The views expressed in this presentation are those of the presenter. Official positions of the FASB are reached only after extensive due process and deliberations.
Agenda

- Non-GAAP
- Financial performance reporting
- Tax Reform
- Revenue, Leases – Implementation
- Disclosure Framework
- Appendix - Hedging
Alternative Performance Measures (Non-GAAP)
U.S. Performance Reporting Landscape

GAAP Measures:
- Revenues
- Net Income
- EPS
- Operating cash flows

Non-GAAP Measures (*):
- Adjusted NI
- Adjusted EPS
- Free cash flows
- EBITDA

Financial KPIs:
- Same-store sales
- Sales per sq. foot
- Return on equity

Nonfinancial KPIs:
- Numb. of stores
- Numb. of employees
- Numb. of subscribers

(*) “...a non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that excludes [includes] amounts... that are included [excluded] in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer.” Source: Regulation G and Item 10(e) of Regulation S-K
Monitoring Non-GAAP Measures

Monitor the use and nature of non-GAAP reporting to consider whether standard-setting improvements are needed, as part of the future technical plans. However, this is not a project on the FASB’s technical or research agenda.

§ Staff Research on:
- Current Practices (types and prevalence of measures and adjustments made)
- Comparisons with Other Measures such as Alternative Performance Measures and Key Performance Indicators
- Discussions with Preparers, Investors, Auditors, Others
- Data Aggregators Use
- Activities of Others in the Financial Reporting System (such as other standard setters, auditors, SEC, PCAOB)
Non-GAAP Reporting: Key Takeaways

The FASB evaluates the use of Non-GAAP reporting to improve GAAP

Non-GAAP Derived from GAAP

Some non-GAAP measures are derived directly from GAAP to display alternative measures of performance. Examples include:

- EBITDA
- Adjusted EBITDA
- Operating earnings
- Free cash flow

Non-GAAP Changing GAAP

Some non-GAAP measures help the FASB to identify improvements to GAAP. Examples include standard-setting changes to reduce non-GAAP adjustments in the income statement such as:

- Recording the debt-valuation adjustment for a company’s own credit risk in other comprehensive income
- Allowing entities to qualify for hedge accounting by making the derivatives qualification guidance easier to apply
FASB – Financial Performance Reporting
Income Statement: Perceived Issues

Aggregation of earnings into only a few line items
- Entities are only required to present certain lines
- SG&A and COGS comprise lots of dissimilar items

Limited transparency of items that are useful in making future earnings predictions
- Nonrecurring items aren’t clearly communicated
- Users rely on Non-GAAP measures to provide greater transparency of performance
- Adjustments and nonrecurring items may not be consistent over time

No requirement to prepare a structured income statement
- Use of Non-GAAP metrics suggests that some performance measures, in addition to net income, are important
Two Work Streams

**Disaggregation of Performance Information**
- Added to active technical agenda
- Focus on disaggregating COGS and SG&A into natural components

**Structure of the Performance Statement**
- Retained on the research agenda
- FASB decided to focus on disaggregation first, after which it may return to consider income statement subtotals and totals
Disaggregation - Next steps

§ Outreach with preparers to understand:

(a) how accounting information is rolled up into COGS and SG&A lines

(b) how entities track and review the components

§ Developing terminology to describe what is a COGS and SG&A lines.
Segment Reporting
Segment Reporting: ITC Feedback

2016 Agenda Consultation
- Users rated segment reporting as a high priority in need of improvement.
- Preparers rated it a low priority but acknowledged that improvements are warranted.

Many support making improvements, but do not consider this a major financial reporting issue:
- Segment disclosures are limited and reconciliations can be difficult to tie out.
- Aggregation criteria is subjective and questions continue to arise in practice.
- Other topics take priority, but continued focus on segments is warranted.

