Expressions of individual views by members of the FASB and staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the FASB on accounting matters are reached only after extensive due process and deliberations.
### Agenda

**FASB Resources**
- Implementation Support

**Standards Effective in 2019 for Private Companies**
- Revenue
- Definition of a Business

**Standards Effective in 2019 for Public Companies**
- Leases
- Financial Instruments that Include Down Round Features

**On the Horizon**
- Current Expected Credit Losses (CECL) Model
- Liabilities and Equity (including Convertible Debt)
- Simplifying the Balance Sheet Classification of Debt
- Reference Rate Reform

### FASB Resources
Standards That Work

Implementation Resources

- Transition resource group (some projects)
- Implementation webpages
- Technical inquiry service
- Regular agenda item for formal and informal advisory groups
- Public Board meetings about implementation status and issues
- Education (FASB webcasts, external conferences)
- Resources to help with implementation
Implementation Web Portal

 Standards Effective in 2019 for Private Companies
Revenue

Overview of Revenue Recognition Model

Core Principle:

Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

Steps to apply the core principle:

1. Identify the contract(s) with the customer
2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue when (or as) a performance obligation is satisfied
Implementation Progress

<table>
<thead>
<tr>
<th>Converged Standards</th>
<th>Key Clarification Amendments Issued</th>
<th>Mandatory PBE Effective</th>
<th>Mandatory Non-PBE Effective</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2014</td>
<td>Mar-May 2016</td>
<td>Jan 2018</td>
<td>Dec 2019</td>
</tr>
</tbody>
</table>

- Joint IASB/FASB Transition Resource Group
- FASB-only TRG (IASB observer)
- FASB available for implementation questions

SAB 74 disclosures on possible impact of application

General Disclosure Requirements*

- **Contracts with Customers**
  - Recognized revenue, presented separately for other sources of revenue
  - Any assets recognized from the costs to obtain or fulfill a contract with a customer

- **Disaggregation of Revenue**
  - Quantitative information based on timing of transfer of goods or services
  - Qualitative information about how economic factors affect the nature, amount, timing and uncertainty of revenue and cash flows

- **Contract Balances**
  - Impairment losses recognized on any receivables or contract assets, presented separately from other sources of losses
  - Opening and closing balances of receivables, contract assets and contract liabilities

* The disclosure slides in this presentation summarize private company requirements. For public company requirements refer to 606-10-50

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Performance Obligation Disclosures

- When satisfaction typically occurs (including for bill-and-hold arrangements)
- Types of warranties and related obligations
- Obligations for returns, refunds, and other similar obligations
- Significant payment terms
- Nature of goods and services promised to be transferred; POs where entity is an agent

Significant Judgments Disclosures

- Judgments, and the related changes to judgments, made that significantly affect the determination of the amount and timing of revenue
- Methods used to recognize revenue for performance obligations satisfied over time
- Methods, inputs and assumptions used for assessing whether an estimate of variable consideration is constrained
Transition

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Retrospective (with optional practical expedients)</td>
<td>Cumulative catch-up</td>
<td>Contracts under new standard</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cumulative effect at date of application</td>
<td>Contracts under legacy standard</td>
<td>Cumulative catch-up</td>
<td>Existing and new contracts under new standard</td>
<td>Existing and new contracts under legacy standard for CY (2019)</td>
</tr>
</tbody>
</table>

Definition of a Business
Current Definition of a Business

- A business consists of inputs and processes applied to those inputs that have the ability to create outputs.

- Although a business usually has outputs, outputs are not required to qualify as a business.

- A business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs.

Project Overview

Objective

- Clarify the definition of a business

Why it Matters

- Determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses
- Affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation
New Screen: Not a Business

- **Threshold**: If substantially all of the fair value of gross assets acquired is concentrated in single asset or group of similar assets, not a business.

- **If Transaction Doesn’t Meet Threshold**: It must be further evaluated under the framework to make determination whether it is a business.

