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- Earnings per Share
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- Equity Method Investees — SEC Reporting Considerations
- Foreign Currency Transactions and Translations
- Income Taxes
- Initial Public Offerings
- Leases
- Noncontrolling Interests
- Non-GAAP Financial Measures
- Revenue Recognition
- SEC Comment Letter Considerations, Including Industry Insights
- Segment Reporting
- Share-Based Payment Awards
- Statement of Cash Flows

Complimentary printed copies of Deloitte Roadmaps can be ordered (or preordered) from Deloitte’s Roadmap Store.
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Preface

December 5, 2019

To our clients and colleagues in the insurance sector:

We are pleased to present the December 2019 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.

The most notable standard-setting development for insurers in 2019 was the FASB’s issuance in November of ASU 2019-09. The amendments in ASU 2019-09 give certain companies a one-year deferral of the effective date of ASU 2018-12, which makes targeted improvements to the accounting for long-duration contracts issued by insurance entities. The FASB also issued an ASU in November 2019 that delays certain effective dates of its major standards on credit losses, derivatives and hedging, and leases. For a list of significant adoption dates and a summary of the current status of, and next steps for, the FASB’s active projects, see Deloitte’s Quarterly Accounting Roundup (the year-in-review edition will be published soon).

We hope that you find this publication to be a useful resource, and we welcome your suggestions for future improvements to it. If you need assistance or have other questions, we encourage you to consult our industry specialists.

Sincerely,

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Introduction

The financial markets performed strongly in 2019 despite an uptick in volatility toward the end of the year. Increased geopolitical instability and significant weather events also affected many insurers’ earnings. In addition, regulators continue to focus on improving the transparency of insurance companies’ operations to help stakeholders make informed investment choices.

Economic Growth

The U.S. economy grew steadily in 2019. In October 2019, the Federal Reserve cut interest rates for the third time in 2019, which had a positive impact on the valuation of equities. Unemployment rates also hit record lows in 2019.

Insurance companies are focused on enhancing their products and the delivery of those products to attract the interest of younger generations of customers and to compete with the abundance of “InsurTech” companies that are disrupting the traditional insurance distribution model. With changes in both the marketplace and the industry, it is more important than ever for insurers to remain nimble.

Accounting Changes

The standard setters made limited changes to the accounting and financial reporting guidance in 2019, so industry participants focused mainly on adopting or preparing to adopt the major standards issued previously by the FASB.

Last year, the FASB issued ASU 2018-12, which significantly changes the accounting for certain long-duration insurance contracts and the amortization of deferred acquisition costs (DAC) related to long-duration contracts by amending both the accounting and disclosure requirements under U.S. GAAP. The new guidance is intended to improve the transparency of insurers’ financial statements.

In November 2019, the FASB issued ASU 2019-09, which defers ASU 2018-12’s effective date for all entities. Under ASU 2019-09, for SEC filers other than smaller reporting companies (as defined by SEC rules), the guidance in ASU 2018-12 is effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. For all other entities, the guidance in ASU 2018-12 is effective for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024. Early adoption of ASU 2018-12 continues to be available for all entities.

Additional Information

For additional information about industry issues and trends, see Deloitte's 2020 Financial Services Industry Outlooks.
Long-Duration Contracts

**Background**

In August 2018, the FASB issued ASU 2018-12 (codified in ASC 944), which amends the accounting and disclosure model for certain long-duration insurance contracts under U.S. GAAP. The ASU's amendments are intended to improve the following aspects of financial reporting related to 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.
- Presentation and disclosures.

**Key Provisions**

**Liability for Future Policy Benefits Related to Certain Insurance Contracts**

For nonparticipating traditional and limited-payment long-duration contracts, ASU 2018-12's amendments change several aspects of how an insurer measures the liability for future policy benefits, including how frequently the insurer updates its cash flow and discount rate assumptions, the nature of those assumptions, the discount rate used for measurement, and how the insurer accounts for its updated cash flow and discount rate assumptions.

Under the revised measurement model, an insurer's measurement of the liability for future benefits incorporates various assumptions, including (1) discount rate, (2) mortality/morbidity, (3) terminations/lapses, and (4) expenses (excluding acquisition costs and costs required to be charged to expense as incurred). The insurer is prohibited from adding a provision for the risk of adverse deviation to its assumptions. To measure the liability for future policy benefits, the insurer uses a discount rate that (1) is based on the yield of an “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.

**Frequency of Assumption Updates**

Under ASU 2018-12, for nonparticipating traditional and limited-payment contracts, an insurer updates its discount rate assumptions on each reporting date (i.e., in both interim and annual periods). The insurer will review the cash flow assumptions it uses to measure the liability for future policy benefits at least annually (at the same time each year) or more frequently if warranted and update them as necessary. The updated assumptions will reflect the insurer's revised estimate of cash flows expected over the contract group's entire life by using (1) actual historical experience and (2) updated future cash flow assumptions. An insurer may also make an entity-wide election to lock in its expense assumption(s) at contract inception.
Accounting for Assumption Updates

ASU 2018-12 requires that when an insurer measures the liability for future policy benefits related to nonparticipating traditional and limited-payment contracts, it cannot “group contracts . . . from different issue years but [must] group contracts into quarterly or annual groups” when it determines the level of aggregation to use for the measurement. When the insurer determines the impact of the change in cash flow assumptions for the contract group being measured, it will first recalculate a revised net premium ratio as of contract inception. The insurer will 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 by using the original (i.e., at contract issuance) discount rate, and (3) compare that updated liability with the liability's previous carrying amount (excluding the effect of previous discount rate changes) at the beginning of the current reporting period and recognize a cumulative catch-up adjustment in current-period earnings. The catch-up adjustment will be presented separately from the current reporting period's benefit expense in the insurer's statement of operations. The insurer also will compute the current reporting period's benefit expense by using the revised net premium ratio that was computed as of the beginning of the reporting period. Experience adjustments will be recognized in the same reporting period in which they arise. Thereafter, the insurer will measure the liability for future policy benefits by using the revised net premium ratio (until the next assumption update).

If the revised cash flow assumptions indicate that the present value of future benefits and expenses will exceed the present value of future gross premiums, the insurer must 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). The premium deficiency test required under current U.S. GAAP is eliminated for nonparticipating traditional and limited-payment insurance contracts after adoption of the ASU.

If the insurer recognizes a loss because the net premium ratio exceeds 100 percent, it must continue to accrue the liability for future policy benefits in subsequent periods (i.e., until assumptions are subsequently updated) with net premiums set equal to gross premiums. The balance of the liability for future policy benefits for a contract group can never be less than zero.

For updates to the discount rate, the insurer recognizes any changes in the liability for future policy benefits arising from changes in the discount rate as an adjustment to other comprehensive income (OCI) at the time the discount rate is updated (i.e., in the current period). However, the liability's interest accretion rate will continue to be the discount rate that was in effect at contract issuance.

Contracts or Contract Features That Provide for Potential Benefits in Addition to the Account Balance

ASU 2018-12 amends the accounting model for certain universal life–type contracts or contracts that contain features that could provide nontraditional contract benefits in addition to the insured's account balance. An insurer that writes such contracts should first assess whether those features meet the definition of market risk benefits. If so, the insurer applies the market risk benefit guidance described below; if not, the insurer should assess whether to account for the features as derivatives or embedded derivatives under ASC 815.
If the benefits do not meet the criteria to be accounted for as derivatives or embedded derivatives, the insurer determines whether the potential additional benefits are payable only upon annuitization (e.g., annuity purchase guarantees or two-tier annuities). If so, the insurer records an additional liability for the contract feature if the present value of the expected annuitization payments on the expected annuitization date exceeds the expected account balance on the expected annuitization date. The insurer also assesses whether “amounts assessed against the contract holder each period for the insurance benefit feature . . . are assessed in a manner that is expected to result in profits in earlier years and losses in subsequent years from the insurance benefit function.” If so, in addition to the account balance, the insurer records a liability for the death or other insurance benefits.

The accounting models for annuitization and death or other insurance benefits generally have not changed; however, certain aspects of those models have been revised to align with other aspects of the ASU. Those changes were discussed in the January 2019 edition of this publication.

