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December 15, 2016

Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2016-330

Re: Proposed Accounting Standards Update, *Targeted Improvements to the Accounting for Long-Duration Contracts*

Dear Ms. Cospers:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Targeted Improvements to the Accounting for Long-Duration Contracts*.

We fully support the Board's objectives of (1) improving, simplifying, and enhancing insurers' financial reporting for long-duration insurance contracts and (2) providing financial statement users with more decision-useful disclosures. In particular, we support the proposed improvements' premise that measuring insurance liabilities by using both updated actuarial assumptions and discount rates that are representative of the nature of reserves for long-duration insurance contracts is more beneficial to the users of financial statements than existing requirements. We also agree with the Board's efforts to simplify the accounting for deferred acquisition costs (DAC) and to provide more consistent accounting for market risk benefits in contracts issued by insurers.

While we broadly support the Board's objectives for this project and the nature of most of the targeted improvements, we believe that the Board should reconsider certain aspects of the proposal to enable insurers to better portray the underlying economics of their insurance contracts in their financial statements and more easily implement the proposed changes. In particular, we ask the Board to focus on the issues discussed below.

Assumption Updates

Although we understand the conceptual appeal of requiring an insurer to retrospectively update the liability for future policy benefits when that insurer updates its cash flow assumptions, we encourage the Board to instead adopt an approach that requires

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prospective updates supplemented with appropriate disclosure. A prospective approach would also provide financial statement users with decision-useful information and allow for financial reporting transparency. In addition, insurers could implement the approach at reduced cost because the accounting would be simpler, both at transition and in subsequent periods. Further, accounting for the effect of cash flow assumption changes prospectively is consistent with how changes in accounting estimates can be effected under ASC 250.

Discount Rate

We agree with the principle that an insurer should use a current interest rate curve with characteristics appropriate for insurance liabilities, and we support the identification of a reasonable proxy that insurers can use as a practical expedient to achieve this goal. However, it is unclear whether a discount rate derived from the interest rates or yield on a high-quality fixed-income instrument (e.g., the AA rate) is an appropriate proxy that would be consistent with the principle noted above. We encourage the Board to perform additional outreach to explore whether, in lieu of using the proposed proxy, constituents could identify a rate that aligns more closely with the principle.

The Board also should consider allowing an insurer to elect using either a “top-down” or “bottom-up” approach to derive a more precise discount rate or rates, as discussed in the IASB’s insurance proposal (the “forthcoming IFRS 17”) or as the Board contemplated in the 2013 proposed ASU *Insurance Contracts* (the “2013 ED”). Providing such an election would allow insurers to derive discount rates that better reflect the characteristics of their different insurance products or the economics of their different geographic locations (e.g., for multinational entities). Although these approaches may pose some practical challenges, an insurer should not be prevented from deriving a discount rate that more faithfully represents the characteristics of its different insurance products or markets if it is willing to work through those challenges. An insurer opting for such an approach should be required to provide additional disclosure regarding how it computed the discount rate or rates.

Deferred Acquisition Costs

We support the Board’s proposal to simplify the amortization of DAC. However, the proposed elimination of an impairment test would require an insurer to continue to amortize DAC over the expected life of an insurance contract even when the anticipated future gross premiums would not be sufficient to recover the total of the future policy benefits and the unamortized DAC. We support an impairment test that would transparently portray the underlying economics of such a contract to financial statement users. The Board and its staff should conduct additional outreach to develop a DAC impairment test based on product cash flows at a disaggregated level. For example, assessing impairment by applying a gross premium valuation test might achieve this objective.

Market Risk Benefit Transition

The proposal’s transition provisions require an insurer to determine the fair value of market risk benefits at contract inception. The mechanics of the fair value calculation would require the insurer to establish an allocation of fees as of contract issuance. Determining this allocation as well as gathering the other information needed to derive a contract issue-date

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valuation for the benefits may be impractical. For example, an insurer may not be able to determine the assumptions (e.g., risk margin, policyholder behavior, and future expected underlying fund performance) it would use to calculate the ascribed fee without being influenced by hindsight. The Board should provide a practical expedient at transition for those insurers that are unable to determine the fair value of market risk benefits at contract inception without undue effort or the use of hindsight.

Participating Contracts

It does not appear as though the proposal's accounting model for participating contracts would fully reflect the manner in which discretionary policyholder dividends are managed. The proposal would require an insurer to include anticipated policyholder dividends in the computation of the net premium ratio; however, the model ignores that an insurer expects to establish future policyholder dividends through a combination of premium received, mortality and expense experience, and investment returns. The proposal's mechanism for computing the liability for future policy benefits does not provide a means of incorporating investment returns that will affect the dividend scales in the net premium ratio computation. Essentially, future changes in the dividend scales that occur as a result of varying (increasing or decreasing) asset portfolio returns are expected to be funded from a portion of the gross premium in the proposed accounting model for participating contracts, although this assumption contradicts the product design and the economics of such contracts.

In its redeliberations, the Board should (1) develop a mechanism to incorporate investment returns into the computation of the net premium ratio for participating contracts, (2) exclude anticipated policyholder dividends from the net premium ratio computation and require insurers to record a separate liability for such dividends, or (3) exclude participating contracts from the targeted improvements (and potentially retain existing DAC accounting for such contracts). If the Board concludes that participating contracts should be removed from the scope of the targeted improvements, it should require insurers to provide more transparent disclosure about their closed blocks of contracts and the possibility of shortfalls in closed block assets.

* * * * *

The appendix to this letter contains our responses to the proposed ASU's questions for respondents, including our recommended improvements and additional discussion of the topics cited above.