Standards Effective in 2019 for Public Companies
Leases

Board meetings held to-date on Topic 842 implementation:

- November 2016 & May 2017 (leases implementation updates)
- June 2017 (technical corrections)
- August 2017 & November 2017 (land easements)
- January 2018 (technical corrections)
- March 2018 (targeted improvements and other implementation requests)
- July 2018 & October 2018 (lessor narrow-scope improvements)
- December 2018 and February 2019 (codification improvements for lessors)

Standard setting activities:

- Land easements ASU (Issued January 25, 2018 as Update 2018-01)
- Technical corrections ASU (Issued July 19, 2018 as Update 2018-10)
- Targeted Improvements ASU (Issued July 30, 2018 as Update 2018-11)
- Narrow-Scope Improvements for Lessors ASU (Issued December 10, 2018 as Update 2018-20)
- Codification Improvements for Lessors ASU (Issued March 5, 2019 as Update 2019-01)

Board and staff stand ready to assist stakeholders.
Leases . . . Additional Transition Method Available

<table>
<thead>
<tr>
<th>Lease Accounting</th>
<th>2017 (comparative period)</th>
<th>2018 (comparative period)</th>
<th>2019 (year of initial adoption)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original Transition method provided in Update 2016-02</td>
<td>842</td>
<td>842</td>
<td>842</td>
</tr>
<tr>
<td>Additional Transition method provided in Update 2018-11</td>
<td>840</td>
<td>840</td>
<td>842</td>
</tr>
</tbody>
</table>

Leases . . . Lessor Practical Expedient

- Accounting policy election by class of underlying asset
- Combine lease and the associated nonlease components into single component if:
  - The timing and pattern of transfer are the same
  - Lease component alone would be an operating lease
  - Nonlease component would have been accounted for under Topic 606
### Leases . . . Sales and Other Similar Taxes

- Exclude qualifying taxes from:
  - Consideration in the contract
  - Variable payments not included in the consideration in the contract
  - Thus, no revenue and corresponding expense recognized

- All taxes assessed by a governmental authority that are both
  - Imposed on and concurrent with a specific lease revenue-producing transaction
  - Collected by the lessor from a lessee

- Examples: Sales, use, value added, some excise taxes
Leases... Operating Lease Example

Sales taxes excluded from consideration and variable payments
Variable payments - lease component
Fixed payments

<table>
<thead>
<tr>
<th>Year</th>
<th>Lease revenue</th>
<th>Sales taxes (at 7.5%) excluded from lease revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>120,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>130,000</td>
<td>9,750</td>
</tr>
<tr>
<td>Year 3</td>
<td>125,000</td>
<td>9,375</td>
</tr>
<tr>
<td>Year 4</td>
<td>110,000</td>
<td>8,250</td>
</tr>
</tbody>
</table>

Leases... Lessor Costs

Current Requirement → Lessor required to report "lessor costs" paid/reimbursed by lessee as revenue and expense under Topic 842

- Decision: No revenue if the uncertainty of the variable payment is not expected to ultimately be resolved
- Outcome
  - Exclude all payments made directly to 3rd party by lessee on behalf of lessor from variable payments
  - Lessee-reimbursed costs are considered lessor costs and should be accounted for as variable payments
Financial Instruments that Include Down Round Features

Targeted Improvements

- **Objective**
  - To make targeted improvements that simplify the accounting guidance related to financial instruments with characteristics of liabilities and equity.

- **Scope of the Project**
  - **Subtopic 815-40 (formerly EITF 07-5):** Determining whether an instrument (or embedded feature) is indexed to an entity’s own stock, specifically as it relates to features for which the strike price adjusts down on the basis of the pricing of future equity offerings (“down round”).
What is a Down Round Feature?

- A feature in a financial instrument that reduces the strike price of an issued financial instrument if the issuer sells shares of its stock for an amount less than the currently stated strike price of the issued financial instrument or issues an equity-linked financial instrument with a strike price below the currently stated strike price of the issued financial instrument.

- A down round feature may reduce the strike price of a financial instrument to the current issuance price, or the reduction may be limited by a floor or on the basis of a formula that results in a price that is at a discount to the original exercise price but above the new issuance price of the shares, or may reduce the strike price to below the current issuance price. A standard antidilution provision is not considered a down round feature.

Current Accounting

For instruments in the scope of Subtopic 815-40, GAAP requires an evaluation of whether an instrument is indexed to and settled in own stock. A down-round feature precludes an instrument (or embedded feature) from being indexed to an entity’s own stock. The instrument (or embedded feature) requires mark-to-market accounting under Topic 815.

Sources of Complexity

- Fair value measurement (initially and at each subsequent reporting period)
- Accounting may not reflect economics (for example, P&L impacts are recorded as stock price increases, even if down round is to protect investor from declines in price)

Example 1: Convertible Instruments with a Down-Round in an Embedded Conversion Option*

- Debt recorded at fair value on Day 1 and accreted up to par value
- Conversion option marked-to-market with changes in value recorded in net income

Example 2: Warrant with a Down-Round

- Instrument marked-to-market with changes in value recorded in net income

* Assume embedded conversion option meets the definition of a derivative
Amendments: Classification

- A financial instrument with a down round feature would no longer be classified as a liability solely because of the existence of a down round feature

