Prospective application is required.

ASU 2015-17: Accounting for Income Taxes: Balance Sheet Classification of Deferred Taxes

• Current GAAP
  – Deferred tax assets and liabilities are classified:
    • By the classification of the related asset or liability that gave rise to the deferred tax item.
    • If there is no related asset or liability, then the timing of the reversal is used to classify the deferred tax item.

• New GAAP
  – All deferred tax assets and liabilities are classified as noncurrent. This is consistent with IFRS.
  – Offsetting of deferred tax assets and liabilities continues within a taxing component of an entity and a particular tax jurisdiction.
ASU 2015-17: Accounting for Income Taxes:
Balance Sheet Classification of Deferred Taxes

• Effective date:
  – Public entities: Years beginning after 12/15/16
    (Private entities, 12/15/17 annual, 12/15/18 interim periods).
  – Early adoption is permitted if started from the
    beginning of the period.
  – May be either prospective or retrospective.

Status of the Project on Leases

• In 2005, the SEC issued a report (required by Sarbanes-Oxley
  Act) on off-balance sheet activities.
• The report estimated that there were about $1.25 trillion* in
  off-balance sheet commitments due to operating leases and
  only about $45 billion* in on-balance sheet commitments due
  to capital leases; therefore, about 97% of all lease
  commitments are off-balance sheet. (*Undiscounted amounts)
• The report recommended that the FASB work with the IASB on
  a joint project to update the accounting standard on leases.

Status of the Project on Leases

• Exposure drafts were issued in 2010 and in 2013; both
  received lots of criticism.
• After significant outreach and major revisions, the FASB is
  scheduled to issue a final standard in early 2016.
• Although this began as a convergence project, the FASB and
  IASB could not reach agreement on some important issues, so
  they are each issuing their own standards.
Status of the Project on Leases

Right-of-Use Model

A lease contract conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Right-of-use asset

Lessor

Lessee

Lease payments

Status of the Project on Leases

• **Scope relief:** Short-term leases (leases with a lease term of 12 months or less) have a recognition and measurement exemption.

• **No significant effect on lessors:** Lessors will account for leases using an approach that is substantially equivalent to existing U.S. GAAP.

Status of the Project on Leases

• **Lessee Accounting Model:**
  – All leases will be reported on the balance sheet by recognizing a right-of-use asset and a lease liability.
  – All leases will be classified as either finance leases or operating leases (“dual approach”), using criteria similar to current standards for capital vs. operating leases.
    – Ownership of the asset transfers to the lessee
    – The agreement contains a bargain purchase option
    – The lease term is for the major part of the asset’s economic life (not considered if the lease term begins near the end of the asset’s life — the last 25% of the asset’s life)
    – The present value of the lease payments amounts to substantially all of the fair value of the asset
    – The asset is so specialized that it is expected to have no alternative use to the lessor at lease expiration (this is new)
Status of the Project on Leases

Lessee Accounting Model:

<table>
<thead>
<tr>
<th>Lease Classification</th>
<th>Balance Sheet</th>
<th>Income Statement</th>
<th>Cash Flow Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance leases</td>
<td>Right-of-use asset</td>
<td>Amortization expense</td>
<td>Principal portion of the lease liability payments are financing activities</td>
</tr>
<tr>
<td></td>
<td>Lease liability</td>
<td>Interest expense</td>
<td></td>
</tr>
<tr>
<td>Operating leases</td>
<td>Right-of-use asset</td>
<td>Single lease expense recognized on a straight-line basis</td>
<td>Interest portion of the lease liability payments are operating activities</td>
</tr>
<tr>
<td></td>
<td>Lease liability</td>
<td></td>
<td>All payments are operating activities</td>
</tr>
</tbody>
</table>

• Key difference from the IASB: The IASB decided on a “single approach” for lessee accounting—all leases will be classified as finance leases.

Status of the Project on Leases

• Effective date:
  – Public business entities: Years beginning after 12/15/18 (All others: 12/15/19 annual, 12/15/20 interim periods).
  – Early adoption is permitted for all entities upon issuance of the standard.
  – Modified retrospective treatment is required.

Status of the Projects on Financial Instruments—Classification and Measurement

• An ASU is still listed as expected in Q4 2015, effective for public business entities for years beginning after 12/15/17 (other entities 12/15/2017 annual, 12/15/18 interim).
• Retrospective application.
Status of the Projects on Financial Instruments—Classification and Measurement

• Assets—equity investments.
  – Carried at fair value with changes in net income except:
    • Equity method investments.
    • Investments with no determinable fair value.
  – No more fair value option for equity method investments.
  – Investments not carried at fair value are impaired if it is “more likely than not” that fair value is less than carrying value. Testing must be done annually.

