Deloitte.

November 2015

EITF Snapshot

by Chris Cryderman, Stephen McKinney, and Bob Uhl, Deloitte & Touche LLP

In This Issue

- Issue 15-B, "Recognition of Breakage for Prepaid Stored-Value Cards"
- Issue 15-D, "Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships"
- Issue 15-E, "Contingent Put and Call Options in Debt Instruments"
- Issue 15-F, "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments"
- Administrative Matters
- Appendix — Summary of Tentative Decisions for Issue 15-F

This *EITF Snapshot* summarizes the November 12, 2015, meeting of the Emerging Issues Task Force (EITF or "Task Force"). Initial Task Force consensuses ("consensuses-for-exposure") are exposed for public comment upon ratification by the Financial Accounting Standards Board (FASB). After the comment period, the Task Force considers comments received and redeliberates the issues at a scheduled meeting to reach a final consensus. Those final consensuses are then provided to the FASB for final ratification and, ultimately, issuance as an Accounting Standards Update (ASU).

The FASB plans to consider the EITF's November 2015 consensuses for ratification at its December 2, 2015, meeting. After that date, the official EITF minutes, including the results of the FASB's ratification process, will be posted to Deloitte's Technical Library and to the FASB's Web site (note that the official EITF minutes may contain details that differ from those in this publication). EITF Issue Summaries (released before the meeting and used to frame the discussion) are also available on those sites.

Issue 15-B, "Recognition of Breakage for Prepaid Stored-Value Cards"

Status: Final consensus.

Affects: Entities that offer prepaid stored-value products (e.g., physical or electronic cards) within the scope of the final consensus (see below).

Background: Entities may offer prepaid stored-value products such as a card that can be redeemed for goods or services provided by a specified company, a group of unaffiliated companies, or any company operating in a specific card network. The entity issuing the prepaid stored-value product records a liability to the consumer upon issuance. If the consumer uses the stored value to purchase goods or services from a third party, the issuer reduces its liability to the consumer and creates a liability to the third party. The card issuer will settle the obligation in cash directly with the third party. For various reasons, consumers may not use all or a portion of the product's prepaid value; this is commonly referred to as "breakage." Views differ on when an entity can derecognize the liability to the consumer as a result of breakage.

In April 2015, the FASB issued a proposed ASU based on the EITF's consensus-for-exposure that would provide a narrow-scope exception to the guidance on derecognition of liabilities to require that breakage be recognized in a manner similar to the guidance in ASC 606.[1] At its September 17, 2015, meeting, the Task Force discussed stakeholder feedback received on the FASB's proposed ASU. The Task Force agreed to amend the scope to include prepaid stored-value products that (1) contain an expiration date and (2) are redeemable at both the issuer's own store and third-party stores. In addition, in response to concerns raised regarding the scope of the proposed ASU, the Task Force directed the FASB staff to develop a principle that would enable an entity to determine to which financial liabilities it could apply the proposed breakage guidance.

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

Summary: At its November 12, 2015, meeting, the EITF reached a final consensus that the scope of this Issue includes all prepaid stored-value products (in both physical and digital forms) that are issued for the purpose of being readily accepted as payment for good or services, except for those that are (1) accounted for under ASC 606, (2) solely redeemable for cash, (3) subject to unclaimed property laws, and (4) attached to a segregated bank account (e.g., a customer deposit account). The Task Force also noted that the scope excludes products such as bearer bonds and nonrecourse debt. Further, the Task Force reaffirmed its consensus-for-exposure to amend ASC 405-20 to indicate that if an entity has an in-scope financial liability, the entity would apply the breakage and subsequent measurement guidance in a manner consistent with ASC 606. That is, if the issuer expects to be entitled to a breakage amount (an amount that will not be redeemed) of the financial liability, the issuer would recognize the effects of the expected breakage "in proportion to the pattern of rights exercised" by the holder to the extent that a significant revenue reversal of the breakage will not occur. Otherwise, the expected breakage of the financial liability would be recognized when the likelihood that the holder will exercise its remaining rights becomes remote.