**Market Risk Benefits**

ASU 2018-12 establishes new accounting requirements for market risk benefits, as defined. Examples of market risk benefits include guaranteed minimum benefit features (e.g., guaranteed minimum death benefits or guaranteed minimum income benefits), commonly known as “GMxBs,” but market risk benefits also may include other contract features.

Under the ASU, insurers apply the new market risk benefit accounting model to contracts or contract features contained in both separate-account and general-account nontraditional products. Under that accounting model, a “contract or contract feature that both provides protection to the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk shall be recognized as a market risk benefit.”

When a long-duration contract has multiple market risk benefits, an insurer must bundle those benefits together into a single, compound market risk benefit.

The ASU requires insurers to:

- Initially measure a market risk benefit at fair value. The insurer recognizes subsequent changes in fair value in current earnings; however, any changes in the fair value of a market risk benefit in a liability position that are attributable to changes in the instrument-specific credit risk are 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).

ASU 2018-12 also modifies certain aspects of how an entity computes the additional liability for annuitization or death or other insurance benefits for consistency with the ASU’s other amendments.

**Deferred Acquisition Costs**

ASU 2018-12 changes the manner and timing of DAC amortization for all long-duration contracts, including participating contracts. The amendments also apply to other capitalized balances (e.g., unearned revenue liability for universal life–type contracts) that were previously amortized in proportion to premiums, gross profits, or gross margins.
The ASU establishes a principle that DAC (and the other capitalized costs referred to above) should be amortized to expense “on a constant level basis — either on an individual contract basis or on a grouped contract basis — over the expected term of the related contract(s).” No interest would accrue on the balance of unamortized DAC.

Under the ASU, an insurer amortizes DAC by using assumptions that are consistent with those used to determine the liability for future policy benefits or related balances for the associated contracts (e.g., terminations). The insurer also (1) reduces the DAC balance to reflect actual experience that exceeds expected experience (e.g., an unexpected contract termination) and (2) prospectively treats the effects of any changes in future estimates (e.g., a change in lapse or mortality assumptions) as a revision of future amortization amounts. However, changes in a contract’s profitability do not trigger an adjustment to DAC. An insurer does not assess DAC for impairment.

Revenue Recognition for Limited-Payment Contracts

Under ASC 944, insurers defer the amount of any gross premium received over net premiums for limited-payment contracts. An insurer recognizes these deferred amounts (the “deferred profit liability” or DPL) in income either (1) in a constant relationship with the discounted amount of insurance in force (for life insurance contracts) or (2) with the amount of expected future benefit payments (for annuity contracts) and accrues interest on the unamortized balance. The ASU changes certain aspects of the DPL accounting model to align with the changes made to the accounting model for the liability for future policy benefits for nonparticipating traditional and limited-payment long-duration contracts. Such changes include (1) using the upper-medium-grade fixed-income instrument yield as the discount rate; (2) accreting interest by using the original discount rate as of the date of contract issuance; (3) reviewing and, if necessary, updating the cash flow assumptions used to determine changes in the DPL at least annually; (4) recalculating the beginning of period DPL on the basis of actual experience, the updated cash flow assumptions, and the amortization method; and (5) recognizing a cumulative catch-up adjustment in current-period earnings.

Disclosures

ASU 2018-12 enhances the disclosures that an insurer must provide in both interim and annual financial statements to allow “users to understand the amount, timing, and uncertainty of future cash flows arising from the [insurance] liabilities.” The ASU imposes significant additional disclosure requirements, including those under which an insurer must provide, in interim and annual periods, disaggregated rollforwards and reconciliations of those rollforwards to the aggregate carrying amounts in the statement of financial position for the certain balances.

Effective Date and Transition

Effective Date

In November 2019, the FASB issued ASU 2019-09, which defers the effective date of the amendments in ASU 2018-12 for all entities. As a result of ASU 2019-09, ASU 2018-12 is effective for (1) SEC filers other than smaller reporting companies (as defined by SEC rules) for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years and (2) all other entities for fiscal years beginning after December 15, 2023, including interim periods within fiscal years beginning after December 15, 2024. Early adoption of ASU 2018-12 continues to be available for all entities.

For more information about ASU 2019-09, see Deloitte’s November 2019 Insurance Spotlight.

When an insurance contract has accumulation and payout phases, the insurer treats the payout phase as a separate contract. Accordingly, the insurer amortizes DAC related to the contract over the duration of the accumulation phase.

1
Transition
ASU 2018-12 provides account-specific transition guidance, as summarized in the January 2019 edition of this publication.

Comparison With IFRS Standards
As discussed in the January 2019 edition of this publication, certain aspects of the accounting and disclosure model for insurance contracts in IFRS 17 differ significantly from those in ASU 2018-12.

Additional information about IFRS 17 is available on Deloitte's IASPlus Web site.

Revenue Recognition

Standard Setting
There were no substantive standard-setting activities this year related to the FASB’s new revenue standard (ASC 606). Calendar-year-end PBEs adopted ASC 606 in the first quarter of 2018, and nonpublic entities have been adopting it in 2019.

In the January 2019 edition of this publication, we addressed implementation topics related to insurance, including accounting for third-party extended service warranty contracts. The AICPA’s Insurance Entities Revenue Recognition Task Force has addressed these and other implementation issues. Finalized Issues are included in Chapter 14 of the AICPA Audit and Accounting Guide Revenue Recognition.

Disclosure Themes Upon Adoption
While some companies made wholesale changes to their financial statements upon the adoption of ASU 2014-09, others were not significantly affected by the new guidance. However, the standard’s new and modified quantitative and qualitative disclosure guidance significantly increased the amount of information that entities in the insurance industry must disclose about revenue activities and related transactions.

Deloitte’s A Roadmap to SEC Comment Letter Considerations, Including Industry Insights highlights some key themes regarding the application of ASC 606 in connection with accounting and disclosure requirements and includes excerpts of SEC comments. As entities navigate ASC 606's disclosure requirements, they may benefit from evaluating the trends described in that publication.
Financial Instruments

Classification and Measurement

Background

In January 2016, the FASB issued ASU 2016-01, which amends the guidance in U.S. GAAP on the classification and measurement of financial instruments 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 that are 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 related to available-for-sale (AFS) debt securities.
- Disclosure requirements for financial assets and financial liabilities.

Before the adoption of ASU 2016-01, marketable equity securities other than equity method investments or those that result in consolidation of the investee 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, before the adoption of ASU 2016-01, insurance entities recognize in OCI changes in the fair value of nonmarketable equity securities. After the adoption of ASU 2016-01, 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.

In February 2018, the FASB issued ASU 2018-03 to clarify certain aspects of the guidance in ASU 2016-01. For more information about the ASUs, see Deloitte’s January 12, 2016, Heads Up and the January 2019 edition of this publication.

Codification Improvements

In April 2019, the FASB issued ASU 2019-04, which clarified certain aspects of the guidance in ASU 2016-01 on the accounting for financial instruments:

- Held-to-maturity debt securities fair value disclosures — Entities other than PBEs are exempt from the “fair value disclosure requirements for financial instruments not measured at fair value on the balance sheet.”
- Measurement alternative in ASC 321-10-35-2 — The measurement alternative in ASC 321-10-35-2 for equity securities without readily determinable fair values represents a nonrecurring fair value measurement under ASC 820; therefore, such securities should be remeasured at fair value when an entity identifies an orderly transaction “for an identical or similar investment of the same issuer,” and applicable ASC 820 disclosures are required.
• **Remeasurement of equity securities at historical exchange rates** — An entity should remeasure equity securities without readily determinable fair values subject to the measurement alternative at historical exchange rates. In addition, the historical exchange rate used should be the rate that existed on the later of (1) the acquisition date or (2) the most recent fair value measurement date.

The amendments in ASU 2019-04 related to ASU 2016-01 are effective for fiscal years beginning after December 15, 2019, including interim periods therein. Early adoption is permitted in any interim period after issuance of ASU 2019-04 for those entities that have already adopted ASU 2016-01.

The amendments related to equity securities without readily determinable fair values require prospective application; however, the remaining amendments should be “applied on a modified-retrospective transition basis by means of a cumulative-effect adjustment to the opening retained earnings balance in the statement of financial position as of the date an entity adopted all of the amendments in Update 2016-01.” ASU 2019-04 also requires certain transition disclosures. For more information, see Deloitte’s May 7, 2019, *Heads Up*.

