FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2017-08
March 2017

Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20)

Premium Amortization on Purchased Callable Debt Securities

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing this Update to amend the amortization period for certain purchased callable debt securities held at a premium. The Board is shortening the amortization period for the premium to the earliest call date. Under current generally accepted accounting principles (GAAP), entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument.

Stakeholders raised concerns that current GAAP excludes certain callable debt securities from consideration of early repayment of principal even if the holder is certain that the call will be exercised. As a result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. Additionally, stakeholders told the Board that there is diversity in practice (1) in the amortization period for premiums of callable debt securities and (2) in how the potential for exercise of a call is factored into current impairment assessments.

Stakeholders noted that generally, in the United States, callable debt securities are quoted, priced, and traded assuming a model that incorporates consideration of calls (also referred to as "yield-to-worst" pricing). Financial statement users also told the Board that the amendment to the amortization period in this Update will provide more decision-useful information because it better aligns the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium).

What Are the Main Provisions?

The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Under current GAAP, premiums and discounts on callable debt securities generally are amortized to the maturity date. An entity must have a large number of similar loans to consider estimates of future principal prepayments when applying the interest method. However, an entity that holds an individual callable debt security at a premium may not amortize that premium to the earliest call date. If that callable debt security is subsequently called, the entity records a loss equal to the unamortized premium.

The amendments in this Update more closely align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities. In most cases, market participants price securities to the call date that produces the worst yield when the coupon is above current market rates (that is, the security is trading at a premium) and price securities to maturity when the coupon is below market rates (that is, the security is trading at a discount) in anticipation that the borrower will act in its economic best interest. As a result, the amendments more closely align interest income recorded on bonds held at a premium or a discount with the economics of the underlying instrument.

When Will the Amendments Be Effective?

For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–8. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 310-20

2. Amend paragraph 310-20-35-33, with a link to transition paragraph 310-20-65-1, as follows:

[Note: The definition of the term *Debt Security* is shown for convenience.]

Debt Security

Any security representing a creditor relationship with an entity. The term debt security also includes all of the following:

a. Preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor
b. A collateralized mortgage obligation (or other instrument) that is issued in equity form but is required to be accounted for as a nonequity instrument regardless of how that instrument is classified (that is, whether equity or debt) in the issuer's statement of financial position
c. U.S. Treasury securities
d. U.S. government agency securities
e. Municipal securities
f. Corporate bonds
g. Convertible debt
h. Commercial paper
i. All securitized debt instruments, such as collateralized mortgage obligations and real estate mortgage investment conduits
j. Interest-only and principal-only strips.

The term debt security excludes all of the following:

a. Option contracts
b. Financial futures contracts
c. Forward contracts
d. Lease contracts

e. Receivables that do not meet the definition of *security* and, so, are not debt securities, for example:
   1. Trade accounts receivable arising from sales on credit by industrial or commercial entities
   2. Loans receivable arising from consumer, commercial, and real estate lending activities of financial institutions.

Receivables—Nonrefundable Fees and Other Costs

Subsequent Measurement

> Estimating Principal Prepayments

310-20-35-33 ~~Assuming that an entity purchases~~To the extent that the amortized cost basis of an individual callable **debt security**~~bond at a premium~~ exceeds the amount repayable by the issuer at the earliest call date, the excess (that is, the premium) shall~~may not~~ be amortized to the earliest call date, unless the guidance in paragraph 310-20-35-26 is applied to consider estimated prepayments. After the earliest call date, if the call option is not exercised, the entity shall reset the effective yield using the payment terms of the debt security. Securities within the scope of this paragraph are those that have explicit, noncontingent call features that are callable at fixed prices and on preset dates. ~~Under paragraph 310-20-35-26, an entity must have a large number of similar loans in order to consider estimates of future principal prepayments when applying the interest method.~~

3. Add paragraph 310-20-65-1 and its related headings as follows:

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*

310-20-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities:*

a. For **public business entities**, the pending content that links to this paragraph shall be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

b. For all other entities, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.
c. The pending content that links to this paragraph shall be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption.
d. Earlier application of the pending content that links to this paragraph is permitted for all entities, including adoption in an interim period. If an entity early adopts the pending content that links to this paragraph in an interim period, any adjustments shall be reflected as of the beginning of the fiscal year that includes that interim period.
e. An entity shall provide the disclosures about a change in accounting principle in paragraphs 250-10-50-1 through 50-3 in the period of adoption.