The Task Force also reaffirmed its decisions to (1) require entities to provide breakage disclosures that are consistent with the breakage disclosures required by ASC 606 and (2) provide a scope exception related to ASC 825's disclosure requirements for financial liabilities within the scope of the proposed amendments.

Effective Date and Transition: For public business entities, the guidance related to the final consensus will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, it will be effective for annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019. Early adoption will be permitted, including adoption before the effective date of ASC 606. A reporting entity will apply the guidance by using a modified retrospective transition approach unless the entity elects to apply it retrospectively.

Next Steps: FASB ratification is expected at the Board's December 2, 2015, meeting, after which a final ASU will be issued.

Issue 15-D, "Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships"

Status: Final consensus.

Affects: Entities with derivative contracts designated in a hedge accounting relationship.

Background: ASC 815 provides guidance on when a derivative instrument may qualify for hedge accounting. Derivative instruments that qualify for, and that are designated in, a hedging relationship may reduce volatility in an entity's earnings that can occur because of the changes in the fair value of the derivative. ASC 815 indicates that a derivative instrument must be dedesignated from a hedging relationship if (1) the derivative instrument is terminated or (2) there has been any change in the critical terms of the hedging relationship as documented at inception. The issue discussed by the Task Force is whether a derivative novation results in the dedesignation of the hedging relationship because the novation is either (1) a termination or (2) a change in a critical term of the derivative contract.

A derivative novation occurs when one party (Company A) in the derivative contract assigns its rights and obligations to a new party (Company B), subject to the approval of the existing derivative counterparty (Company C). After the novation, Company C and Company B are the legal counterparties since Company A no longer has any rights or obligations under the contract. Derivative novations occur for various reasons, including business mergers with the surviving entity novated as the new counterparty, novations between legal entities of the same parent company, and regulatory requirements that result in novations to central derivative clearing counterparties.

Summary: At this meeting, the EITF reaffirmed its consensus-for-exposure that a novation of a counterparty in a derivative contract does not, in itself, result in the dedesignation of the derivative from the hedge accounting relationship. The Task Force decided that a change in a counterparty's creditworthiness is the critical term to consider and that an entity would assess this term when evaluating hedge effectiveness in each reporting period under current U.S. GAAP. Task Force members noted that if the counterparty's creditworthiness is significantly different, the derivative hedge may not meet the highly effective hedge threshold for hedge accounting.

Effective Date and Transition: For public business entities, the guidance related to the final consensus will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, it will be effective for annual reporting periods beginning after December 15, 2017, and interim periods beginning after December 15, 2018. Early adoption is permitted. A reporting entity will apply the guidance prospectively unless the entity elects to apply it retrospectively.

Next Steps: FASB ratification is expected at the Board's December 2, 2015, meeting, after which a final ASU will be issued.

Issue 15-E, "Contingent Put and Call Options in Debt Instruments"

Status: Final consensus.

Affects: Entities that invest in or issue debt instruments containing contingent put or call options.

Background: Debt instruments that contain embedded features, including contingent put and call options, are evaluated to determine whether the embedded features that are derivatives are not clearly and closely related to the host and therefore may be bifurcated and accounted for as derivative instruments with changes in fair value recorded through income.

The guidance on when contingent put and call options embedded in debt instruments must be bifurcated is unclear. The guidance contains a four-step decision sequence[2] related to determining whether a put or call option that accelerates the repayment of the debt contract's principal is clearly and closely related to the debt instrument. Some believe that the result of the four-step process is determinative. Others believe that in addition to the four-step process, a contingent put or call option is not considered clearly and closely related[3] to the host contract unless *exercise* of the put or call is also *only indexed to interest rates or credit risk and not some extraneous event or factor*. The four-step decision sequence does not require that the exercise of the contingent put or call option be indexed only to an interest rate or credit risk and not some extraneous event or factor. As a result, it is unclear whether (1) the assessment of embedded features should be limited to the four-step decision sequence

[2] See ASC 815-15-25-42.

