ACCOUNTING

Goodwill impairment: Reporting units with negative equity

When testing goodwill for impairment, debt should be included in the reporting unit if (a) the debt relates to the operations of the reporting unit, and (b) the debt is likely to be transferred in the event the reporting unit is sold. This would be the case where the buyer would either assume the debt or, as more commonly done, pay off the debt on behalf of the seller at the time of closing. In most cases, the inclusion of long-term debt in a reporting unit would not impact the results of the impairment test, since the debt also will be subtracted from the calculated enterprise value to arrive at the fair value of equity. The result could be different if the fair value of the debt differs from its carrying amount.

The consideration as to whether debt should be included in a reporting unit is most important when the carrying amount of the reporting unit is negative. Prior to the adoption of Financial Accounting Standards Board Accounting Standards Update (ASU) 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, if a reporting unit had a negative carrying amount, a qualitative assessment first was performed to determine whether it was more likely than not that goodwill was impaired. If it was determined that goodwill was likely impaired, Step 2 was performed to determine the amount of impairment. However, ASU 2017-04 eliminated Step 2 of the impairment test. Instead, goodwill impairment is recognized based on the amount by which the carrying amount of the reporting unit exceeds its fair value. As a result, where the carrying amount of a reporting unit is negative, goodwill will automatically not be impaired, and no test would be performed.

When a reporting unit has a negative value as a result of the inclusion of debt, the entity should take a close look at whether the inclusion of the debt is appropriate. A common consideration is related party debt. Debt payable to a significant shareholder should not be included in a reporting unit. Upon a sale of the company, the related party debt likely would be forgiven or otherwise converted to equity. Even if a buyer would pay the debt, the payment might in-substance be no different than payment for equity.

Other liabilities that might be excluded from a reporting unit when testing goodwill include warrant liabilities, equity instruments that are required to be classified as liabilities under the provisions of ASC 480, and instruments classified as temporary equity following SEC guidelines.

Where it has been concluded that debt should not be included in the carrying amount of a reporting unit, the debt also would not be deducted from the enterprise value when determining the fair value of equity.
Narrow-scope amendments to financial instruments standards

The Financial Accounting Standards Board recently issued Accounting Standards Update (ASU) 2019-04, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, to make clarifying amendments to certain financial instrument standards, which are summarized in part below. Reference should be made to ASU 2019-04 for a complete understanding of its provisions and the related effective dates.

Related to ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, the amendments allow an entity to:

- Measure the allowance for credit losses on accrued interest receivable balances separately from other components of the amortized cost basis of associated financial assets
- Make accounting policy elections to:
  - Not measure an allowance for credit losses on accrued interest receivable amounts if the entity writes off the uncollectible accrued interest receivable balance in a timely manner and makes certain disclosures
  - Write off accrued interest amounts by reversing interest income or recognizing credit loss expense, or a combination of both
  - Present accrued interest receivable balances and the related allowance for credit losses for those accrued interest receivable balances separately from the associated financial assets on the balance sheet
  - Adjust the effective interest rate used to discount expected future cash flows for expected prepayments on financial assets within the scope of Subtopic 326-20 and on available-for-sale debt securities within the scope of Subtopic 326-30 to appropriately isolate credit risk in determining the allowance for credit losses
  - Elect a practical expedient to disclose separately the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements

Additionally, among other provisions, the amendments related to ASU 2016-13 also clarify that:

- With respect to the allocation of equity method losses when an investor has other investments, such as loans and debt securities, in the equity method investee, entities should refer to Topic 326 for the subsequent measurement of those loans and debt securities
- Recoveries should be included when estimating the allowance for credit losses
- Expected recoveries of amounts previously written off and expected to be written off should be included in the valuation account and should not exceed the aggregate of amounts previously written off and expected to be written off
- An allowance for credit losses that is added to the amortized cost basis of collateral-dependent financial assets should not exceed amounts previously written off
- All reinsurance recoverables within the scope of Topic 944, “Financial Services—Insurance,” are within the scope of Subtopic 326-20
- There is flexibility in determining the allowance for credit losses by removing the prohibition of using projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate financial instruments
- The estimated costs to sell should be considered when foreclosure on a financial asset is probable and the entity intends to sell rather than operate the collateral
• Line-of-credit arrangements that convert to term loans should be presented in a separate column in the vintage disclosures
• Extension and renewal options that are not unconditionally cancellable by the entity should be considered when determining the contractual term of a financial asset

The amendments related to ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, clarify certain matters, including those related to:
• Partial-term fair value hedges of interest rate risk
• Amortization and disclosure of fair value hedge basis adjustments
• Consideration of the hedged contractually specified interest rate under the hypothetical derivative method
• Its application to not-for-profit entities
• Reclassification of a debt security from held-to-maturity to available-for-sale and other transition matters