Amendments to Subtopic 942-320

4. Amend paragraph 942-320-35-1, with a link to transition paragraph 310-20-65-1, as follows:

Financial Services—Depository and Lending—Investments—Debt and Equity Securities

Subsequent Measurement

> Amortization or Accretion Period

942-320-35-1 The period of amortization or accretion for debt securities shall generally extend from the purchase date to the maturity date, unless other Topics are applicable~~not an earlier call date~~.

Amendments to Subtopic 946-320

5. Amend paragraph 946-320-35-20, with a link to transition paragraph 310-20-65-1, as follows:

Financial Services—Investment Companies—Investments—Debt and Equity Securities

Subsequent Measurement

> Premiums and Discounts

946-320-35-20 Premiums and discounts shall be amortized using the interest method. The amortization of premiums on purchased callable debt securities that have explicit, noncontingent call features that are callable at fixed prices on preset dates shall be consistent with the guidance in paragraph 310-20-35-33.

Amendments to Status Sections

6. Amend paragraph 310-20-00-1, by adding the following items to the table, as follows:

310-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Public Business Entity	Added	2017-08	03/30/2017
310-20-35-33	Amended	2017-08	03/30/2017
310-20-65-1	Added	2017-08	03/30/2017

7. Amend paragraph 942-320-00-1, by adding the following item to the table, as follows:

942-320-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
942-320-35-1	Amended	2017-08	03/30/2017

8. Amend paragraph 946-320-00-1, by adding the following item to the table, as follows:

946-320-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
946-320-35-20	Amended	2017-08	03/30/2017

The amendments in this Update were adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Mr. Siegel dissented.

Mr. Siegel does not support the amendments in this Accounting Standards Update because he believes that they fail to address the original objective of the project, which was to provide additional disclosures about interest income on purchased debt securities and loans. Mr. Siegel's concern is further heightened because the Board also decided to remove from its technical agenda any further consideration of those disclosures, thereby failing to address a challenge that many financial statement users face in understanding the relationship of net interest margin and the sufficiency of the allowance for loan losses of purchased loans with those of originated loan portfolios.

Mr. Siegel agrees with the amendments in this Update about the premium amortization on purchased callable debt securities. However, in his view, the Board has squandered an opportunity to address issues raised by many investors, including several members of the FASB's Investor Advisory Committee, who agreed with the project objective when the project was added to the technical agenda. The original project objective was "to enhance the transparency and usefulness of the information provided in the notes to the financial statements about interest income on purchased debt securities and loans." On September 16, 2015, the Board expanded the scope of the project to consider targeted improvements about the accounting for the amortization of premiums for purchased callable debt securities but did not remove the objective related to transparency of interest income on purchased debt securities and loans. While the amendments in this Update address the premium amortization issue that was added to the project's scope in September 2015, Mr. Siegel's concern is that the original project objective has not been resolved and is no longer on the technical agenda.

Mr. Siegel notes that in many forums over the last several years, including multiple meetings of the Investor Advisory Committee, investors raised concerns about the effect on financial statement trends of purchasing material amounts of financial assets that are not within the scope of Subtopic 310-30, Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality. Historical trends of important ratios such as the loan allowance to gross loan ratio and net interest margin ratio can be significantly affected by large purchases of loan portfolios. Mr. Siegel notes that this concern has been exacerbated with an increasing number of bank consolidations following the financial crisis. Mr. Siegel acknowledges that the recently finalized guidance in Topic 326, Financial Instruments—Credit Losses, allows for the gross up of more-than-insignificant purchase credit discounts, partially addressing the issue of credit discounts flowing through interest income by capturing more purchased financial assets within its scope. However, he remains concerned that interest income will continue to be affected by purchased loans because of the sheer volume of loans with credit discounts that may not qualify for gross-up treatment. Additionally, the earliest time the guidance in Topic 326 will be applied is 2019.