[3] ASC 815-15-25-1(a) states that one of the criteria for when an embedded derivative must be separated from the host contract is that the "economic characteristics and risks of the embedded derivative are not *clearly and closely* related to the economic characteristics and risks of the host contract" (emphasis added). A put or call option that accelerates the repayment of the debt contract's principal can be clearly and closely related unless (1) the debt involves a substantial premium or discount and (2) the call (put) option is only contingently exercisable.

or (2) an entity should apply the four-step decision sequence **and** evaluate whether the *exercise*[4] of the contingent put or call option is indexed to only an interest rate or credit risk and not some extraneous event or factor.

Summary: The Task Force reaffirmed its consensus-for-exposure that an entity would only apply the four-step sequence when assessing whether a contingent put or call option embedded in a debt instrument may be bifurcated as an embedded derivative and recorded at fair value through earnings. Thus, a potential embedded derivative would not fail to be clearly and closely related solely because the exercise of the contingent put or call option is indexed to an extraneous event or factor. Further, the Task Force reaffirmed its decision that an entity may elect the fair value option for debt instruments with embedded puts and calls that, as a result of this guidance, would no longer need to be separate and may account for the contingent put or call as a derivative contract.

Effective Date and Transition: For public business entities, the guidance related to the final consensus will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, it will be effective for annual reporting periods beginning after December 15, 2017, and interim periods beginning after December 15, 2018. Early adoption is permitted. A reporting entity will apply the final consensus by using a modified retrospective transition approach. Under this approach, a reporting entity would be required to use the four-step sequence to determine whether an embedded derivative is clearly and closely related to the debt host by taking into account the facts and circumstances that existed on the date it issued or acquired the instrument.

Next Steps: FASB ratification is expected at the Board's December 2, 2015, meeting, after which a final ASU will be issued.

Issue 15-F, "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments"

Status: Consensus-for-exposure on certain subissues.

Affects: Entities that prepare a statement of cash flows.

Background: ASC 230 provides some guidance on cash payments and receipts that are classified as either financing or investing activities. Cash flows associated with cash payments and receipts that do not qualify as financing or investment activities are classified in operating activities.[5] However, ASC 230 does not have consistent principles for evaluating the classification of cash payments and receipts in the statement of cash flows, which has led to diversity in practice and, in certain circumstances, financial statement restatements.

The Task Force deliberated six subissues at its June 2015 meeting, reaching tentative decisions on four of them. At its September 2015 meeting, the Task Force redeliberated one subissue from the June 2015 meeting and discussed three new subissues, reaching tentative decisions on all of them.

Summary: The EITF reached a consensus-for-exposure on all of the subissues discussed at the June 2015 and September 2015 meetings except for the one related to restricted cash. The EITF continued deliberating restricted cash, including issues related to the (1) definition of restricted cash, (2) classification of changes in restricted cash, and (3) presentation of cash payments and cash receipts that directly affect restricted cash. Because Task Force members' views differed on these issues, the EITF did not reach tentative decisions on issues (1) and (3) above and directed the staff to perform

4 For example, the exercise might be contingent on a change in the price of gold.

5 The glossary in ASC 230 further defines operating activities as those that "involve producing and delivering goods and providing services" and cash flows that generally affect "transactions and other events that enter into the determination of net income."

Tune into Deloitte's November 17 *Dbriefs* webcast "EITF Roundup: Highlights From the November Meeting," which will take place at 2 p.m. (EST). Register for this webcast today.

further research. With respect to issue (2), the Task Force tentatively decided that changes in restricted cash would be classified as investing activities (i.e., on the basis of the nature of the cash flow). For a summary of tentative decisions reached and the status of each subissue, see the appendix.

The Task Force decided that the consensus-for-exposure would not include examples illustrating the application of the predominance principle.[6]

Effective Date and Transition: The Task Force decided that the guidance related to the eight subissues would be applied retrospectively to all periods presented. However, the Task Force decided to incorporate an impracticability[7] principle.

Next Steps: At its March 3, 2016, meeting, the Task Force is expected to redeliberate the subissue related to restricted cash. The Task Force will discuss the effective date at a future meeting.