<table>
<thead>
<tr>
<th>Certain equity-linked financial instruments (or embedded features) with down round features</th>
<th>Current Accounting</th>
<th>Accounting Standards Update</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability classified under ASC 815</td>
<td>Warrants classified in equity¹</td>
<td></td>
</tr>
<tr>
<td>Mark-to-market each reporting period</td>
<td>Convertible instruments move from derivatives model to specialized convertible instruments models in Subtopic 470-20²</td>
<td></td>
</tr>
</tbody>
</table>

¹ Assumes that no other feature in the instrument results in derivatives accounting or liability classification

² A down round generally would be considered a contingent beneficial conversion feature

Amendments: Earnings per Share

- Earnings Per Share (EPS): For those entities in the scope of Topic 260:
  - For freestanding equity-classified instruments, the effect of a down round trigger is a deduction to the numerator in basic EPS
  - No impact to diluted EPS
  - Recognize adjustment within equity for trigger
On the Horizon

Current Expected Credit Losses (CECL) Model
Digesting ASU 2016-13

What’s Changing?

**Amortized Cost Model**

<table>
<thead>
<tr>
<th>Loans</th>
<th>Debt Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Held for Investment</td>
<td>CECL</td>
</tr>
<tr>
<td>Held for Sale</td>
<td>Lower of amortized cost basis or market **</td>
</tr>
<tr>
<td>Trading</td>
<td>FV-NI **</td>
</tr>
</tbody>
</table>

**Under new credit-loss model for AFS, credit losses will be recorded through an allowance. Allowance will be limited to difference between debt security’s amortized cost basis and its fair value.**

**No substantive change to current practice.**

| Allowance for purchased financial assets with credit deterioration determined in similar manner; however, initial allowance added to purchase price, rather than as provision expense. |
Current Expected Credit Losses (CECL) Model

**Allowance for Credit Losses . . .**
- A valuation account
- Deducted from amortized cost basis of financial assets
- Used to present "net amount expected to be collected"
- Changes flow through net income

\[ A - B = C \]

- Amortized cost . . . unpaid principal balance (UPB) lent to a customer adjusted for loan fees and origination expenses, repayments, writeoffs, nonaccrual practices, and certain hedging transactions
- Amount expected to be collected . . . remaining amounts expected to be collected from loans

### Upcoming Effective Dates

**Beginning of fiscal year:**

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Instruments: Recognition and Measurement</td>
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<tr>
<td>Public Business Entities (Annual and Interim)</td>
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<td>Non-Public Business Entities* (Annual and Interim Periods Only)</td>
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<td>Leases</td>
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<td>Early adoption permitted</td>
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<td>Credit Losses</td>
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<td>Early adoption permitted</td>
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<tr>
<td>Public Business Entities that are SEC Filers (Annual and Interim)</td>
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</tr>
<tr>
<td>Public Business Entities that are not SEC Filers (Annual and Interim)</td>
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<tr>
<td>Non-Public Business Entities* (Annual and Interim Periods Only)</td>
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<tr>
<td>Non-Public Business Entities* (Annual Periods Only)</td>
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</tr>
</tbody>
</table>

*Includes not-for-profit entities and employee benefit plans

### Classification: Operating Income Reversals Out of CECL
### Disclosures . . . Summary of Requirements

#### Description of Estimate
- Description of how expected losses are developed
- Factors that influenced the current estimate of losses, including a discussion of the risk characteristics changes that influenced management’s decision that were not considered in the previous period (changes in loss severity, portfolio composition, volume of assets, etc.)
- Reasons for significant changes in the amount of write-offs
- Amount of significant purchases and sales of debt instruments during the period
- Amount of any significant sales or reclassifications held for sale for financial assets during the period
- For collateral-dependent assets—qualitative discussion of the type of collateral, extent to which collateral secures financial assets, and any changes that impacted how much collateral secures the asset

#### Quantitative Disclosures
- Disaggregation of loss factors (loan to value, risk rating, geography, etc.) by vintage:
  - Need not exceed more than five annual reporting periods
  - Prior to fifth annual reporting period shown in aggregate
  - Reconciliation between purchase price and par value of purchased credit deteriorated (PCD) assets
  - Rollforward of the allowance for credit losses

#### Policy Disclosures
- Policy for charging off uncollectible debt instruments
- Changes to accounting policies or methodology from the prior period
- Policy for accounting for nonaccrual financial assets