Others do not support making improvements:
- Segments are not a major concern and changes are unnecessary.
- Management perspective is sound.
- Post-implementation review noted that the standard is effective.
- It is not possible to force better disclosures under the management approach.
## Segment Reporting: Potential Improvements

<table>
<thead>
<tr>
<th>Potential alternatives</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(1)</strong> Segment disclosure requirements:</td>
</tr>
<tr>
<td>• Adding items to the list of required segment disclosures</td>
</tr>
<tr>
<td>• Requiring information to be reported in a table</td>
</tr>
<tr>
<td><strong>(2)</strong> Aggregation criteria</td>
</tr>
<tr>
<td>• Remove the aggregation criteria, yet retain the practical limit</td>
</tr>
<tr>
<td>• Reorder the reportable segments process and have the size tests appear earlier in that process</td>
</tr>
</tbody>
</table>

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8 August 2017 – Staff undertaken outreach with preparers, users, regulators and audit firms to understand the impact of the different alternatives

8 September 2017 - The Board decided to add a project will focus these areas

8 February 2018 – Discussed issues related to the aggregation criteria
Segment Reporting—Field Testing

§ We plan to undertake field testing
§ Seeking small & large preparers from a variety of industries
§ Please contact lmottley@fasb.org if you would be interested in participating
FASB – Tax Reform
Staff Q&As: Topic 740, Income Taxes

§ On December 22, 2017, the U.S. federal government enacted a tax bill, H.R. 1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (Tax Cuts and Jobs Act).

§ As a result of the Tax Cuts and Jobs Act, stakeholders requested feedback on the following financial reporting issues:
- Whether private companies and not-for-profit entities can apply U.S. Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act
- Whether to discount the tax liability on the deemed repatriation
- Whether to discount alternative minimum tax credits that become refundable
- Accounting for the base erosion anti-abuse tax
- Accounting for global intangible low-taxed income.

§ In response, the FASB staff issued five Staff Q&A documents.
§ These can be found at: http://www.fasb.org/taxcutsjobsact
FASB – Revenue Implementation
Resources to Help with Implementation

- Transition resource group
  - 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)
Level of Implementation Questions: Revenue Recognition Trend

Number of TRG submissions compared with the number of technical inquiries received since the issuance of the standard through April 25, 2018.

Technical Inquiries and TRG Submissions by Year
FASB – Leases Implementation
Targeted Improvements

§ Proposed ASU issued Q1 2018
   - Proposed an additional transition option that would allow entities to adopt Topic 842 with a cumulative-effect adjustment to retained earnings in the period of adoption
   - Proposed a practical expedient to allow lessors to not separate lease and related nonlease component(s) if certain conditions are met

§ Comment letter respondents unconditionally supported the additional transition, and generally supported expanding the lessor practical expedient.

§ In March 2018, the Board decided to:
   - Affirm its decision to provide an additional (and optional) transition method, but require the prior year 840 disclosures
   - Allow lessors to not separate nonlease components from the associated lease components and account for them as a single component when:
     • The timing and pattern of transfer of the nonlease component(s) and associated lease component are the same.
     • The lease component, if accounted for separately, would be classified as an operating lease.
   - Require the combined component to be accounted for in accordance with Topic 606 when the nonlease component(s) is predominant component. Otherwise, account for as an operating lease in accordance with Topic 842.
Other Implementation Requests

March 2018 Board Meeting

§ The Board discussed the accounting for certain lessor costs, such as:
   - Sales taxes
   - Property taxes and insurance.

§ For sales taxes, the Board decided that a lessor can make an accounting policy election to exclude sales taxes collected by the lessor from the lessee as lease income (similar to the accounting policy in par. 606-10-32-2A)

§ The Board also decided to not recognize lessor costs paid directly by a lessee as variable lease payments when the uncertainty in the amount paid by the lessee will not get resolved

§ The project to address these issues is separate from the targeted improvements on the previous slide
FASB – Disclosure Framework
Disclosure Framework - Concepts

- Addition of Concepts Statement No. 8, Conceptual Framework for Financial Reporting - Chapter 8, Notes to Financial Statements
  - Helps the Board identify information that could be appropriate for inclusion in notes to financial statements
  - Describes the purpose of notes and general limitations
  - Promotes consistent decision-making when determining disclosure requirements at the standards level

- Amendments to Concepts Statement No. 8, Conceptual Framework for Financial Reporting - Chapter 3, Qualitative Characteristics of Useful Financial Information
  - Definition of materiality aligned to definitions and discussions of the SEC, auditing standards of the PCAOB and AICPA, and the judicial system in the United States
Topic-Level Testing