In addition, the FASB issued a [proposed ASU](#) in September 2019 aimed at reducing the cost and complexity of determining whether debt should be classified as current or noncurrent in a classified balance sheet. The proposed ASU would amend the current guidance in ASC 470-10 and establish a uniform principle for determining debt classification. It would also provide application guidance that clarifies how covenant violations, covenant waivers, post-balance-sheet refinancing transactions, and subjective acceleration clauses affect debt classification.

### 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., deferred acquisition costs 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.
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. See the January 2019 edition of this publication for additional information about ASU 2017-08, including detailed discussion of the ASU’s scope, as well as its effective dates and transition approaches.

**Fair Value Measurement Disclosures**

**Background**

In August 2018, the FASB issued **ASU 2018-13**, which changes the fair value measurement disclosure requirements in ASC 820. The ASU’s amendments are the result of a broader disclosure project on notes to financial statements that culminated in the issuance of Chapter 8 of FASB Concepts Statement 8 in August 2018.

**ASU 2018-13 at a Glance**

The table below summarizes the ASU’s amendments and indicates the types of entities to which they apply upon adoption.

<table>
<thead>
<tr>
<th>Summary of Changes to ASC 820</th>
<th>Applicable to:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Entities Other Than Nonpublic Entities</td>
</tr>
<tr>
<td>New Disclosure Requirements:</td>
<td></td>
</tr>
<tr>
<td>Changes in unrealized gains or losses included in OCI for recurring Level 3 fair value measurements held at the end of the reporting period</td>
<td>Yes</td>
</tr>
<tr>
<td>Explicit requirement to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements</td>
<td>Yes</td>
</tr>
<tr>
<td>Eliminated Disclosure Requirements:</td>
<td></td>
</tr>
<tr>
<td>Amount of and reasons for transfers between Level 1 and Level 2</td>
<td>Yes</td>
</tr>
<tr>
<td>Valuation processes for Level 3 fair value measurements</td>
<td>Yes</td>
</tr>
<tr>
<td>Policy for timing of transfers between levels of the fair value hierarchy</td>
<td>Yes</td>
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<tr>
<td>Changes in unrealized gains and losses included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period</td>
<td>No</td>
</tr>
<tr>
<td>Modified Disclosure Requirements:</td>
<td></td>
</tr>
<tr>
<td>Deletion of “at a minimum” from the phrase “an entity shall disclose at a minimum,” which is intended to promote the appropriate exercise of discretion by entities</td>
<td>Yes</td>
</tr>
<tr>
<td>Ability to disclose transfers into and out of Level 3 and purchases and issues of Level 3 assets and liabilities in lieu of reconciling the opening balances to the closing balances of recurring Level 3 fair value measurements</td>
<td>No</td>
</tr>
</tbody>
</table>

² Nonpublic entities are still subject to the quantitative requirements in ASC 820-10-50-2(bbb)(2) but are not subject to the requirements in ASC 820-10-50-2(bbb)(2)(i).

³ Under current U.S. GAAP, nonpublic entities are exempt from this disclosure requirement. Accordingly, elimination or modification of this disclosure requirement by the ASU does not affect nonpublic entities.
(Table continued)

<table>
<thead>
<tr>
<th>Summary of Changes to ASC 820</th>
<th>Applicable to:</th>
</tr>
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<tbody>
<tr>
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<td>Entities Other Than Nonpublic Entities</td>
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<tr>
<td><strong>Modified Disclosure Requirements:</strong></td>
<td>Yes</td>
</tr>
<tr>
<td>Clarification that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date</td>
<td>Yes</td>
</tr>
<tr>
<td>For investments in certain entities that calculate net asset value, a requirement to disclose the timing of liquidation of an investee’s assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Effective Date and Transition**

ASU 2018-13 is effective for all entities for fiscal years beginning after December 15, 2019, including interim periods therein. Early adoption is permitted upon the ASU’s issuance, including in any interim period for which financial statements have not yet been issued or made available for issuance. Entities making this election are permitted to early adopt the eliminated or modified disclosure requirements\(^5\) and delay the adoption of all the new disclosure requirements\(^6\) until their effective date.

Entities would use the prospective method (for only the most recent interim or annual period presented in the initial fiscal year of adoption) to adopt the new disclosure requirements related to (1) changes in unrealized gains and losses included in OCI and (2) the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. They would also apply the prospective method to adopt modifications to their disclosures as a result of the requirement to use a narrative description of measurement uncertainty. The effects of all other amendments made by the ASU must be applied retrospectively to all periods presented.\(^7\)

For more information about ASU 2018-13, see Deloitte’s August 31, 2018, *Heads Up*.

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\(^4\) See footnote 3.

\(^5\) See ASC 820-10-65-12(c), which states that “an entity is permitted to early adopt the removed or modified disclosures in paragraph 820-10-50-2(bb), (c)(3), (f), and (g), paragraph 820-10-50-2G, and paragraph 820-10-50-6A(b) and (e).”

\(^6\) See ASC 820-10-65-12(c), which states that an entity may “adopt the additional disclosures in paragraph 820-10-50-2(bbb)(2)(i) and (d) upon their effective date.”

\(^7\) See ASC 820-10-65-12(b), which states that “[a]n entity shall apply the pending content that links to this paragraph retrospectively to all periods presented, except for the changes in unrealized gains and losses required by paragraph 820-10-50-2(d), the range and weighted-average disclosure required by paragraph 820-10-50-2(bbb)(2)(i), and the narrative description of measurement uncertainty in accordance with paragraph 820-10-50-2(g) that are required to be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption.”
Credit Losses

Background
The approach used to recognize impairment losses on financial assets has long been identified as a major weakness in current U.S. GAAP, resulting in delayed recognition of such losses and leading to increased scrutiny during the financial crisis. After years of deliberating various models to remedy that weakness (some jointly with the International Accounting Standards Board), the FASB issued its new standard on the measurement of expected credit losses, ASU 2016-13 (codified as ASC 326).

ASU 2016-13 adds to U.S. GAAP an impairment model (known as the current expected credit loss (CECL) model) that is based on expected losses rather than incurred losses. That is, the expected credit losses estimated over the lifetime of a financial instrument are recognized at inception (i.e., on day 1). 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). The FASB believes that the new guidance will result in more timely recognition of such losses. ASU 2016-13 is also intended to reduce the complexity of U.S. GAAP by decreasing the number of credit impairment models that entities use to account for debt instruments.

Effective Date Changes and Transition
In November 2019, the FASB issued ASU 2019-10, which gives private companies, not-for-profit (NFP) organizations, and certain small public companies additional time to implement FASB standards on credit losses, leases, and hedging. For more information about ASU 2019-10, see Deloitte’s November 19, 2019, Heads Up.

Upon the adoption of ASU 2016-13, all entities record a cumulative-effect adjustment in retained earnings on the balance sheet as of the beginning of the year of adoption (i.e., retrospective application is prohibited).

For more information about ASU 2016-13, see Deloitte’s June 17, 2016, Heads Up.
Other Developments

**Final ASUs**

ASU 2019-04 also makes certain technical corrections and amendments to the guidance on credit losses in ASC 326. The tables below, which are reproduced from ASU 2019-04, summarize those amendments. For additional information, see Deloitte’s May 7, 2019, *Heads Up*.