### Disclosures . . . Credit-Quality Indicators (aka Vintage Disclosures)

#### Current GAAP

<table>
<thead>
<tr>
<th>Term Loans</th>
<th>2023</th>
<th>2024</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Rating</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 – 2 internal grade</td>
<td>34,614</td>
<td>37,122</td>
</tr>
<tr>
<td>3 – 4 internal grade</td>
<td>23,076</td>
<td>24,746</td>
</tr>
<tr>
<td>5 internal grade</td>
<td>43,417</td>
<td>44,607</td>
</tr>
<tr>
<td>6 internal grade</td>
<td>3,265</td>
<td>2,638</td>
</tr>
<tr>
<td>Total residential mortgage loans</td>
<td>103,041</td>
<td>109,060</td>
</tr>
</tbody>
</table>

#### Residential Mortgage loans:

- Current-period gross writeoffs: 110
- Current-period recoveries: 11
- Current-period net writeoffs: 96

### Future GAAP

<table>
<thead>
<tr>
<th>Term Loans</th>
<th>2023</th>
<th>2024</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Rating</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 – 2 internal grade</td>
<td>8,313</td>
<td>7,784</td>
</tr>
<tr>
<td>3 – 4 internal grade</td>
<td>5,542</td>
<td>5,190</td>
</tr>
<tr>
<td>5 internal grade</td>
<td>12,673</td>
<td>11,177</td>
</tr>
<tr>
<td>6 internal grade</td>
<td>695</td>
<td>595</td>
</tr>
<tr>
<td>Total internal grade</td>
<td>27,339</td>
<td>22,853</td>
</tr>
</tbody>
</table>

#### Residential Mortgage loans:

- Current-period gross writeoffs: 29
- Current-period recoveries: -
- Current-period net writeoffs: 29

The provided tables summarize credit quality indicators and vintage disclosures, including expected credit losses, write-offs, recoveries, and other relevant financial data, adhering to the new GAAP standards.
Three Truths to Keep in Mind… #1

- Expected credit losses shall be measured on . . .
  - Collective (pool) basis if . . .
    - Asset has similar risk characteristic(s) with other financial assets
    - Risk characteristics may include (not all inclusive):
      - Credit score/rating (internal or external), asset or collateral type, size, effective interest rate, term, geographical location, borrower industry, vintage, historical or expected loss patterns, reasonable and supportable forecast period
  - An individual basis if . . .
    - Asset does not have similar risk characteristic(s) with other financial assets
    - For example, a loan in default or a receivable past a delinquency period
      - But not included in both

Three Truths to Keep in Mind… #2

- Expected credit losses may be determined using . . .
  - Various methods
    - For example: discounted cash flow (DCF), loss rate, roll rate, probability of default, provision matrix
  - Not required to . . .
    - Utilize probability-weighted DCF model
    - Reconcile estimation technique with DCF model
Three Truths to Keep in Mind… #3

- Expected credit losses shall be measured, even if remote
  - However, not required to measure when expectation that nonpayment is zero
    - Expectation can’t be solely based on current value of collateral
  - Board did not explicitly state specific financial assets where nonpayment is zero
    - “Bright-line” approach is not appropriate given nature and characteristics of financial assets change over time
    - However, Board provided Example 8 as one way an entity could evaluate U.S. Treasury securities
      - Not intended to be only applicable to USTs

Implementation . . . Various Resources

- FASB Resources
  - FASB CECL Standard
  - Transition Resource Group (TRG)
  - TRG – Meeting Materials
  - Submit an Issue for Credit Losses
  - Technical Inquiry Service

- AICPA Accounting for Credit Losses Resources
Liabilities and Equity (including Convertible Debt)

Project Overview

Targeted improvements to reduce cost and complexity in financial reporting for convertible instruments and contracts in an entity’s own equity.

- September 2017: Project added to the agenda
- June 2018: Board decisions: convertible instruments
- February 2019: Board decisions: derivatives scope exception, disclosures, and earnings per share (EPS)
- 1st Half 2019: Complete initial deliberations
- 2nd Half 2019: Exposure Draft projected to be issued
- 1st Half 2019: Stakeholder outreach
Convertible Instruments
(primarily Topic 470)

Simplification of accounting for convertible instruments

Number of convertible instrument models
• Cash Conversion Model, Beneficial Conversion Model, and Substantial Premium Model would be removed