§ Fair Value Measurement
§ Defined Benefit Plans
§ Income Taxes
§ Inventory
§ Government Assistance
Disclosure Framework: Fair Value Measurement

Removals
- Amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy
- Policy for timing of transfers between levels
- Valuation processes for Level 3 fair value measurements

Modifications
- NAV disclosure
- Measurement uncertainty disclosure

Additions
- Unrealized gains and losses in OCI for Level 3 recurring fair value measurements held at period end
- Range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements
Disclosure Framework: Defined Benefit Plans

**Confirmed**
- Removal of several disclosures
- Addition of the interest crediting rate for cash plans

**Not Confirmed**
- NAV disclosures
- General characteristics
- Reorganization of the standard

**Revised**
- Reasons for significant gains and losses
- Effect of changes in the healthcare cost trend rate
Next Steps

Summer 2018 (expected): Final documents issued for Board’s Decision Process, Fair Value Measurement, and Defined Benefit Plans

Remaining on the agenda: Inventory and Income Taxes
Appendix - Hedging
Why Does Hedge Accounting Exist?

§ Derivatives are always at Fair Value but hedged exposures (e.g. Inventory and some Financial Instruments) are not. Derivatives are also used to hedge future transactions that have not been recognized (e.g. future commodity purchases or issuances of debt).

§ Without hedge accounting, the use of derivatives to economically manage price and cash flow volatility results in volatile reported results.

§ With hedge accounting, the derivative marks and the price volatility offset one another and volatility is reduced, which is believed to better reflect a company’s economic position.
Why Does Hedge Accounting Exist?

When derivatives are highly effective in offsetting input price volatility (e.g. commodities or interest rates), financial statement reporting is improved when accounting volatility is reduced by reflecting the effects of the hedging derivative and hedged item together.
Example: Hedging Future Corn Prices (Cash Flow Hedge)

No Hedge Accounting

Period 1: Derivative (P&L Gain)
Period 2: COGS (P&L Loss)

With Hedge Accounting

Period 1: Derivative (OCI/Equity Gain)
Period 2: Derivative (P&L Gain)

COGS (P&L Loss)

P&L = Hedged!
Example: Hedging Interest Rates (Swap Fixed Rate to Variable Rate)

No Hedge Accounting

Period 1

Int Rate Derivative (P&L Gain)

LIBOR % 1.25

With Hedge Accounting

Period 1

Int Rate Derivative (P&L Gain)

B/S Debt (Basis Adjustment for Gain/Loss)

LIBOR % 1.25
Component Hedging . . . Nonfinancial Items

Eligible Hedged Risks for Non-Financial Items

**Existing Guidance**

- Variability in total cash flows or overall changes in fair value

**Amended Guidance**

- New: Variability in a contractually specified component
- OR
- Variability in total cash flows or overall changes in fair value

*Note: The proposed amendments do not modify the guidance on hedges of foreign exchange risk*
Component Hedging

Indexes Eligible to be Designated in a Hedge of Interest Rate Risk

Variable rate financial instruments

- Any Contractually Specified Rate*

Fixed rate financial instruments

- U.S. Treasury Rate
- LIBOR Swap Rate
- Overnight Index Swap Rate (OIS)
- SIFMA*

* The contractually specified rate and Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate are newly allowed based on the amended guidance.
Hedge Accounting . . . Overview

For Qualifying Hedging Relationships

- Effective and ineffective portions of derivative gain / loss recorded in current period earnings
- NEW: Presentation of derivative gain / loss in the same income statement line item as hedged item.
- Basis of hedged item adjusted for changes in FV attributable to hedged risk—also through earnings
- Basis adj offsets derivative mark to earnings

- Effective portion of derivative gain / loss deferred in OCI
- NEW: Ineffective portion of derivative gain / loss deferred in OCI
- Amounts previously recorded in AOCI reclassified to earnings when the hedged item affects earnings
- NEW: Presentation of amounts reclassified to earnings in the same income statement line item as hedged item.