Mr. Siegel would have preferred that the amendments in this Update addressed the original problem embedded in the original project objective. To have done that in the most cost-effective manner, Mr. Siegel would have limited the scope of the suggested disclosure improvements to purchased loans. Those disclosure improvements would have included, at a minimum, a requirement in a period in which an entity purchased loans to disclose a reconciliation of the difference between the purchase price of the loan and the par value of the loan, including (1) the purchase price, (2) the discount (or premium), and (3) the par value. Mr. Siegel notes that an identical reconciliation is required under Topic 326 for purchased financial assets with credit deterioration. Providing similar requirements for purchased loans that have not experienced credit deterioration would help users with comparing and evaluating interest income and the allowance for loan losses across the loan portfolio and in addressing the initial issue that was embedded in the original project objective. In addition to this reconciliation, Mr. Siegel also would have preferred that the Board required disclosure of the weighted-average remaining life of the loans. Mr. Siegel notes that those two disclosures could be implemented before the effective date of Topic 326 and that they would be a cost-effective way to help financial statement users understand the effect of the acquired portfolio on trends in the ratio of allowance for loan losses to gross loans as well as the potential effect on future net interest margin.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. In April 2014, users told the Board that they found it difficult to project future cash inflows from interest income because disclosures about the interest income associated with purchased debt securities and loans were limited. Specifically, those users wanted additional insight on what portion of interest income was attributable to cash flows and what portion was attributable to the amortization of premiums and discounts.

BC3. Additionally, other stakeholders told the Board that the accounting for interest income on callable debt securities held at a premium did not reflect the underlying economics of the instruments. Under Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs, any difference between the initial investment and the principal amount of a purchased loan or debt security must be recorded as an adjustment of yield over the contractual life of the instrument (in other words, yield to maturity). Paragraph 310-20-35-26 states that prepayments shall not be anticipated in calculating the constant effective yield necessary to apply the interest method for recognizing interest income, except if an entity holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated. In addition to instruments that fall within the scope of paragraph 310-20-35-26, prepayments are considered in estimating the effective yield for financial instruments within the scope of Subtopic 325-40, Investments—Other—Beneficial Interests in Securitized Financial Assets.

BC4. Stakeholders raised concerns that certain callable debt securities would not meet the requirements necessary under the guidance in paragraph 310-20-35-26 or within Subtopic 325-40 to be able to consider anticipated early repayments in calculating effective yield, even if the holder is certain that the borrower will repurchase the security at the call date. Stakeholders said that the existing amortization period for premiums on callable debt securities does not reflect the economics of the underlying transactions. Preparers noted that in the United States, pricing quotes for securities incorporate consideration of calls. In most cases, investors price securities to the call date that produces the worst yield when the coupon is above current market rates (that is, the security is trading at a premium) and price securities to maturity when the coupon is below market rates (that is, the security is trading at a discount) in anticipation that the borrower will act in its economic best interest.

BC5. At its agenda prioritization meeting on March 18, 2015, the Board discussed the feedback from both users and other stakeholders and decided to add a project to its agenda to require disclosures about interest income on purchased debt securities and loans. This Board decision left the accounting for interest income unchanged.

BC6. Subsequently, the Board received additional feedback from preparers in the financial services industry. As a result of that feedback, at its September 16, 2015 Board meeting, the Board amended the scope of the project to include the method of amortization for callable debt securities. Separately, before issuing a public document for comment, on July 27, 2016, the Board reconsidered the scope of the project in its entirety and decided to limit the scope only to the method of amortization (see reasons in paragraph BC25 below).