Bifurcation of conversion options
• No changes to Embedded Derivative Model

Convertible Debt

Current GAAP: Five Models

<table>
<thead>
<tr>
<th>Model</th>
<th>Initial Measurement Attribute</th>
<th>Conversion Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Embedded Derivative</td>
<td>Residual (liability)</td>
<td>Fair Value (liability)</td>
</tr>
<tr>
<td>2) Cash Conversion</td>
<td>Fair Value w/o conversion option (liability)</td>
<td>Residual (equity)</td>
</tr>
<tr>
<td>3) Beneficial Conversion Feature</td>
<td>Residual (liability)</td>
<td>Intrinsic Value (equity)</td>
</tr>
<tr>
<td>4) Substantial Premium</td>
<td>Residual (liability)</td>
<td>Premium (equity)</td>
</tr>
<tr>
<td>5) Traditional Convertible Debt</td>
<td>No separation – entire instrument carried at amortized cost (liability)</td>
<td></td>
</tr>
</tbody>
</table>

Future GAAP: Two Models

- Embedded Derivative
- Traditional Convertible Debt

Objective: Simplification
Derivatives Scope Exception for Contracts in an Entity’s Own Equity (Subtopic 815-40)

- **Use of management’s judgment**
  - Disregard contingent events that are remote of occurring

- **Strict rules**
  - Removal of 3 conditions for equity classification (such as settlement in registered shares)

- **Form over substance classification outcomes**

---

Derivatives Scope Exception Example

**The Contract**
- A company issues warrants that require settlement in registered shares.

**Current GAAP**
- Fails the settlement condition of the derivatives scope exception.
- Accounted for as a derivative. The contract is fair valued every period and is classified as a liability or asset.

**Future GAAP**
- Does not fail the settlement condition of the derivatives scope exception based on the feature.
- Assuming other requirements are met, the contract is equity classified and is not adjusted every period.
Simplifying the Balance Sheet
Classification of Debt

• Liability is contractually due to be settled more than one year (or operating cycle, if longer) after the balance sheet date.
• 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.

Classification Principle
(For entities that present a classified balance sheet)

Debt arrangements would be classified as a noncurrent liability if either of the following criteria are met as of the balance sheet date:

• Liability is contractually due to be settled more than one year (or operating cycle, if longer) after the balance sheet date.
• 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.
Major Decisions To Date

Refinancing after the Balance Sheet Date
- The classification principle would be applied to short-term debt that is refinanced on a long-term basis after the balance sheet date, which would result in a current liability classification.

Waivers of Debt Covenant Violations
- If the entity receives a waiver that meets certain conditions before the financial statements are issued, the proposed amendments would continue to require that an entity classify debt as a noncurrent liability when there has been a debt covenant violation.

Separate Line Item Presentation
- The proposed amendments would require separate line item presentation in a classified balance sheet for the amount of debt that is classified as a noncurrent liability because of a waiver of a debt covenant violation obtained after the balance sheet date.

Subjective Acceleration Clause (SAC)
- The SAC would affect classification of debt only when it is triggered (no probability assessment).

Disclosures
- Required disclosures—provide information about:
  - Events of default (including violations of a loan covenant and triggers of a SAC).
  - Grace periods provided when the violation (1) has not been cured before the financial statements are issued and (2) would make the long-term obligation callable.
New Decisions in the Upcoming Exposure Draft

Grace Periods

- Apply the classification principle to long-term debt arrangements in which a borrower violates a provision at the balance sheet date and the creditor provides a grace period for the borrower to cure the violation.
- Because of the grace period, the lender cannot demand payment of the debt at the balance sheet date; therefore, the debt arrangement would be classified as a noncurrent liability.

Unused Financing Arrangements

- An unused long-term financing arrangement in place at the balance sheet date should be disregarded in determining the classification of debt.

Reference Rate Reform
## Reference Rate Reform

### LIBOR
- The most commonly used reference rate for derivatives and loans
- $200 trillion: approximate gross notional value of all financial products tied to US LIBOR
- In 2014 the Federal Reserve created a plan to transition away from LIBOR
- The rate could potentially go away after the end of 2021

### SOFR
- The FED’s Alternative Reference Rates Committee selected the Secured Overnight Financing Rate as LIBOR’s replacement
- Measures the cost of overnight borrowings through repo transactions collateralized with US Treasuries
- Based on actual transactions
- Rate is published daily by the New York Fed

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## Reference Rate Reform

- **Background:** Recent Accounting Standards Update (October 2018) adding a new benchmark interest rate for hedge accounting purposes

- **Objective of new “Reference Rate Reform” project:** To facilitate the effects on financial reporting of the market-wide migration from interbank offered rates (IBORs) to alternative reference rates

- **Early research phase; Initial areas of focus:**
  - Hedge accounting — for example, whether existing hedging relationships can be preserved if the reference rate changes
  - Loan/debt modifications — for example, whether (for accounting purposes) a change in the reference rate results in (a) the extinguishment of an instrument and the recognition of a new instrument or (b) the modification of an existing instrument
Questions or Comments?