The concept of separately recording “ineffectiveness” would be eliminated. The term “ineffectiveness” no longer would be used.
## Income Statement Tabular Disclosure Example

**The Effect of Derivative Instruments on the Statement of Financial Performance**
for the Years Ended December 31, 20X1 and 20X0

<table>
<thead>
<tr>
<th>Location and Amount of Gain or (Loss) Recognized in Income on Fair Value and Cash Flow Hedging Relationships</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Goods Sold</td>
<td>XXX,XXX</td>
<td>$XX,XXX</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>$XX,XXX</td>
<td>XXX,XXX</td>
</tr>
</tbody>
</table>

Total amounts of income and expense line items presented in the statement of financial performance in which the effects of fair value or cash flow hedges are recorded:

<table>
<thead>
<tr>
<th>Cost of Goods Sold</th>
<th>Interest Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>$XX,XXX</td>
<td>$XX,XXX</td>
</tr>
</tbody>
</table>

The effects of fair value and cash flow hedging on line items:

**Gain or (loss) on fair value hedging relationships in Subtopic 815-20**

- **Interest contracts**
  - Hedged items: n/a, XX,XXX
  - Derivatives designated as hedging instruments: n/a, XX,XXX
  - Amount excluded from effectiveness testing: n/a, XX,XXX

**Gain or (loss) on cash flow hedging relationships in Subtopic 815-20**

- **Commodity contracts**
  - Amount of gain or (loss) reclassified from accumulated other comprehensive income into income: XX,XXX, n/a, XX,XXX
  - Amount excluded from effectiveness testing: XX,XXX, n/a, XX,XXX

Users will be able to understand how hedging affected certain income statement line items.
### Balance Sheet Disclosure Example

<table>
<thead>
<tr>
<th>Line Item in the Statement of Financial Position in Which the Hedged Item Is Included</th>
<th>Carrying Amount of the Hedged Assets/(Liabilities)</th>
<th>Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets/(Liabilities)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans Receivable (s)</td>
<td>20X2</td>
<td>20X1</td>
</tr>
<tr>
<td></td>
<td>$115</td>
<td>$124</td>
</tr>
</tbody>
</table>

|                                                                                 | 20X2 | 20X1 |
|                                                                                 | $10  | 60   |
|                                                                                 | 20   | 20   |

(a) These amounts include the amortized cost basis of closed portfolios used to designate hedging relationships in which the hedged item is the last layer expected to be remaining at the end of the hedging relationship. At December 31, 20X2 and 20X1, the amortized cost basis of the closed portfolios used in these hedging relationships was $52 and $60, respectively, the cumulative basis adjustments associated with these hedging relationships was $5 and $7, respectively, and the amounts of the designated hedged items were $16 and $18, respectively.

(b) The balance includes $2 of hedging adjustment on a discontinued hedging relationship.

The purpose of this disclosures is to provide users with information about the amount, timing, and uncertainty of prospective cash flows associated with hedged assets or liabilities.
Hedge Accounting... Last-of-Layer Approach

- Allows an entity to align the maturity dates of all assets in a portfolio

- Allows an entity to align the interest rate component of all assets in a portfolio using the benchmark rate component cash flows

End result is a portfolio of identical assets

- For fair value hedges of interest rate risk
- The hedged item will be a designated last amount in a closed portfolio of prepayable financial assets.
- As long as the remaining balance in the portfolio is expected to be greater than that amount designated in the hedging relationship, the hedged item would remain valid. The entity would consider all prepayments to occur first on the “unhedged” layer of the portfolio.
- Because the portfolio is closed, a similar assets test will only need to be performed at hedge inception for the purpose of determining whether the hedged item can be considered valid.
- Basis adjustments can be estimated and accounted for at the portfolio level during the life of the hedging relationship.
- If prepayments occur such that the last amount is breached, the hedge must be redesignated.
Effective Date . . . Final Standard

Beginning of fiscal year:

2018  2019  2020  2021  2022

Hedging
Early adoption permitted

Public Business Entities (Annual and Interim)

Non-Public Business Entities* (Annual Periods Only)

Non-Public Business Entities* (Annual and Interim Periods)

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

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