<table>
<thead>
<tr>
<th>Area for Improvement</th>
<th>Summary of Amendments</th>
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<tbody>
<tr>
<td><strong>Issue 1A: Accrued Interest</strong></td>
<td>The amendments to Subtopic 326-20 allow an entity to:</td>
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<td>a. Measure the allowance for credit losses on accrued interest receivable balances separately from other components of the amortized cost basis of associated financial assets.</td>
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<td>b. Make an accounting policy election not to measure an allowance for credit losses on accrued interest receivable amounts if an entity writes off the uncollectible accrued interest receivable balance in a timely manner and makes certain disclosures.</td>
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<td>c. Make an accounting policy election to write off accrued interest amounts by reversing interest income or recognizing credit loss expense, or a combination of both. The entity also is required to make certain disclosures.</td>
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<td>d. Make an accounting policy election to present accrued interest receivable balances and the related allowance for credit losses for those accrued interest receivable balances separately from the associated financial assets on the balance sheet. If the accrued interest receivable balances and the related allowance for credit losses are not presented as a separate line item on the balance sheet, an entity should disclose the amount of accrued interest receivable balances and the related allowance for credit losses and where the balance is presented.</td>
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<td>e. Elect a practical expedient to disclose separately the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements.</td>
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<td>Certain amendments in (a) through (e) above are applicable to Subtopic 326-30.</td>
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</table>
### Issue 1B: Transfers Between Classifications or Categories for Loans and Debt Securities

Subtopics 310-10, Receivables — Overall, and 948-310, Financial Services — Mortgage Banking — Receivables, provide guidance on how an entity should account for loans with various classifications. While a significant portion of that guidance was superseded by Update 2016-13, stakeholders questioned how to account for the allowance for credit losses or valuation allowance when transferring nonmortgage loans between classifications (that is, not-held-for-sale and held-for-sale classifications) and mortgage loans between classifications (that is, held-for-long-term-investment and held-for-sale classifications).

Subtopic 320-10, Investments — Debt Securities — Overall, provides guidance on how an entity should account for transfers of debt securities between categories. Stakeholders questioned how to account for the allowance for credit losses when transferring debt securities between the available-for-sale category and the held-to-maturity category.

The amendments require that an entity reverse in earnings, any allowance for credit losses or valuation allowance previously measured on a loan or debt security, reclassify and transfer the loan or debt security to the new classification or category, and apply the applicable measurement guidance in accordance with the new classification or category.

### Issue 1C: Recoveries

The guidance in paragraph 326-20-35-8 states that recoveries of financial assets and trade receivables previously written off should be recorded when received. Without proper clarification, stakeholders noted that this guidance could be interpreted to prohibit the inclusion of recoveries in the estimation of expected credit losses on financial assets measured at amortized cost basis.

Furthermore, stakeholders questioned how an entity should account for an amount expected to be collected greater than the amortized cost basis.

The amendments clarify that an entity should include recoveries when estimating the allowance for credit losses.

The amendments clarify that expected recoveries of amounts previously written off and expected to be written off should be included in the valuation account and should not exceed the aggregate of amounts previously written off and expected to be written off by the entity. In addition, for collateral-dependent financial assets, the amendments clarify that an allowance for credit losses that is added to the amortized cost basis of the financial asset(s) should not exceed amounts previously written off.

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<td><strong>Issue 2A: Conforming Amendment to Subtopic 310-40</strong></td>
<td>Stakeholders noted that the cross-reference to paragraph 326-20-35-2 in Example 2 in Subtopic 310-40, Receivables — Troubled Debt Restructurings by Creditors, is incorrect. The illustration describes an entity that determines that foreclosure is probable on a collateral-dependent loan. Therefore, stakeholders asked whether the cross-reference should instead link to paragraphs 326-20-35-4 through 35-5, which require that an entity use the fair value of collateral to determine expected credit losses when foreclosure is probable. The amendment clarifies the illustration by removing the incorrect cross-reference to paragraph 326-20-35-2 and replacing it with the correct cross-reference to paragraphs 326-20-35-4 through 35-5, which require that an entity use the fair value of collateral to determine expected credit losses when foreclosure is probable.</td>
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<tr>
<td><strong>Issue 2B: Conforming Amendment to Subtopic 323-10</strong></td>
<td>Stakeholders noted that the guidance on equity method losses in paragraphs 323-10-35-24 and 323-10-35-26 was not amended in Update 2016-13. Specifically, the guidance describes the allocation of equity method losses when an investor has other investments, such as loans and debt securities, in equity method investee. Stakeholders asked whether the guidance should refer an entity to Topic 326 for the subsequent measurement of those loans and debt securities. The amendment clarifies the equity method losses allocation guidance in paragraphs 323-10-35-24 and 323-10-35-26 by adding cross-references to Subtopics 326-20 and 326-30 for the subsequent measurement of loans and available-for-sale debt securities, respectively.</td>
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<td><strong>Issue 2C: Clarification That Reinsurance Recoverables Are Within the Scope of Subtopic 326-20</strong></td>
<td>Stakeholders asked whether reinsurance recoverables measured on a net present value basis in accordance with Topic 944, Financial Services — Insurance, are within the scope of Subtopic 326-20. As written, the scope could be interpreted to exclude those recoverables because they are not measured at amortized cost basis. The amendment clarifies the Board’s intent to include all reinsurance recoverables within the scope of Topic 944 within the scope of Subtopic 326-20, regardless of the measurement basis of those recoverables.</td>
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| **Issue 2D: Projections of Interest Rate Environments for Variable-Rate Financial Instruments** | Stakeholders asked whether the prohibition of using projections of future interest rate environments in estimating expected future cash flows and determining the effective interest rate to discount expected cash flow for variable-rate financial instruments was consistent with the Board's intent. As written, an entity that chooses to use a discounted cash flow method to determine expected credit losses on a variable-rate financial instrument is precluded from forecasting changes in the variable rate for the purposes of estimating expected cash flows and determining the effective interest rate with which to discount those cash flows. Stakeholders also asked if an entity is required to use a prepayment-adjusted effective interest rate if it uses projections of interest rate environments for variable-rate financial instruments in estimating expected cash flows.  

The amendments clarify the Board's intent to provide flexibility in determining the allowance for credit losses by removing the prohibition of using projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate financial instruments. The amendments clarify that an entity that uses projections or expectations of future interest rate environments in estimating expected cash flows should use the same assumptions in determining the effective interest rate used to discount those expected cash flows. The amendments also clarify that if an entity uses projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate financial instruments, it also should adjust the effective interest rate to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments. |
| **Issue 2E: Consideration of Prepayments in Determining the Effective Interest Rate** | Stakeholders asked whether an entity may adjust the effective interest rate used to discount expected cash flows in a discounted cash flow method for the entity's expectations of prepayments on financial assets. Stakeholders noted that expected prepayments are required to be considered in estimating expected cash flows. However, they noted that without incorporating those expected prepayments into determining the effective interest rate, the discounted cash flow calculation fails to appropriately isolate credit risk in the determination of an allowance for credit losses.  

The amendments permit an entity to make an accounting policy election to adjust the effective interest rate used to discount expected future cash flows for expected prepayments on financial assets within the scope of Subtopic 326-20 and on available-for-sale debt securities within the scope of Subtopic 326-30 to appropriately isolate credit risk in determining the allowance for credit losses. The amendments also clarify that an entity should not adjust the effective interest rate used to discount expected cash flows for subsequent changes in expected prepayments if the financial asset is restructured in a troubled debt restructuring. |
Area for Improvement | Summary of Amendments
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**Issue 2F: Consideration of Estimated Costs to Sell When Foreclosure Is Probable**

Stakeholders asked whether an entity is required to consider estimated costs to sell the collateral when using the fair value of [the] collateral to estimate expected credit losses on a financial asset because foreclosure is probable in accordance with paragraph 326-20-35-4. Stakeholders noted that the collateral-dependent financial asset practical expedient in paragraph 326-20-35-5 requires that an entity consider estimated costs to sell if repayment or satisfaction of the asset depends on the sale of the collateral.

Stakeholders also noted that paragraphs 326-20-35-4 through 35-5 require that an entity adjust the fair value of collateral for the estimated costs to sell on a discounted basis if it intends to sell rather than operate the collateral. Stakeholders asked why an entity is required to estimate the costs to sell on a discounted basis if the fair value of collateral should be based on amounts as of the reporting date.

The amendments clarify the guidance in paragraph 326-20-35-4 by specifically requiring that an entity consider the estimated costs to sell if it intends to sell rather than operate the collateral when the entity determines that foreclosure on a financial asset is probable.

Additionally, the amendments clarify the guidance that when an entity adjusts the fair value of collateral for the estimated costs to sell, the estimated costs to sell should be undiscounted if the entity intends to sell rather than operate the collateral.

**Issue 5A: Vintage Disclosures — Line-of-Credit Arrangements Converted to Term Loans**

Stakeholders asked how an entity should disclose line-of-credit arrangements that convert to term loans within the vintage disclosure table.

The amendments require that an entity present the amortized cost basis of line-of-credit arrangements that are converted to term loans in a separate column as illustrated in Example 15.