BC7. In September 2016, the Board issued proposed Accounting Standards Update, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities* (the proposed Update), which proposed amendments to shorten the amortization period for callable debt securities purchased at a premium—specifically, that the premium should be amortized to the earliest call date. The Board received 28 comment letters on the proposed Update.

Basis for Conclusions

Scope

BC8. Stakeholders originally raised concerns about municipal securities, which make up the majority of the callable premium securities market. Municipal issuers typically sell bonds with 30-year maturities and 10-year issuer-par-call options at premium dollar prices often because of investor demand that is driven by tax law. Tax-exempt bonds acquired by individuals at a “more-than-de-minimis” discount are subject to ordinary income tax rates on their appreciation back to par, while bonds purchased at higher prices are subject to a capital gains rate. Therefore, tax laws incentivize individual investors to purchase municipal bonds at either a premium or a modest discount. Therefore, municipalities are incentivized to issue bonds at a premium to reduce the probability of the bonds trading at a “more-than-de-minimis” discount in the secondary markets. Furthermore, absent increases in market interest rates, the effect of the tax laws provides the incentive for municipalities to call the bonds at the earliest call date as a result of issuing bonds at a premium.

BC9. The Board considered whether the scope of the amortization period change should include all callable debt securities or callable municipal securities only. The

Board decided that the scope should include all callable debt securities, primarily because it concluded that there is no economic difference between callable municipal securities and other types of callable debt securities when held at a premium; therefore, there was no conceptual basis for limiting the scope to only callable municipal securities. Furthermore, the Board added that this scope would be clearer to financial statement users and more operable for preparers of financial statements. Both preparers and users indicated that they preferred a scope of all callable debt securities because the accounting would be consistent for similar instruments. Therefore, the scope of the amendments in the proposed Update was not limited to certain types of issuers of callable debt securities.

BC10. Respondents to the proposed Update asked for clarity on the scope of the proposed amendments, specifically relating to which type of "callable" instruments the guidance would be applicable. The Board concluded that the proposed amendments would be difficult to operationalize if the scope included call features in which the call date or call price were not known in advance. Therefore, the Board decided that the scope of the guidance in paragraph 310-20-35-33 should be limited to securities that have explicit, noncontingent call features that are callable at fixed prices and on preset dates. However, for instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the amendments in this Update. As a result of this scope decision, the existence of prepayment features in which the prepayment date is not preset (that is, it is immediately prepayable) or the price is not known in advance does not result in the instrument being included within the scope of the amendments in this Update. Similarly, the existence of such prepayment features in financial assets securitized into debt securities does not result in those debt securities, such as mortgage-backed securities, being included within the amendments' scope. However, the Board understands that in practice entities apply the guidance in paragraph 310-20-35-26 to certain prepayable debt securities to determine interest income. The Board's intent is not to change current practice relating to paragraph 310-20-35-26 for estimating prepayments; therefore, the Board expects entities will continue to apply paragraph 310-20-35-26 to certain debt securities when relevant.

BC11. Respondents to the amendments in the proposed Update also asked that the Board clarify whether only purchase premiums, or all premiums, regardless of how they were generated (for example, deferred acquisition costs and cumulative fair value hedge adjustments that increase the amortized cost basis of a callable security above par value), should be amortized to the earliest call date. The Board decided that the amortization period should apply to all premiums, regardless of how they were generated, for two main reasons. First, the Board could not identify a conceptual basis to differentiate the accounting for purchase premiums from other premiums. The Board stated that any such differentiation would result in other carrying value adjustments being amortized in a manner that is inconsistent with the market economics of a callable security and, therefore, contrary to the stated objective of better aligning the accounting with the market expectations incorporated in pricing. Second, the Board added that requiring entities to amortize multiple basis adjustments over separate time periods would introduce unnecessary complexity for both preparers and users of financial statements.