• Assets—debt investments.
  – Must apply two tests:
    • Contractual cash flows (principal and interest only?)
    • Business model.
  – Three classifications:
    • Held-to-collect contractual cash flows—at amortized cost—public entities must disclose fair value parenthetically on the balance sheet. (Previously held-to-maturity.)
    • Held-to-collect contractual cash flows and to sell—at fair value with changes in other comprehensive income. (Previously AFS.) May elect the fair value option.
    • All others—at fair value with changes in net income. (Hybrid instruments are not bifurcated since they are carried at fair value.)

• Liabilities
  – Continue to carry at amortized cost. Public entities must disclose fair value parenthetically on the balance sheet.
  – The fair value option is still available. If used, changes in fair value caused by “instrument specific credit risk” are reported in other comprehensive income instead of net income.
  – Bifurcation is still required for hybrid instruments. But only the financial liability component is covered by this ASU.
Status of the Projects on Financial Instruments—Impairments (Credit Losses)

- An ASU is expected in Q1 2016, effective for public SEC filers for years beginning after 12/15/18 (other public business entities 12/15/19, other entities 12/15/19 annual, 12/15/20 interim periods).
- Covers any financial assets not measured at fair value.
  - Primary focus is on debt instruments. But also extends to trade receivables, lease receivables, loan commitments, etc. (receivables that represent a contractual right to receive cash).

Status of the Projects on Financial Instruments—Impairments (Credit Losses)

- Current Expected Credit Losses (CECL) model
  - Must estimate all future contractual cash flows not expected to be collected (no time limit).
  - Eliminates “probable” from consideration. Must consider both the probability of loss and the probability of no loss.
  - Adds consideration of forecasts to assessment criteria.
  - Time value of money must be considered.
- Use an allowance account (shows both credit deterioration and/or improvement).
- Write-off when there is no reasonable expectation of recovery.

Status of the Project on the Transition to the Equity Method

- Exposure draft issued June 5, 2015 proposed:
  - Eliminating amortization of differences between the cost of an investment and the underlying equity in net assets.
  - Eliminating retroactive restatement when an investment previously accounted for under another method qualifies for the equity method.
  - FASB reaffirmed the elimination of retroactive restatement but moved the amortization issue to a new project seeking additional improvements to the equity method.
Status of the Project on the Transition to the Equity Method

• An ASU eliminating retroactive restatement is expected in Q1 2016, effective for all entities for years beginning after 12/15/16 with an option for early application.
  – Prospective application.
  – Investments previously classified as available-for-sale must recognize any unrealized holding gains or losses currently in other comprehensive income as part of net income when the equity method first applies.

Projects Related to Revenue Recognition

• ASU 2015-14: Revenue Recognition—Deferral of the Effective Date of ASU 2014-09.
  – Defers effective dates for one year
    • Public entities: Years beginning after 12/15/17 (Private entities, 12/15/18 annual, 12/15/19 interim periods).
    • Early adoption is permitted only after 12/15/16.
    • Retrospective (if apply in 2017, restate 2015 and 2016 and show a cumulative effect as of 1/1/2015).

Projects Related to Revenue Recognition

• ASU 2014-09: What's the problem?
  – No one seems to care.
    • Survey says more than 3/4 of respondents have not attempted to quantify the effects of the ASU on their financial statements.
    • Survey says more than 1/2 of respondents don’t believe the ASU will materially affect their financial statements.
Projects Related to Revenue Recognition

- FASB is already tweaking the ASU. (So we’re all waiting to see what it will really look like!)
  - Identifying performance obligations and licenses (update expected Q4 2015).
  - Narrow-scope improvements and practical expedients (exposure draft re-deliberations).
  - Principal versus agent (reporting revenues gross versus net) (exposure draft re-deliberations).

Accounting Standards Updates Issued in 2015

- ASU 2015-16  Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments
- ASU 2015-15  Interest—Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements—Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting (SEC Update)
- ASU 2015-14  Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date

Accounting Standards Updates Issued in 2015

- ASU 2015-13  Derivatives and Hedging (Topic 815): Application of the Normal Purchases and Normal Sales Scope Exception to Certain Electricity Contracts within Nodal Energy Markets (a consensus of the FASB Emerging Issues Task Force)
- ASU 2015-11  Inventory (Topic 330): Simplifying the Measurement of Inventory
Accounting Standards Updates Issued in 2015

• ASU 2015-10 Technical Corrections and Improvements
• ASU 2015-09 Financial Services—Insurance (Topic 944): Disclosures about Short-Duration Contracts
• ASU 2015-08 Business Combinations (Topic 805): Pushdown Accounting—Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115 (SEC Update)
• ASU 2015-07 Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) (a consensus of the FASB Emerging Issues Task Force)
• ASU 2015-06 Earnings Per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions (a consensus of the FASB Emerging Issues Task Force)

Accounting Standards Updates Issued in 2015

• 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 2015-01 Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items