**Issue 5B: Contractual Extensions and Renewals**

Stakeholders asked whether an entity should consider contractual extension or renewal options in determining the contractual term of a financial asset. Stakeholders stated that the guidance in paragraph 326-20-30-6 appears to preclude an entity from considering those contractual extension or renewal options.

The amendments clarify that an entity should consider extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.

In May 2019, the FASB issued ASU 2019-05, which allows entities to irrevocably elect, upon the adoption of ASU 2016-13, the fair value option for financial instruments that (1) were previously recorded at amortized cost, (2) are within the scope of ASC 326-20, and (3) are eligible for the fair value option under ASC 825-10. Entities would make this election on an instrument-by-instrument basis. The fair value option election does not apply to held-to-maturity debt securities.

First-time adopters of ASU 2016-13 would elect the fair value option upon their adoption of ASU 2016-13 and would apply a modified retrospective approach under which the cumulative effect of the election would be recorded in beginning retained earnings in the period of adoption. Early adoption is permitted in any interim period within the fiscal years beginning after December 15, 2018, provided that the entity has adopted ASU 2016-13. ASU 2019-10 gives private companies, NFP organizations,
and certain small public companies additional time to implement the FASB's major standards on credit losses, leases, and hedging (for more information, see Deloitte's November 19, 2019, Heads Up).

In November 2019, the FASB issued ASU 2019-11, which amends certain aspects of the Board's new credit losses standard, including guidance related to the following:

- Purchased credit-deteriorated financial assets.
- Transition relief for troubled debt restructurings.
- Disclosure relief for accrued interest receivable.
- Financial assets secured by collateral maintenance provisions.

ASU 2019-11 also makes conforming amendments to ASC 805-20. For entities that have not yet adopted ASU 2016-13, the amendments in ASU 2019-11 are effective on the same date as those in ASU 2016-13. For entities that have adopted ASU 2016-13, the amendments in ASU 2019-11 are effective for fiscal years beginning after December 15, 2019, and interim periods therein.

For more information about ASU 2019-11, see Deloitte's December 2, 2019, Heads Up.

Hedging

Targeted Improvements to the Accounting for Hedging Activities

Background

In August 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. However, as a result of subsequent stakeholder feedback on the ASU, the FASB decided to make certain Codification improvements, some of which were addressed in ASU 2019-04.

Key Changes to the Hedge Accounting Model

ASU 2019-04 clarified various aspects of ASU 2017-12, including its guidance on the following:

- Certain aspects of partial-term fair value hedges of interest rate and foreign exchange risk.
- The amortization period for fair value hedge basis adjustments.
- Disclosure requirements for fair value hedge basis adjustments when the hedged item is an AFS debt instrument.
- Consideration of the hedged contractually specified interest rate for measuring hedge effectiveness for a cash flow hedge when the hypothetical derivative method is used.
- Application of a first-payments-received cash flow hedging technique to overall cash flows on a group of variable interest payments.
- The requirements for NFP entities related to the treatment of an excluded component in a fair value hedge.
- The transition relief provided for certain NFP entities.
- Transition guidance for all entities.
Effective Date and Transition
As noted in ASU 2019-04, “[f]or entities that have not yet adopted the amendments in Update 2017-12 as of the issuance date of this Update, the effective dates and transition requirements for the amendments to Topic 815 are the same as the effective dates and transition requirements in Update 2017-12.” See the Changes to Effective Dates section below.

For entities that have adopted ASU 2017-12, ASU 2019-04 is effective “as of the beginning of the first annual reporting period beginning after the date of issuance of Update 2019-04.” Those entities may early adopt ASU 2019-04 at any time after its issuance.


Changes to Effective Dates
In November 2019, the FASB issued ASU 2019-10, which (1) provides a framework to stagger effective dates for future major accounting standards and (2) gives private companies, NFP organizations, and certain small public companies additional time to implement the FASB’s major standards on credit losses, leases, and hedging. For more information about ASU 2019-10, see Deloitte’s November 19, 2019, *Heads Up*.

Implementation Developments
The FASB is continuing its efforts to improve ASU 2017-12. For example, in November 2019, the Board issued a proposed ASU that would clarify certain aspects of the ASU, including (1) changes in hedged risk in a cash flow hedge, (2) contractually specified components in cash flow hedges of nonfinancial forecasted transactions, (3) foreign-currency-denominated debt instruments designated as hedging instruments and hedged items, and (4) using the term “prepayable” under the shortcut method. Comments on the proposed ASU are due by January 13, 2020.

In addition, the FASB’s technical agenda includes a narrow-scope project on the last-of-layer method. As indicated on the Board’s project update page, the FASB held a meeting on August 21, 2019, at which it “discussed outreach performed and issues encountered in (1) developing a last-of-layer model for multiple layers and (2) potentially providing further guidance on the accounting for fair value hedge basis adjustments for both the existing single-layer model and proposed multiple-layer model.” At its October 16, 2019, meeting, the FASB reached tentative decisions related to its project on last-of-layer hedging. See Deloitte’s October 22, 2019, journal entry for further details.

SOFR OIS Rate as a Benchmark Interest Rate
In October 2018, the FASB issued ASU 2018-16, which permits entities to use the SOFR OIS rate as a U.S. benchmark interest rate for hedge accounting purposes under ASC 815. The ASU defines the SOFR OIS rate as the “fixed rate on a U.S. dollar, constant-notional interest rate swap that has its variable-rate leg referenced to the [SOFR] (an overnight rate) with no additional spread over SOFR on that variable-rate leg. That fixed rate is the derived rate that would result in the swap having a zero fair value at inception because the present value of fixed cash flows, based on that rate, equates to the present value of the variable cash flows.”
Entities that have not yet adopted ASU 2017-12 must adopt ASU 2018-16 when they adopt ASU 2017-12. If an entity has already adopted ASU 2017-12, the effective date of ASU 2018-16 will be as follows:

- For PBEs, for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.
- For all other entities, for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years.

Early adoption is permitted in any interim period after issuance of the ASU. Entities will adopt the ASU prospectively “for qualifying new or redesignated hedging relationships entered into on or after the date of adoption.”

For additional information about ASU 2018-16, see Deloitte’s November 7, 2018, journal entry.

**Reference Rate Reform**

In response to the market-wide migration away from the LIBOR and other IBOR reference rates, the FASB has initiated a project on reference rate reform. The Board held several meetings in 2019 to discuss the project and to consider hedge accounting relief and broader transition implications. For information about the tentative views expressed by the Board at these meetings, see Deloitte’s June 26, 2019, and July 22, 2019, journal entries.

As a result of the meetings, (1) the Board issued a proposed ASU in September 2019. At its November 13, 2019, meeting, the Board discussed feedback on the proposed ASU and tentatively decided to provide “temporary, optional guidance to ease the potential burden in accounting for, or recognizing the effects of, reference rate reform on financial reporting.” The FASB directed its staff to draft a final ASU for a vote by written ballot.

In addition, the SEC staff issued a statement in July 2019 on LIBOR transition that includes:

- A discussion of the expected discontinuation of LIBOR use and how the transition from LIBOR may significantly affect financial markets and market participants (including public companies, investment companies and advisers, and broker-dealers).
- Questions and considerations for market participants related to new or existing contracts and other business risks.

Although there are still some questions about the ultimate resolution and timing of the transition from LIBOR, the SEC staff strongly encourages market participants that have not already done so to begin assessing their risks associated with the transition. Furthermore, the staff notes that it is actively monitoring participants’ progress with their risk identification and risk management efforts related to the LIBOR transition. The statement notes the following regarding existing and new contracts:

- **Existing contracts** — Market participants are encouraged to assess their exposure to LIBOR in existing contracts that extend beyond 2021 in a timely manner to avoid potential market or business disruptions. As specified in the statement, many such contracts “did not contemplate the permanent discontinuation of LIBOR and, as a result, there may be uncertainty or disagreement over how the contracts should be interpreted. In addition, in circumstances where the contractual interpretation is clear, the adjustment may be inconsistent with expectations of
the affected parties” (e.g., a floating-rate contract would become fixed-rate). Since renegotiating contracts with counterparties can be time-consuming, it is important for market participants to promptly assess their LIBOR exposure.

