FASB's Simplification Project Update – 2018

BKD
CPAs & Advisors

Table of Contents

Executive Summary

The Financial Accounting Standards Board (FASB) has issued numerous standards under its simplification initiative and plans to issue more. FASB issues these tightly focused standards to simplify accounting while improving or maintaining the usefulness of information reported to investors and other users of financial statements. Reduced complexity in accounting standards generally means reduced costs for preparers and auditors. Each standard includes specific transition guidance and early adoption criteria. The resulting operational relief will depend on each company's facts and circumstances. Companies should carefully consider the potential benefits from early adopting the below standards. The following is a summary of the simplification projects completed and pending.

This article includes all simplification standards effective for annual reporting periods beginning after December 15, 2017, and uncompleted simplification projects on FASB's agenda. Links to corresponding **BKD Thoughtware®** are provided.

Completed Projects

Classification of Deferred Taxes

Effective Dates	**Public Business Entity (PBE)**	**All Other**
ASU 2015-17	Annual and interim statements beginning after December 15, 2016	Annual statements beginning after December 15, 2017, and interim periods after December 15, 2018

This Accounting Standards Update (ASU) requires the classification of all deferred tax liabilities and assets as noncurrent in a classified statement of financial position. The amendments have no effect on entities not presenting a classified statement of financial position.

Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period.

Resource: [Simplifying Classification of Deferred Taxes]

Improvements to Employee Share-Based Payment Accounting

Effective Dates	**PBE**	**All Other**
ASU 2016-09	Annual and interim statements beginning after December 15, 2016	Annual statements beginning after December 15, 2017, and interim periods after December 15, 2018

This ASU addresses clarity, comparability and the economics of stock-based compensation transactions. The amendments are applicable to all companies that issue share-based payment awards to their employees and could have a significant effect on net income, earnings per share (EPS) and the statement of cash flows upon adoption.

The guidance requires recognition of the income tax effects of share-based payment transactions in the income statement upon award vesting or settlement. This eliminates additional paid-in capital pools and revises the amount of employee shares an employer is allowed to withhold to meet the employer's minimum statutory withholding obligation without triggering liability classification, *e.g.*, awards with repurchase features. The update also changes the classification of excess tax benefits, clarifies the classification of employee taxes paid in the statement of cash flows and offers a simplified accounting alternative for award forfeitures.

In addition to the amendments applicable to all entities, the update adds two practical expedients to simplify accounting for nonpublic entities. A nonpublic entity generally is defined in Topic 718, *Compensation—Stock Compensation*, as an entity whose equity securities do not trade in a public market. The practical expedients will allow nonpublic companies to more easily estimate the expected term for all awards with performance or service conditions that have certain characteristics, and they may make a one-time change in accounting principle to switch from measuring all liability-classified awards at fair value (FV) to intrinsic value.

Companies are permitted to early adopt in any interim or annual period, provided they adopt all amendments in the same period. Depending on the provision, adoption can be on a prospective, retrospective or modified retrospective basis.

Resource: Share-Based Payment Accounting Simplifications

Accounting for Income Taxes: Intra-Entity Asset Transfers

Effective Dates
ASU 2016-16

PBE
Annual and interim statements beginning after December 15, 2017

All Other
Annual statements beginning after December 15, 2018, and interim periods after December 15, 2019

This ASU requires entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. This eliminates the exception that disallows the recognition of income taxes for intra-entity asset transfers other than inventory until the assets have been sold to an outside party—a current exception to the principle of comprehensive recognition of current and deferred income taxes in generally accepted accounting principles. The amendments do not include new disclosure requirements.

Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements—interim or annual—have not been issued or made available for issuance, *i.e.*, earlier adoption should be in the first interim period if an entity issues interim financial statements. Entities will apply the amendments on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the adoption period.