Among other provisions, the amendments related to ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, clarify that:
• Entities that are not public business entities are exempt from fair value disclosure requirements for financial instruments that are not measured at fair value on the balance sheet, including held-to-maturity debt securities
• The remeasurement of an equity security without a readily determinable fair value when an orderly transaction is identified for an identical or similar investment of the same issuer is a nonrecurring fair value measurement, subject to the relevant disclosure requirements of Topic 820, “Fair Value Measurement”

Definition of “direct care” of collection items

Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2019-03, Not-for-Profit Entities (Topic 958): Updating the Definition of Collections, modified one of the criterion in the definition of “collections,” allowing the proceeds from sales of collection items to be used to support the direct care of existing collections, in addition to the acquisition of other items for collections. Because the term “direct care” is not defined in the FASB Accounting Standards Codification, the American Institute of Certified Public Accountants recently issued Q&A 6140.27, “Definition of Direct Care of Collection Items.”

Per this guidance, when determining which costs are considered “direct care” of collection items, important characteristics to consider include, but are not limited to, whether those costs:
• Enhance the life, usefulness or quality of an entity’s collection
• Provide a benefit to the collections (and not the entity as a whole or other areas of the entity beyond the collections)
• Exclude expenditures that are regular and ongoing in nature, such as expenditures for routine maintenance of the collection

ASU 2019-03 is effective for financial statements issued for fiscal years beginning after December 15, 2019. Early application of the amendments is permitted. Amendments made in the adoption of ASU 2019-03 should be applied on a prospective basis.
PUBLIC SECTOR

Actuarial valuation: New mortality tables for public-sector plans

Professional associations of actuaries and actuarial companies occasionally develop and publish updated mortality tables to reflect changes in mortality conditions based on recent historical trends and other information. The Society of Actuaries (SOA) has released new mortality tables, Pub-2010, the first mortality tables designed specifically for use by public-sector plans.

Most public-plan sponsors will see their pension and OPEB liabilities increase with the adoption of the Pub-2010 tables, but the magnitude of the increase will depend both on the specific table adopted and the mortality assumption currently in place.

Pub-2010 is not a single mortality table but rather a family of 94 tables. The SOA analyzed multiple variables that might reasonably be expected to have a significant effect on mortality rates, and the published tables reflect multiple combinations of:

- Gender (male/female)
- Job category (teachers/public safety/general (all others))
- Employment status (active/retired/contingent survivors)
- Health status (healthy/disabled)
- Amount above or below median (income for active employees/benefit amount for retirees)

In addition, Pub-2010 includes separate tables that are weighted by headcount and by amount of income/benefit.

Currently, the mortality assumptions used by public-sector clients vary broadly, with some clients using assumptions based on their own credible experience, others using the most recently published private-sector tables (RP-2014) and still others using older tables such as RP-2000. Since all of the publicly available tables were constructed exclusively with mortality data from private-sector plans, public-sector plans generally have exercised a degree of latitude in selecting their mortality assumption, and the range of assumptions considered to be reasonable has been broader than the range for private-sector plans.

The following tables show the expected increase in annuity values (and therefore liabilities) at various ages and relative to the current use of various mortality assumptions (note that “RP-2006 WC” shown below refers to the White Collar version of that table):
For example, the liability for a female teacher, age 55, with the current valuation assumption for mortality being RP-2006 (RP-2014 adjusted to 2006) with mortality improvement based on scale MP-2017 is expected to increase by 7.3%.

### PUBLIC SAFETY

| Age 25 | 1.1735 | 1.1671 | 1.1960 | 1.12406 | 5.7% | 6.3% | 3.7% |
| Age 35 | 2.2720 | 2.2594 | 2.3191 | 2.4113 | 6.1% | 6.7% | 4.0% |
| Age 45 | 4.4101 | 4.3812 | 4.5028 | 4.6932 | 6.4% | 7.1% | 4.2% |
| Age 55 | 8.6263 | 8.5443 | 8.7849 | 9.1655 | 6.3% | 7.1% | 4.3% |
| Age 65 | 13.0772 | 12.9595 | 13.3331 | 13.9245 | 6.5% | 7.4% | 4.4% |
| Age 75 | 9.8517 | 9.6858 | 10.0300 | 10.5286 | 6.9% | 8.7% | 5.0% |
| Age 85 | 6.3586 | 6.0423 | 6.2543 | 6.6215 | 4.1% | 9.6% | 5.9% |
| Age 25 | 1.1220 | 1.0994 | 1.1543 | 1.1867 | 5.8% | 7.9% | 2.8% |
| Age 35 | 2.1668 | 2.1251 | 2.2369 | 2.3018 | 6.2% | 8.3% | 2.9% |
| Age 45 | 4.1995 | 4.1143 | 4.3391 | 4.4721 | 6.5% | 8.7% | 3.1% |
| Age 55 | 8.2051 | 8.0345 | 8.4670 | 8.7317 | 6.4% | 8.7% | 3.1% |
| Age 65 | 12.3695 | 12.2340 | 12.8373 | 13.2171 | 6.9% | 8.0% | 3.0% |
| Age 75 | 8.9093 | 8.9690 | 9.4431 | 9.7232 | 9.1% | 8.4% | 3.0% |
| Age 85 | 5.3409 | 5.4378 | 5.6904 | 5.8822 | 10.1% | 8.2% | 3.4% |
As can be seen in the tables, increases for teachers are expected to be more significant than for other job categories, but some level of increase is expected for all job categories. It is also important to note that the tables above show expected increases for only a few of the mortality assumptions currently in use. Public-sector plans using older mortality tables, or an older (or no) assumption for mortality improvement could see their liability increase more than is shown in these tables.