- **New contracts** — Market participants that enter into new contracts are encouraged to assess whether those contracts should refer to an alternative reference rate instead of LIBOR or should incorporate fallback provisions that take into account the LIBOR transition. The statement notes that the “ARRC has published recommended fallback language for new issuances of floating rate notes, syndicated loans, bilateral business loans, and securitizations” (footnotes omitted). The staff also acknowledges the efforts of the International Swaps and Derivatives Association to develop “robust fallback language” for derivative contracts.

Further, the SEC staff urged registrants to consider other business risks that may be affected by the discontinuation of LIBOR as well as to consider providing additional disclosures about the status of risk identification and appropriate information regarding exposures. See Deloitte’s August 6, 2019, Heads Up, for more information about the statement.

## Leases

As discussed in the January 2019 edition of this publication, the primary objective of the FASB’s leases project 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\(^8\) (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). For comprehensive guidance, see Deloitte’s A Roadmap to Applying the New Leasing Standard.

### 2019 Developments

#### ASU 2019-01 (Issued March 2019)

As issued, the new leasing standard (ASU 2016-02, codified as ASC 842) eliminated the fair value option provided in ASC 840-10-55-44 for determining fair value and its application to lease classification and measurement for lessors that are not manufacturers or dealers (qualifying lessors). In response to feedback on ASC 842 from stakeholders, the Board decided to issue ASU 2019-01, which amends ASC 842 to establish a fair value exception that is similar to the one provided in ASC 840-10-55-44. In addition, ASU 2019-01 eliminates the guidance in ASC 842 that conflicts with the industry-specific guidance in ASC 942 for depository and lending lessors on the presentation of principal payments received from sales-type and direct financing leases. Accordingly, depository and lending lessors should classify principal payments received from sales-type and direct financing leases as “investing activities.”

Finally, ASU 2019-01 clarifies the guidance in ASC 842-10-65-1(i) by specifying that interim disclosures about the effect on income in the year of adoption of ASC 842 are excluded from the required disclosures during the transition from ASC 840 to ASC 842.

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\(^8\) Assuming that the lessee has made an accounting policy election not to account for short-term leases on the balance sheet.
Assessing the Collectibility of Operating Lease Receivables

In November 2018, the FASB issued ASU 2018-19 to clarify certain aspects of ASU 2016-13. The guidance clarifies that operating lease receivables are not within the scope of ASC 326-20 and that an entity would instead apply other U.S. GAAP to account for changes in the collectibility assessment for operating leases.

Although ASU 2018-19 amended only ASC 326, which is not effective for calendar-year PBEs until January 1, 2020, we believe that the FASB's clarification that operating lease receivables are within the scope of ASC 842 rather than ASC 326 may result in a change in how some lessors account for the collectibility of operating lease receivables upon the adoption of ASC 842. We understand that there is currently diversity in practice related to how some lessors account for credit losses associated with operating lease receivables under ASC 840. For example, under current practice, certain lessors account for the collectibility of operating lease receivables in a manner consistent with the way they account for the collectibility of trade receivables (i.e., recognize an allowance for uncollectible accounts and a corresponding bad-debt expense), whereas others account for these credit losses as an adjustment to the related lease income.

Given the potential change, while adopting ASC 842 in 2019, lessors have inquired about the appropriate accounting for operating lease receivables recognized by a lessor that are or are expected to become impaired since they are excluded from the scope of the new impairment guidance in ASC 326. On the basis of a technical inquiry with the FASB staff earlier this year, we understand the following:

- Application of the guidance in ASC 842-30 requiring an assessment of the probability of an individual customer's (tenant's) future payment is mandatory.
- A lessor may elect to supplement the ASC 842-30 guidance with the use of a general or portfolio reserve approach (aligned with the legacy application of ASC 450-20).
- If a lessor elects to record a general reserve, the income statement impact may be recorded as a reduction to lease income or as bad-debt expense.
- Given the expected diversity in practice, consistent application and transparent disclosure of the policy elected are critical.

See Deloitte’s July 1, 2019, Financial Reporting Alert on assessing the collectibility of operating lease receivables for more information about this topic.

Effective Date Changes

In November 2019, the FASB issued ASU 2019-10, which (1) provides a framework to stagger effective dates for future major accounting standards and (2) gives private companies, NFP organizations, and certain small public companies additional time to implement the FASB's major standards on credit losses, leases, and hedging. For more information about ASU 2019-10, see Deloitte’s November 19, 2019, Heads Up.
Income Taxes

**Proposed ASUs on Disclosure Requirements and Simplifying the Accounting for Income Taxes**

**FASB Proposes Changes to Income Tax Disclosure Requirements**

In March 2019, the FASB issued a proposed ASU that would modify or eliminate certain requirements related to income tax disclosures as well as establish new disclosure requirements. The proposed guidance, which is part of the Board’s disclosure framework project, is intended to increase the relevance of income tax disclosures for financial statement users.

The proposed ASU is a revised version of the FASB’s July 2016 exposure draft on changes to the income tax disclosure requirements. The Board discussed stakeholder feedback on the initial exposure draft in January 2017 and again in November 2018, when it also assessed whether updates would be needed as a result of the 2017 Tax Cuts and Jobs Act.

The proposed ASU would affect various disclosure topics in ASC 740, including those related to the disaggregation of certain metrics (i.e., income (or loss) from continuing operations), indefinitely reinvested foreign earnings, unrecognized tax benefits, valuation allowances, a company’s rate reconciliation, and operating loss and tax credit carryforwards. It would also affect interim disclosure requirements and make other minor changes to existing guidance. Entities would be required to adopt the proposed ASU’s guidance prospectively. The FASB will determine an effective date, and whether early adoption is permitted, in subsequent meetings about the proposal.

Comments on the proposed ASU were due to the FASB by May 31, 2019. The Board is expected to redeliberate the proposed ASU on the basis of feedback received from stakeholders. The final standard will be drafted after those redeliberations.

For more information about the proposed ASU, see Deloitte’s March 29, 2019, *Heads Up*.

**FASB Proposes Simplifications to the Accounting for Income Taxes**

In May 2019, the FASB issued a proposed ASU that would modify ASC 740 to simplify the accounting for income taxes under GAAP. The suggested changes were originally submitted by stakeholders in connection with the FASB’s simplification initiative, which is intended to reduce complexity in accounting standards.

The proposed ASU would affect various aspects of ASC 740, including the accounting for taxes under hybrid tax regimes, the accounting for increases in goodwill, the allocation of tax amounts to separate company financial statements within a group that files a consolidated tax return, intraperiod tax allocation, interim-period accounting, and the accounting for ownership changes in investments, among other minor codification improvements.

At its meeting on September 4, 2019, the FASB discussed comments received from stakeholders on the proposed ASU. The Board made tentative decisions about the transition method entities may apply when adopting the proposed amendments, the effective dates applicable to PBEs and non-PBEs, and early adoption. The FASB directed its staff to draft a final ASU for the Board’s vote by written ballot. The FASB expects to complete and approve the final standard in the fourth quarter of 2019.

For additional information about the FASB’s tentative decisions on the proposed ASU, see the summary of the September 4 meeting and Deloitte’s May 29, 2019, *Heads Up* on the proposed guidance.
SEC Comment Letter Themes Related to Income Taxes

The SEC staff's comments to registrants about income taxes continue to focus on (1) valuation allowances, (2) disclosures related to the income tax rate, (3) the tax effects of significant or unusual transactions that occurred during a period, (4) noncompliance with disclosure requirements (e.g., omission of required disclosures), and (5) the impacts of the 2017 Tax Cuts and Jobs Act.

Further, the SEC staff often asks registrants to provide early-warning disclosures to help financial statement users understand key estimates and assumptions related to recording these items and how changes to those estimates and assumptions could potentially affect the financial statements in the future. The SEC staff also continues to issue comments on non-GAAP measures, with a particular focus on the income tax impact of adjustments made to GAAP measures. For additional information about non-GAAP measures, see Deloitte’s *A Roadmap to Non-GAAP Financial Measures*.

Historically, the SEC staff has stated that boilerplate language should be avoided with respect to income tax disclosures in MD&A and that approaches more conducive to effective disclosure would include:

- Using the income tax rate reconciliation as a starting point, and describing the details of the material items.
- Discussing significant foreign jurisdictions, including statutory rates, effective rates, and the current and future impact of reconciling items.
- Providing meaningful disclosures about known trends and uncertainties, including expectations regarding the countries where registrants operate.