Resource: Changes to Tax Accounting for Intra-Entity Asset Transfers

Goodwill

Effective Dates
ASU 2017-04

PBE SEC Filers
Impairment tests after December 15, 2019

PBE Non-SEC Filers
Impairment tests after December 15, 2020

All Other
Impairment tests after December 15, 2021

The ASU removes Step 2 from the impairment test and modifies the concept of impairment from the condition that exists when the carrying amount of goodwill exceeds its implied FV to the condition that exists when a reporting unit's carrying amount exceeds its FV. The same one-step impairment test applies to all reporting units, including those with zero or negative carrying amounts. Entities are permitted to apply the guidance to any impairment tests performed after January 1, 2017. Prospective application is required.

Resources: Goodwill Impairment Testing Simplified

Considerations for Early Adoption of Goodwill Impairment

Premium Amortization

Effective Dates
ASU 2017-08

PBE
Annual and interim statements beginning after December 15, 2018

All Other
Annual statements beginning after December 15, 2019, and interim periods after December 15, 2020

Under current guidance, when a debt security or loan is purchased at a premium, the premium is typically amortized to the maturity date by adjusting the yield, despite the possibility that the borrower may prepay the debt instrument earlier than the contractual maturity date. This interest income model may result in the recognition of too much interest income prior to prepayment and delayed recognition of a loss for the unamortized premium. These amendments require the premium on certain debt securities to be amortized to the earliest call date.

Entities should apply these amendments through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in the year of adoption. This ASU requires no new disclosures; however, in the period of adoption, an entity would provide disclosures about an accounting principle change.

Early adoption is permitted for all entities, including in interim periods.

Resource: Relief for Early Calls on Debt

Down-Round Features

Effective Dates
ASU 2017-11

PBE
Annual and interim statements beginning after December 15, 2018

All Other
Annual statements beginning after December 15, 2019, and interim periods after December 15, 2020

The classification of financial instruments as debt or equity is a complex area of accounting and one of the most common causes of financial statement restatements. Under this ASU, a financial instrument with a down-round feature would no longer be classified as a liability solely because that feature exists. The ASU relies on existing guidance for subsequent measurement, depending on whether the instrument is classified as equity or a liability. The changes will provide the greatest relief in accounting for freestanding warrants with a down-round feature—the earnings effect will be eliminated, and an EPS adjustment would be made instead. A small number of instruments with down-round features will continue to be classified as a liability—bifurcation would no longer be required, and accounting would be governed by existing, complicated guidance on beneficial conversion features. **Entities issuing financial instruments with down-round features that do not present EPS information will not recognize a balance sheet effect in value transferred between certain classes of shareholders.**

Early adoption is permitted for all entities, including adoption in an interim period.

The amendments would be applied to outstanding financial instruments with a down-round feature at the effective date. Retrospective adoption is required. Entities can choose a modified approach by adjusting the opening balance of retained earnings for the cumulative effect of the change or a full retrospective approach by restating any prior years presented.

Resource: Down-Round Treatment Simplified

Hedge Accounting

Effective Dates
ASU 2017-12

PBE
Annual and interim statements beginning after December 15, 2018

All Other
Annual statements beginning after December 15, 2019, and interim periods after December 15, 2020

The standard makes targeted but substantial improvements:

- Expanding component hedging to nonfinancial risks for preparers to more accurately present—and users to better understand—an entity's risk exposures and risk management activities
- Eliminating the separate measurement and presentation of hedge ineffectiveness that has resulted in complexity in the financial reporting process and hindered the decision usefulness of reported information
- Aligning the financial reporting for hedges of interest rate risk with the economic results of those risk management activities
- Reducing the costs and complexity of monitoring the effectiveness of a hedging relationship by allowing more qualitative assessments
- Allowing more time for the preparation of hedge documentation for preparers that elect hedge accounting

Numerous one-time transition elections are permitted to allow entities to apply these amendments to existing hedging relationships. For private companies that are not financial institutions and not-for-profits (NFP) that have not issued—or are a conduit bond obligor for—securities that are traded, listed or quoted on an exchange or an over-the-counter market, the transition elections shall be determined before the next interim or annual financial statements are available to be issued. For all other entities, the elections shall be determined before the first quarterly effectiveness assessment date after the adoption date.

