

Heads Up

In This Issue:

- Introduction
- Scope
- Disclosure Requirements
- Transition and Effective Date
- Appendix — Illustrative Disclosure Example

Pulling Back the Curtain

FASB's Proposed ASU Aims to Increase Transparency of Hybrid Financial Instruments With Embedded Derivatives

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Introduction

On February 24, 2015, the FASB issued a [proposed Accounting Standards Update \(ASU\)](#) that would establish new disclosure requirements for hybrid financial instruments with bifurcated embedded derivatives. This proposal stems from the Board's decision in its classification and measurement project¹ to retain existing U.S. GAAP guidance on the bifurcation of embedded derivatives. Although the Board chose not to amend the existing bifurcation guidance, it hopes that the proposed disclosures will address stakeholders' concerns regarding the transparency and usefulness of information about such instruments in the financial statements. In its Basis for Conclusions, the Board acknowledges that "even though the host contract and the bifurcated embedded derivative encompass one legal contract, [under existing U.S. GAAP] they often are disclosed in the footnotes as if they are two separate instruments." The proposal requires entities to disclose the link between bifurcated embedded derivatives and their host contracts so that financial statement users can "analyze the overall economics and cash flows for the entire hybrid financial instrument."

The Board decided to separately expose the proposed disclosure requirements for comment because they were not included in the 2013 proposed ASU on recognition and measurement of financial assets and financial liabilities. Comments on the proposal are due by April 30, 2015.

Scope

The proposed ASU would apply to issuers of and investors in hybrid financial instruments with embedded derivatives for which bifurcation is required.² All entities (both public and nonpublic) would be required to provide the disclosures.

¹ For more information about the FASB's project on recognition and measurement of financial assets and financial liabilities, see Deloitte's February 2, 2015, [Heads Up](#).

² ASC 815-15-25-1 requires separation of an embedded derivative if all of the following conditions are met: (1) the embedded derivative is not clearly and closely related to the host contract, (2) the hybrid instrument is not remeasured at fair value, and (3) the embedded derivative on its own would meet the requirements as a derivative under ASC 815-10-15.

Editor's Note: The proposal's scope is limited to embedded features that must be bifurcated under ASC 815-15-25-1. Other embedded features, such as cash conversion options or beneficial conversion features, are excluded from its scope. Further, the proposal does not apply to nonfinancial hybrid instruments with bifurcated embedded derivatives; however, the proposed ASU solicits views on whether its scope should be expanded to include nonfinancial instruments.

Disclosure Requirements

The proposal would not amend current U.S. GAAP disclosure requirements for hybrid financial instruments or bifurcated embedded derivatives, such as those in ASC 815-10-50; instead, it would require entities to link the financial instrument host contracts to the bifurcated embedded derivatives in their footnotes to the financial statements. The proposal states that for every annual and interim reporting period presented, an entity would disclose, either in a tabular or nontabular format:

- a. For each bifurcated embedded derivative:
 - 1. The location and fair value amounts reported in the statement of financial position
 - 2. The location and amounts of the gains and losses reported in the statement of financial performance.
- b. For each host contract related to each bifurcated embedded derivative above:
 - 1. The location in the statement of financial position, carrying amount, and measurement attribute
 - 2. The location and amounts reported in the statement of financial performance.

Within the disclosure, instruments may be aggregated by derivative type if all activity for the grouped bifurcated embedded derivatives and grouped related host contracts is presented in the same line items within the statements of financial position and financial performance. The appendix of this *Heads Up* contains an example, extracted from the proposed ASU, illustrating the disclosures provided in a tabular format.

Transition and Effective Date

The proposed ASU would be applied prospectively to all hybrid financial instruments with bifurcated embedded derivatives that exist as of the beginning of the fiscal year of adoption. The Board will deliberate the effective date after considering stakeholder feedback.

Appendix — Illustrative Disclosure Example

The following table, which has been reproduced from the ASU, is an example illustrating the disclosures provided in a tabular format:

Bifurcated Embedded Derivatives					Related Host Contracts					
Derivative Type	Balance Sheet Location	Fair Value	Location of Gain or Loss Reported in Income	Amount of Gain or Loss Reported in Income	Related Host Contract Type	Balance Sheet Location	Measurement Attribute	Carrying Amount	Location of Amount Reported in Statement of Financial Performance	Amount Reported in Statement of Financial Performance
Equity Contracts	Long-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Long-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Equity Contracts	Short-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Short-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Commodity Contracts	Long-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Long-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Interest-Rate Contracts	Securities Owned	\$XXXX	Other Income / Expense	\$YYYY	Equity Hosts	Securities Owned	Fair Value through Other Comprehensive Income	\$XXXX	Investment Income	\$YYYY

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