Administrative Matters

The next EITF decision-making meeting is tentatively scheduled for March 3, 2016.

6 See ASC 230-10-45-22 and 45-23.

7 The impracticability principle would be applied in a manner similar to ASC 250-10-45-9.

Appendix — Summary of Tentative Decisions for Issue 15-F

Cash Flow Classification Issue	Status
Debt Prepayment or Extinguishment Costs Cash payments for debt prepayment or extinguishment costs would be classified as cash outflows in financing activities.	Consensus-for-exposure
Settlement of Zero-Coupon Bonds At settlement, the cash outflows of a zero-coupon bond would be classified in operating and financing activities. The cash payment of the accreted interest would be classified in operating activities, while the cash payment attributable to the original proceeds (i.e., the principal) would be classified in financing activities.	Consensus-for-exposure
Restricted Cash Changes in restricted cash that affect an entity's cash and cash equivalent balance would be classified as investing activities (i.e., on the basis of the nature of the cash flow). The remaining restricted cash-related issues will be discussed at a future meeting.	Tentative decisions
Contingent Consideration Payments Made After a Business Combination Contingent consideration payments that were not made on the acquisition date or soon before or after the business combination would be classified in operating and financing activities. Cash payments up to the fair value amount of the contingent consideration liability, including any measurement-period adjustments, that are recognized as of the acquisition date would be classified in financing activities, while any excess cash payments would be classified in operating activities.	Consensus-for-exposure
Proceeds From the Settlement of Insurance Claims The cash proceeds from the settlement of insurance claims would be based on the nature of the insurance coverage (i.e., nature of the loss), including lump-sum payments for which the nature of the loss can be reasonably estimated.	Consensus-for-exposure
Proceeds From the Settlement of Corporate-Owned Life Insurance (COLI) Policies Cash proceeds from the settlement of COLI polices would be classified in investing activities. However, an entity would be permitted, but not required, to align the classification of premium payments on COLI policies with the classification of COLI proceeds.	Consensus-for-exposure
Distributions Received From Equity Method Investees Distributions received by an equity method investee would be classified in operating and investing activities by applying the cumulative earnings approach.	Consensus-for-exposure
Beneficial Interests in Securitization Transactions The transferor's beneficial interests received as proceeds from the securitization of an entity's assets would be disclosed as a noncash activity. Subsequent cash receipts on beneficial interests from the securitization of an entity's trade receivables would be classified in investing activities.	Consensus-for-exposure
Application of the Predominance Principle The Task Force decided to retain and clarify the predominance principle in ASC 230.	Consensus-for-exposure

Subscriptions

If you wish to receive *EITF Snapshot* and other Deloitte accounting publications, please register at www.deloitte.com/us/subscriptions.

Dbriefs for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy and tax.
- Driving enterprise value.
- Financial reporting.
- Financial reporting for taxes.
- Governance, risk, and compliance.
- Technology.
- Transactions and business events.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk. Subscribe to *Dbriefs* to receive notifications about future webcasts at www.deloitte.com/us/dbriefs.

Technical Library and US GAAP Plus

Deloitte makes available, on a subscription basis, access to its online library of accounting and financial disclosure literature. Called Technical Library: The Deloitte Accounting Research Tool, the library includes material from the FASB, EITF, AICPA, PCAOB, IASB, and SEC, in addition to Deloitte's own accounting and SEC manuals and other interpretive accounting and SEC guidance.

Updated every business day, Technical Library has an intuitive design and navigation system that, together with its powerful search features, enable users to quickly locate information anytime, from any computer. Technical Library subscribers also receive *Technically Speaking*, the weekly publication that highlights recent additions to the library. For more information, including subscription details and an online demonstration, visit www.deloitte.com/us/techlibrary.

In addition, be sure to visit US GAAP Plus, our free Web site that features accounting news, information, and publications with a U.S. GAAP focus. It contains articles on FASB activities and updates to the *FASB Accounting Standards Codification*™ as well as developments of other U.S. and international standard setters and regulators, such as the PCAOB, AICPA, SEC, IASB, and IFRS Interpretations Committee. Check it out today!