Because the Pub-2010 mortality tables have been published and are publicly available, the actuaries at Risk & Regulatory Consulting who review benefit plans for RSM will expect that public-sector plans will either adopt these tables, or the actuary for the plan will document that these tables were considered and provide the reason they were not adopted. Large public-sector plans relying on tables constructed or adapted from their own credible experience are expected to continue to use their own tables.

If you have questions about the Pub-2010 tables, or about how they might be expected to affect the liability for a specific public-sector plan, please contact one of the actuaries at Risk & Regulatory Consulting (Joe Belger (joe.belger@riskreg.com, (312) 961-1122); Steve LaPlant (steve.laplant@riskreg.com, (214) 755-4928); Todd Muchnicki (todd.muchnicki@riskreg.com, (631) 626-1954); or John Zomchick (john.zomchick@riskreg.com, (917) 548-9938).

GASB releases implementation guidance

The Governmental Accounting Standards Board (GASB) recently issued Implementation Guide No. 2019-1, Implementation Guidance Update – 2019, to provide guidance that clarifies, explains and elaborates on recent GASB Statements. The implementation guide addresses a wide array of practice issues, including questions related to standards on postemployment benefits, derivative instruments, nonexchange transactions, fund balance reporting, tax abatement disclosures, irrevocable split-interest agreements, and pensions, among others.

The requirements of the Implementation Guide are effective for reporting periods beginning after June 15, 2019.
SEC

Proposed disclosure amendments: Acquired and disposed businesses

The SEC recently proposed amendments to the financial disclosure requirements in Rules 3-05, 3-14, and Article 11 of Regulation S-X, as well as related rules and forms, for financial statements of businesses acquired or to be acquired and for business dispositions. If finalized, among other reforms, the proposed changes would:

- Update the significance tests under these rules by revising the investment test and the income test, expanding the use of pro forma financial information in measuring significance, and conforming the significance threshold and tests for a disposed business.
- Require the financial statements of the acquired business to cover up to the two most recent fiscal years rather than up to the three most recent fiscal years.
- Permit disclosure of financial statements that omit certain expenses for certain acquisitions of a component of an entity.
- Clarify when financial statements and pro forma financial information are required.
- No longer require separate acquired business financial statements once the business has been included in the registrant’s post-acquisition financial statements for a complete fiscal year.
- Align Rule 3-14 with Rule 3-05 where no unique industry considerations exist.
- Clarify the application of Rule 3-14 regarding the determination of significance, the need for interim income statements, special provisions for blind pool offerings, and the scope of the rule’s requirements.
- Amend the pro forma financial information requirements to include disclosure of “Transaction Accounting Adjustments” reflecting the accounting for the transaction, and “Management’s Adjustments” reflecting reasonably estimable synergies and transaction effects.
- Make corresponding changes to the smaller reporting company requirements in Article 8 of Regulation S-X and to the Regulation A requirements.

The SEC also proposed new Regulation S-X Rule 6-11 and amendments to govern financial reporting for fund acquisitions by investment companies and business development companies.

INTERNATIONAL

Proposed amendments address interest rate benchmark uncertainty

International Financial Reporting Standards (IFRS) require companies to use forward-looking information to apply hedge accounting. Ongoing interest rate benchmark reform has led to uncertainty about when the current interest rate benchmarks will be replaced and with what interest rate. This uncertainty could result in a company having to discontinue hedge accounting solely because of the reform’s effect on its ability to make forward-looking assessments.

The International Accounting Standards Board recently issued proposed amendments to IFRS 9, Financial Instruments, and International Accounting Standard 39, Financial Instruments: Recognition and Measurement. If finalized, the amendments would modify specific hedge accounting requirements so that entities would apply those requirements assuming that the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of interest rate benchmark reform. The proposed amendments would not provide relief from any other consequences arising from interest rate benchmark reform.

The Exposure Draft, Interest Rate Benchmark Reform, is available for comment until June 17, 2019.