For more information about SEC comment letter themes that may pertain to the insurance industry, see Deloitte’s *A Roadmap to SEC Comment Letter Considerations, Including Industry Insights* and Appendix E of Deloitte’s *A Roadmap to Accounting for Income Taxes*, which contains excerpts of SEC comments.

Consolidation

In October 2018, the FASB issued ASU 2018-17, which amends two aspects of the related-party guidance in ASC 810. Specifically, the ASU (1) adds an elective private-company scope exception to the variable interest entity (VIE) guidance for entities under common control and (2) removes a sentence in ASC 810-10-55-37D regarding the evaluation of fees paid to decision makers to conform with the amendments in ASU 2016-17 (issued in October 2016).

**Key Provisions of ASU 2018-17**

**Private-Company Scope Exception to the VIE Guidance for Certain Entities**

ASU 2018-17 broadens the existing accounting alternative available to private companies by allowing all legal entities under common control to elect not to apply the VIE guidance as long as the reporting entity, the common-control parent, and the legal entity being evaluated for consolidation are not PBES and meet the criteria in ASC 810-10-15-17AD (added by the ASU). ASC 810-10-15-17AD states, in part:

A legal entity need not be evaluated by a private company (reporting entity) under the guidance in the Variable Interest Entities Subsections if all of the following criteria are met:

- The reporting entity and the legal entity are under common control.
- The reporting entity and the legal entity are not under common control of a public business entity.
- The legal entity under common control is not a public business entity.
- The reporting entity does not directly or indirectly have a controlling financial interest in the legal entity when considering the General Subsections of this Topic. The Variable Interest Entities Subsections shall not be applied when making this determination.
ASC 810-10-15-17AE (added by the ASU) provides guidance on applying criterion (a) above, which requires a determination that the reporting entity and the legal entity are under common control. Specifically, ASC 810-10-15-17AE provides that solely for the purpose of applying criterion (a), a private-company reporting entity should consider only the voting interest model when making this determination. That is, a private-company reporting entity is not required to consider the VIE guidance when determining whether criterion (a) is met.

As stated above, a reporting entity that wishes to apply the private-company scope exception in ASU 2018-17 is required to determine whether the reporting entity and legal entity are under common control solely on the basis of the voting interest model. Therefore, in structures in which a common-control parent has the majority vote in both the reporting entity and the legal entity and no other investors have substantive participating rights, criterion (a) in ASC 810-10-15-17AD would be met (i.e., the reporting entity and legal entity would be determined to be under common control). In addition, criterion (d) would be met because the common-control parent rather than the reporting entity would have a controlling financial interest in the legal entity. Consequently, the reporting entity would be eligible to apply the scope exception provided that the common-control parent, reporting entity, and legal entity are not PBEs in accordance with criteria (b) and (c) in ASC 810-10-15-17AD.

The FASB decided that the guidance in ASU 2018-17 would supersede the existing accounting alternative under ASC 810 (from ASU 2014-07) because the Board believes that the new guidance on common-control relationships for private companies would encompass existing leasing arrangements that qualified for the previous scope exception. Like the accounting alternative under current guidance, the private-company scope exception in ASU 2018-17 would be considered an accounting policy that, if elected, should be applied consistently to all legal entities that qualify for it.

Private-company reporting entities that apply the scope exception because they have met all the criteria in ASC 810-10-15-17AD would not consolidate under the VIE model and also would not consolidate under the voting interest entity model since those entities would not have qualified for the scope exception if they had a controlling financial interest under the voting interest entity model per criterion (d). Consequently, private-company reporting entities that apply the scope exception will be required to provide enhanced disclosures in a manner similar to entities that apply the VIE guidance. For a list of the disclosure requirements, see the appendix of Deloitte’s November 19, 2018, Heads Up.

If a reporting entity applies the new private-company scope exception upon transition to ASU 2018-17 and one of the entities (the parent, reporting entity, or legal entity) subsequently becomes a PBE, the reporting entity can no longer apply the scope exception. In that case, the accounting would depend on which entity became a PBE. If the reporting entity is not the entity that became a PBE, prospective application of the VIE guidance would be required. However, if the reporting entity is the entity that became a PBE, retrospective application of the VIE guidance would be required. Therefore, the reporting entity must continually assess whether it can continue to apply the scope exception.

For further discussion of private-company accounting alternatives, see Section 3.5 of Deloitte’s A Roadmap to Consolidation — Identifying a Controlling Financial Interest.
Compensation

Evaluation of Fees Paid to a Decision Maker

ASC 810 currently requires indirect interests held by related parties under common control to be considered in their entirety\(^9\) in the evaluation of whether a decision maker’s fee arrangement is a variable interest under ASC 810-10-55-37(c). ASU 2016-17 amended ASC 810-10-25-42 to require consideration of these indirect interests on a proportionate basis in the primary-beneficiary analysis but did not align current guidance with the considerations related to the variable interest analysis. Accordingly, ASU 2018-17 now aligns the guidance by removing a sentence in ASC 810-10-55-37D\(^10\) to conform the guidance in that paragraph with the amendments in ASU 2016-17.

The changes made by ASU 2018-17 do not affect interests held through a subsidiary since such interests should be treated as direct interests of the consolidated group in a consolidation assessment.

For further discussion, see Section 4.3.11.4 of Deloitte’s A Roadmap to Consolidation — Identifying a Controlling Financial Interest.

Effective Date and Transition

For entities other than private companies, ASU 2018-17 is effective for fiscal years beginning after December 15, 2019, including interim periods therein. For private companies, the ASU is effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted. In a manner consistent with the amendments in previously issued ASUs related to ASC 810, the amendments in ASU 2018-17 are required to be applied retrospectively, with a cumulative-effect adjustment to retained earnings at the beginning of the earliest period presented.

Compensation

Improvements to Nonemployee Share-Based Payment Accounting

Background

In June 2018, the FASB issued ASU 2018-07, which simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under the ASU, most of the guidance on such payments to nonemployees is aligned with the requirements for share-based payments granted to employees.

Before adopting the ASU, entities apply ASC 505-50 to account for nonemployee share-based payments issued for goods and services. ASC 505-50, before the ASU’s amendments, differs significantly from ASC 718. Differences include (but are not limited to) the guidance on (1) the determination of the measurement date (which generally is the date on which the measurement of equity-classified share-based payments becomes fixed), (2) the accounting for performance conditions, (3) the ability of a nonpublic entity to use certain practical expedients for measurement, and (4) the accounting for (including measurement and classification) share-based payments after vesting.

\(^9\) Specifically, ASC 810-10-55-37D.

\(^10\) ASU 2018-17 removes the following sentence: “Indirect interests held through related parties that are under common control with the decision maker should be considered the equivalent of direct interests in their entirety.”
The ASU supersedes ASC 505-50 and expands the scope of ASC 718 to include all share-based payment arrangements related to the acquisition of goods and services from both nonemployees and employees. However, some differences remain between the accounting for employees and nonemployees under ASC 718, primarily related to the following:

- **Manner and period of cost recognition** — Although the total cost recognized for nonemployee awards could change under ASU 2018-07, the manner of and period(s) for recognizing costs will not. Thus, any cost recognized for nonemployee share-based payments will continue to be recognized under other applicable accounting guidance as though the grantor paid cash. That is, an entity should recognize an asset or expense (or reverse a previously recognized cost) in the same period(s) and in the same manner as if the entity had paid cash for the goods or services. Accordingly, the entity recognizes the cost of nonemployee awards “when it obtains the goods or as services are received.”

- **Fair-value-based measurement** — The fair-value-based measurement objective for nonemployee awards is aligned with that for employee awards. However, in calculating the fair-value-based measurement of nonemployee stock options and similar instruments, an entity can elect on an award-by-award basis to use the contractual term as the expected term. If the entity does not elect to use the contractual term, it must estimate the expected term for those awards.

### Effective Date

For PBEs, the amendments in ASU 2018-07 are effective for fiscal years beginning after December 15, 2018, including interim periods therein. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted if financial statements have not yet been issued (for PBEs) or have not yet been made available for issuance (for all other entities), but no earlier than an entity’s adoption date of ASC 606. If early adoption is elected, all amendments in the ASU that apply must be adopted in the same period. In addition, if early adoption is elected in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. See Deloitte’s August 1, 2018, **Financial Reporting Alert** for additional information about adoption of the ASU in an interim period.