Entities may early adopt as of the standard's issuance date.

Resources: A Deep Dive into Hedging

Easier Hedge Accounting Rules Now Available

Active Projects

Nonemployee Share-Based Payment Accounting Improvements

Proposed Effective Dates

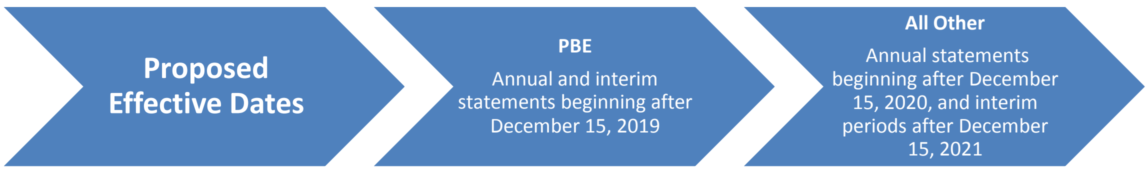
PBE
Annual and interim statements beginning after December 15, 2018

All Other
Annual statements beginning after December 15, 2019, and interim periods after December 15, 2020

These amendments expand Topic 718's scope to include all share-based payment transactions for acquiring goods and services for nonemployees. This will align the postvesting classification—equity versus liability—requirements for nonemployee share-based payment awards to those for employees. The contractual term—versus expected term—is required as an input for measuring nonemployee share-based payment transactions. The final standard will include an anti-abuse provision. Nonpublic entities would be allowed to substitute calculated value in place of expected volatility as a measurement input and make a policy election to measure all liability-classified nonemployee share-based awards at fair or intrinsic value.

Entities would be required to apply the accounting updates on a modified retrospective approach to outstanding awards, with a cumulative-effect adjustment to the operating balance of retained earnings as of the adoption date. Nonpublic entities would be required to apply a prospective approach for all awards granted or modified after the adoption date when electing to substitute calculated values for expected volatilities as measurement inputs. New disclosures would not be required beyond the transition disclosures required by Topic 250, *Accounting Changes and Error Corrections*. A final standard is expected in the first quarter of 2018.

Balance Sheet Classification of Debt



An entity would classify a debt as noncurrent if either of these criteria is met as of the balance sheet date:

- The liability is contractually due to be settled more than one year—or operating cycle, if longer—after the balance sheet date
- The entity has a contractual right to defer settlement of the liability for at least one year—or operating cycle, if longer—after the balance sheet date

Debt should be classified based on existing facts and circumstances at the balance sheet date with one exception. Covenant violations that occur as of the balance sheet date but subsequently are waived before financial statement issuance would not cause the debt to be classified as current provided certain conditions are met.

An entity that does not present a classified balance sheet would be unaffected by these amendments.

The ASU adds new disclosures about debt covenant violations and the existence of significant subjective acceleration clauses and covenants. A final standard is expected in the second quarter of 2018.

Distinguishing Liabilities from Equity

The project's objective is to improve understandability and reduce complexity (without loss of information for users). The project would focus on indexation and settlement (in the context of the derivative scope exception), convertible debt, disclosures and EPS. Initial deliberations began in December 2017.

Research Projects

Goodwill

This project's objective is to determine whether some or all elements of the private company alternatives—issued in ASU 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill*, and ASU 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*—should be extended to PBEs and NFP organizations, including:

- Subsuming certain customer-related intangible assets and all noncompete agreements into goodwill

- Testing goodwill for impairment upon a triggering event, testing impairment either at a reporting unit or entity level and/or amortizing goodwill

Accounting for Income Taxes

The project's objective is to make narrow-scope targeted improvements to reduce unnecessary complexity while maintaining or improving the usefulness of financial information for financial statement users.

BKD will continue monitoring developments in FASB's simplification initiative. For a complete listing of BKD accounting and auditing Thoughtware, visit our webpage.

For more information, contact your BKD advisor.

Contributor

Anne Coughlan
Director
317.383.4000
acoughlan@bkd.com