BC12. Callable debt securities within the scope of the amendments in this Update also may be hedged items in hedge accounting relationships within Topic 815, Derivatives and Hedging. A company with an active hedging relationship that hedges interest rate risk on callable debt should continue to follow its policies under Subtopic 815-25, Derivatives and Hedging—Fair Value Hedges, to account for hedge accounting basis adjustments. To the extent the hedging relationship is discontinued and a hedge accounting basis adjustment remains, a company must then follow the amendments in this Update.

Amortization Period

BC13. In concluding on the amortization period, the Board considered the cost and complexity of a management expectation model similar to the International Financial Reporting Standards (IFRS) guidance under IFRS 9, *Financial Instruments*. IFRS differs from GAAP in that, under IFRS, prepayment options are factored into the calculation of the effective interest rate in most cases for financial instruments measured at amortized cost. Under IFRS 9, measuring the amortized cost of a financial instrument with prepayment options is based on the notion of the instrument's expected life. Therefore, IFRS 9 requires an entity to estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call, and similar options). However, the Board determined that the increased cost and complexity of this model may not justify the benefits when applied only to callable debt securities.

BC14. Additionally, at the request of certain respondents to the amendments in the proposed Update, the Board considered the cost and complexity of requiring a yield-to-worst amortization methodology rather than a yield-to-earliest call amortization methodology. Those respondents pointed out that some callable bonds have multiple call dates with differing prices (that is, call tables). The yield-to-worst pricing methodology assumes that the issuer will call on the call date that produces the worst yield, which is not necessarily the earliest call date. For example, if there are different call premiums associated with different call dates, the earliest call date might not produce the worst yield.

BC15. Certain Board members preferred a yield-to-worst amortization methodology because it is more consistent with market pricing and results in a more precise reflection of the economics of the debt security. Also, it presents an opportunity to align GAAP reporting with regulatory reporting requirements for preparers in the insurance industry.

BC16. However, consistent with the view of the majority of respondents to the proposed Update, the Board decided that amortizing to the earliest call date substantially achieves the stated objective of better aligning the accounting with expectations incorporated in market pricing while reducing the cost and effort necessary to analyze and conclude on a likely call date broadly across all industries to which the amendments in this Update apply. The cost of considering all call dates within a particular callable security may be higher for companies without access to sophisticated pricing systems or those companies that have an active investment portfolio of callable securities. In addition, the Board learned that in a majority of purchases the yield would be the same under either approach but to perform a yield-to-worst calculation for each purchase would create unnecessary internal controls and financial reporting costs.

BC17. Furthermore, the effective rate as determined under a yield-to-worst pricing methodology can change from period to period when interest rates change. Therefore, to be consistent with a yield-to-worst pricing methodology, a yield-to-worst amortization methodology also would require companies to periodically reassess their effective rate. Such an approach also might have required the Board to develop guidance to determine how to report a changing effective rate from period to period, and companies would have potentially needed to implement systems to account for the effect of such a change in circumstances. Alternatively, the Board could have required a modified yield-to-worst amortization methodology in which the effective rate is set upon purchase and not updated periodically, which more closely follows insurance regulatory requirements. However, that approach would still contain the potential operational complexities and cost-benefit considerations described in paragraph BC16.

BC18. Lastly, only those bonds that have varying call prices on varying call dates or those that have other features such as increasing interest rates (that is, step-up bonds) may have a “worst yield” that is determined by amortizing the premium to a call date other than the first call date. However, those types of securities are a relatively small portion of all callable bonds. In summary, the Board determined that a yield-to-worst amortization methodology provides further precision to a small minority of callable debt securities but that the yield-to-worst amortization methodology does not provide greater benefits or a reduction in costs to the greater population of callable debt securities.

BC19. After considering the costs and complexities associated with a yield-to-worst approach, the Board concluded that a yield-to-earliest call approach was a more cost-effective way to better align interest income recorded on bonds at a premium with the economics of the underlying instrument than current GAAP. Therefore, the Board affirmed its decision to require a yield-to-earliest call amortization methodology rather than a more precise yield-to-worst amortization methodology.