### Transition and Related Disclosures

ASU 2018-07 generally requires an entity to use a modified retrospective transition approach, with a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year, for all (1) liability-classified nonemployee awards that have not been settled as of the adoption date and (2) equity-classified nonemployee awards for which a measurement date has not been established. In the application of a modified retrospective transition approach:

- The ASU’s transition provisions do not apply to equity-classified awards for which a measurement date was previously established under ASC 505-50 because of the existence of a performance commitment or because performance was complete.

- It may be difficult for some entities to determine the grant-date fair-value-based measure of nonemployee equity-classified awards. The ASU therefore requires equity-classified awards (for which a measurement date has not been previously established) to be remeasured on the basis of their adoption-date fair-value-based measure.

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11 The FASB retained the current definitions in ASC 718 of a “public entity” and a “nonpublic entity” for use in the determination of whether a nonpublic entity practical expedient can be elected. However, an entity will determine the ASU’s effective date on the basis of whether it meets the ASC master glossary’s definition of a “public business entity.”
• An entity applies the guidance on modifications of an award from liability to equity classification (i.e., the unsettled liability award as measured on the adoption date would be reclassified to equity) to determine the cumulative-effect adjustment to equity for unsettled awards that are currently classified as a liability but will be classified as equity under the ASU.

• An entity should not adjust the basis of assets that include nonemployee share-based payment costs if the assets are completed (e.g., finished goods inventory or fixed assets for which amortization has commenced).

However, if a nonpublic entity changes its measurement of nonemployee awards to calculated value instead of a fair-value-based measure, the ASU requires the entity to use a prospective approach.

In the first interim and fiscal year of adoption, an entity is required to disclose the following:

• The nature of and reason for the change in accounting principle.
• The cumulative effect of the change on retained earnings (or other components of equity or net assets) in the statement of financial position as of the beginning of the period of adoption.

For additional information about the ASU, see Chapter 9 of Deloitte's *A Roadmap to Accounting for Share-Based Payment Awards* and Deloitte's June 21, 2018, *Heads Up*.

**FASB Clarifies the Accounting for Share-Based Payments Issued as Sales Incentives to Customers**

In November 2019, the FASB issued ASU 2019-08, which clarifies the accounting for share-based payments issued as consideration payable to a customer in accordance with ASC 606. Under the ASU, entities apply the guidance in ASC 718 to measure and classify share-based payments issued to a customer that are not in exchange for a distinct good or service (i.e., share-based sales incentives).

For more information about ASU 2019-08, see Deloitte's November 13, 2019, *Heads Up*.

**Cloud Computing Arrangements**

**Background**

In August 2018, the FASB issued ASU 2018-15, which amends ASC 350-40 to address a customer's accounting for implementation costs incurred in a cloud computing arrangement (CCA) that is a service contract. ASU 2018-15 aligns the accounting for costs incurred to implement a CCA that is a service arrangement with the guidance on capitalizing costs associated with developing or obtaining internal-use software. Therefore, a customer should apply the framework in ASC 350-40 to determine which implementation costs should be capitalized in a CCA that is considered a service contract.

The FASB clarified in ASU 2015-05 that a CCA is considered to be a service contract if the customer either does not have the “right to take possession of the software at any time during the hosting period without significant penalty” or cannot feasibly “either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.” (For more information about ASU 2015-05, see Deloitte's April 17, 2015, *Heads Up*.)

Common examples of CCAs include software as a service, platform or infrastructure as a service, and other similar types of hosting arrangements. Many companies in the insurance sector are increasing their use of CCAs to reduce the costs of maintaining their IT infrastructure, improve data security, and boost the efficiency and effectiveness of core operations (e.g., underwriting and managing claims).
See Deloitte's September 11, 2018, *Heads Up* or the January 2019 edition of this publication for more information about ASU 2018-15, including detailed discussion of its key provisions as well as the effective dates and transition approaches.

**NAIC Update**

The National Association of Insurance Commissioners (NAIC) continues to establish the statutory accounting principles for financial reporting in the insurance industry. For highlights of the NAIC’s spring and summer 2019 meetings, including updates on the accounting and reporting changes discussed, adopted, and exposed by the Statutory Accounting Principles Working Group, the Accounting Practices and Procedures Task Force, and the Financial Condition Committee, see Deloitte’s *NAIC Update: Spring 2019 National Meeting* and *NAIC Update: Summer 2019 National Meeting*.

The next NAIC meeting will be held December 7–10, 2019, in Austin, Texas.
Appendix A — Titles of Standards and Other Literature

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

**AICPA Literature**

**Audit and Accounting Guide**

*Revenue Recognition*

**FASB Literature**

**ASC Topics**

ASC 310, *Receivables*

ASC 320, *Investments — Debt and Equity Securities*

ASC 321, *Investments — Equity Securities*

ASC 323, *Investments — Equity Method and Joint Ventures*

ASC 326, *Financial Instruments — Credit Losses*

ASC 350, *Intangibles — Goodwill and Other*

ASC 450, *Contingencies*

ASC 470, *Debt*

ASC 505, *Equity*

ASC 606, *Revenue From Contracts With Customers*

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 942, Financial Services — Depository and Lending

ASC 944, Financial Services — Insurance

ASC 948, Financial Services — Mortgage Banking

**ASUs**

ASU 2014-07, Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements — a consensus of the Private Company Council

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

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 2016-02, Leases (Topic 842)

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

ASU 2016-17, Consolidation (Topic 810): Interests Held Through Related Parties That Are Under Common Control

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

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


ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting

ASU 2018-12, Financial Services — Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts

ASU 2018-13, Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement

ASU 2018-15, Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract

ASU 2018-16, Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes

ASU 2018-17, Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities

ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments — Credit Losses

ASU 2019-01, Leases (Topic 842): Codification Improvements

ASU 2019-04, Codification Improvements to Topic 326, Financial Instruments — Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments
ASU 2019-05, Financial Instruments — Credit Losses (Topic 326): Targeted Transition Relief

ASU 2019-08, Compensation — Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements — Share-Based Consideration Payable to a Customer

ASU 2019-09, Financial Services — Insurance (Topic 944): Effective Date

ASU 2019-10, Financial Instruments — Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates

ASU 2019-11, Codification Improvements to Topic 326, Financial Instruments — Credit Losses

Concepts Statement
No. 8, Conceptual Framework for Financial Reporting — Chapter 8: Notes to Financial Statements

Proposed ASUs


No. 2019-770, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting

No. 2019-780, Debt (Topic 470), Simplifying the Classification of Debt in a Classified Balance Sheet (Current Versus Noncurrent) — Revision of Exposure Draft Issued January 10, 2017

No. 2019-790, Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting
Appendix B — Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AFS</td>
<td>available for sale</td>
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<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
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<td>ARRC</td>
<td>Alternative Reference Rates Committee</td>
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<tr>
<td>ASC</td>
<td>FASB Accounting Standards Codification</td>
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<td>ASU</td>
<td>FASB Accounting Standards Update</td>
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<td>CCA</td>
<td>cloud computing arrangement</td>
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<td>CECL</td>
<td>current expected credit loss</td>
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<td>DAC</td>
<td>deferred acquisition cost</td>
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<td>DPL</td>
<td>deferred profit liability</td>
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<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<td>GAAP</td>
<td>generally accepted accounting principles</td>
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<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>IBOR</td>
<td>Interbank Offered Rate</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standard</td>
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<td>LIBOR</td>
<td>London Interbank Offered Rate</td>
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<td>NAIC</td>
<td>National Association of Insurance Commissioners</td>
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<td>NFP</td>
<td>not-for-profit</td>
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<td>OCI</td>
<td>other comprehensive income</td>
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<td>OIS</td>
<td>Overnight Index Swap</td>
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<td>PBE</td>
<td>public business entity</td>
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<td>ROU</td>
<td>right of use</td>
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<td>SEC</td>
<td>U.S. Securities and Exchange Commission</td>
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<td>SOFR</td>
<td>Secured Overnight Financing Rate</td>
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<td>VIE</td>
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