BC20. The Board considered whether amortizing premiums to the earliest call date would be appropriate in circumstances in which a security was not called as expected on the earliest call date. In that situation, if the call price is at par, as it is in most circumstances, the interest income would be lower in the periods before the earliest call date, because of the amortization of the premium, and higher after the earliest call date, because of interest income being reset to the coupon rate. If the security was not called at the earliest call date, it would likely be because of market interest rates rising above the security's coupon rate. Therefore, resetting the interest rate to the coupon rate after the earliest call would reflect the rise in market interest rates. The Board determined that this approach is appropriate because this outcome is consistent with the market economics of the security. Additionally, for these same reasons, the Board concluded that this accounting change is appropriate regardless of the interest rate environment (that is, in a period of rising, falling, or stagnated interest rates) and because it is an improvement to GAAP because it better reflects the economics at the point in time of the purchase of the security and in subsequent periods.

BC21. In situations in which an entity amortizes a premium to a call price greater than par and the debt security is not called on the earliest call date, an entity would reset the yield using the payment terms of the debt security. If the security contained additional future call dates, the entity would consider whether the amortized cost basis exceeded the amount repayable by the issuer at the next call date. If so, the excess would be amortized to the next call date.

BC22. In summary, the Board determined that amortizing the premium (that is, the excess of amortized cost basis over the amount repayable at the earliest call date) to the earliest call date improves the usefulness of the information provided to financial statement users by more closely aligning accounting with market economics while reducing cost and complexity.

Disclosures

BC23. As described in paragraphs BC2–BC7 above, before the issuance of the proposed Update, in addition to amending the amortization period for purchased callable debt securities, the Board considered adding disclosures that could enhance the transparency of the components that make up interest income on purchased debt securities and loans.

BC24. The Board considered whether to split effective yield into (a) contractual interest and (b) other adjustments or to incorporate a reconciliation of the difference between the purchase price of the financial assets and the par value of the financial assets similar to a disclosure that is required for purchased financial assets with credit deterioration in accordance with Topic 326, Financial Instruments—Credit Losses.

BC25. The Board decided not to propose any new interest income disclosures during its deliberations before the issuance of the proposed Update because some Board members noted that they did not have sufficient information to conclude whether the proposed disclosures would continue to be relevant after Topic 326 is adopted. The guidance in Topic 326 would prevent the credit discount from affecting interest income specifically for purchased financial assets with credit deterioration. Also, other Board members were not confident that the disclosure requirements being considered would capture the necessary elements that would be useful to financial statement users.

Benefits and Costs

BC26. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC27. The Board does not anticipate that entities will incur significant costs as a result of the amendments in this Update. The amendments do not require the use of new methodologies or information that is not already available because current pricing methodologies already consider call information. In the Board's view, the amendments to the amortization period for debt securities held at a premium provide better information to financial statement users because the scenarios in which interest income is overstated in earlier periods with a loss recognized upon call date no longer occur. Furthermore, both users and preparers indicated a preference for the change to financial reporting, noting that it is similar to the pricing methodology employed by market participants and regulators. In addition, preparers noted that because amortized cost and fair value of a callable debt security are better aligned, the potential for accounting outcomes to influence an investor's economic decisions about whether to hold or sell a security is reduced.

Effective Date and Transition

BC28. The Board decided that for public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The decisions on the effective date for fiscal years and interim periods for entities other than public business entities are consistent with the guidelines in the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies.* The Board added that this guidance gives preparers sufficient time to update their systems and processes, while allowing for early adoption for those preparers that can apply the amendments much earlier.

BC29. The Board decided that the amendments in this Update should be applied through a modified-retrospective transition approach that requires a cumulative-effect adjustment directly to retained earnings in the statement of financial position as of the beginning of the period of adoption. Acknowledging the concerns of full retrospective application, the Board decided that this transition allows an entity to use the same basis of accounting for all purchased callable debt securities in a cost-efficient manner. Additionally, in the period of adoption, an entity is required to provide disclosures about a change in accounting principle.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2018 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.