We appreciate the opportunity to comment on the proposed ASU. If you have any questions about our comment letter, please feel free to contact Rick Sojkowski at (860) 725-3094, Bala Bellur at (813) 769-3210, or Mark Bolton at (203) 761-3171.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

Appendix Deloitte & Touche LLP Responses to Questions for Respondents

Liability for Future Policy Benefits — Contracts Other Than Participating Contracts

Question 1 — Scope: *Do you agree with the scope of the proposed amendments on the accounting for the liability for future policy benefits for contracts other than participating contracts? If not, what types of contracts, contract features, or transactions should be included in or excluded from the scope and why?*

We agree that the scope of the proposed amendments on the accounting for the liability for future policy benefits for contracts other than participating contracts is appropriate.

Question 2 — Cash flow assumption update method and presentation: *Do you agree that the effect of updating cash flow assumptions should be calculated and recognized on a retrospective basis in net income? If not, what other approach or approaches do you recommend and why?*

Although we understand the conceptual and theoretical appeal of requiring an insurer to calculate and recognize the effects of updating the cash flow assumptions used to determine the liability for future policy benefits on a retrospective basis and to record a cumulative catch-up adjustment, we believe that an approach that requires prospective updates (i.e., requires an insurer to reflect historical experience and updates to assumptions of cash flows in future periods), supplemented with appropriate disclosure, is a preferred alternative. A prospective model would still provide financial statement users with decision-useful information and allow for financial reporting transparency. However, it would also offer the following advantages:

- *Full reflection of actual experience* — Under a prospective update model, an insurer would recognize the effects of changes in its cash flow assumptions for the liability for future policy benefits over the remaining life of the insurance policy. The prospective method fully reflects actual experience, whereas the retrospective method dampens those effects in the current-period financial statements.
- *Reduced implementation costs* — The costs and complexities of implementing a prospective model, both in the year of adoption and in subsequent years, may be less significant than those that would be incurred to implement a retrospective model and would be less prone to errors.
- *Alignment with how changes in other accounting estimates are accounted for* — A prospective model of accounting for updated cash flow assumptions also is consistent with how changes in accounting estimates can be accounted for under ASC 250.

If the Board ultimately adopts a prospective updating model, it should require an insurer to disclose in each reporting period in which the insurer updates its cash flow assumptions (1) the nature and impact of the cash flow assumption updates and (2) sufficient detail about the mechanics of the prospective updating model to allow financial statement users to understand the short- and long-term impacts of the assumption update on the insurer's current and future financial reporting.

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Question 3 — Cash flow assumption update frequency: *Do you agree that cash flow assumptions should be updated on an annual basis, at the same time every year, or more frequently if actual experience or other evidence indicates that earlier assumptions should be revised? If not, what other approach or approaches do you recommend and why?*

We believe that an appropriate framework for updating assumptions is provided by industry practice and the following existing guidance in ASC 944-30-35-5:

Estimated gross profit . . . shall include estimates of all of the [elements listed in ASC 944-30-35-5(a) through (e)], **each of which shall be determined based on the best estimate of that individual element over the life of the book of contracts without provision for adverse deviation.** [Emphasis added]

Although cash flow assumptions under the proposed accounting model should be assessed for reasonableness in each reporting period, they are long-term in nature and therefore should not be subject to revision solely on the basis of a specified timeline. In a manner consistent with existing guidance, they should reflect the insurer's best estimate. In practice, insurers monitor assumptions on a timely basis and generally stagger the timing of the execution of experience studies. This timing is affected by (1) the emergence of deviations in actual versus expected experience, (2) new product design, (3) when the pricing function requires feedback, or (4) the desire to balance workload. Accordingly, there is no need for insurers to update their assumptions annually, at the same time each year.

Question 4 — Discount rate assumption: *Do you agree that expected future cash flows should be discounted on the basis of a high-quality fixed-income instrument yield that maximizes the use of current market observable inputs? If not, what other approach or approaches do you recommend and why?*

We agree that (1) the interest rate curve used to discount expected future cash flows should reflect the characteristics of the liabilities in the insurance contract portfolio and (2) an insurer should maximize its use of current market observable inputs when it identifies the appropriate discount rate curve. We support the identification of a reasonable proxy that insurers can use as a practical expedient to discount insurance contracts. However, it is unclear whether a discount rate derived from the interest rates or yield on a high-quality fixed-income instrument (e.g., the AA rate) is an appropriate proxy that would be consistent with the discount rate principle noted above. We encourage the Board to perform additional outreach to explore whether, in lieu of using the proposed proxy, constituents could identify a rate that aligns more closely with the principle.

In addition, the final ASU should clarify that the discount rate locked in at the inception of the contract that is used as a basis for the net premium ratio computations is actually the interest rate curve in effect on that date and not a single rate on that curve.

The Board should also consider allowing an insurer to elect using either a "top-down" or "bottom-up" approach to derive a more precise discount rate or rates, as discussed in the forthcoming IFRS 17 or as the Board contemplated in the 2013 ED. Since not all long-duration insurance products and characteristics are uniform, different discount rates may be appropriate for different insurance products. Further, multinational insurers may believe that it is appropriate to use different discount rates in different geographic locations to

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reflect the market economics in each location, and it is likely that those insurers will use a discount rate as defined in the forthcoming IFRS 17. The final ASU should clarify whether different rates could be used for different products and/or geographic locations. Providing a top-down or bottom-up election would allow insurers to derive discount rates that better reflect the characteristics of their different insurance products or the economics of their different geographic locations (e.g., for multinational entities).

We understand that the Board rejected requiring the use of such approaches because constituents indicated that “determining an illiquidity premium or identifying which yield to strip out was conceptually and practically challenging.” However, an insurer should not be prevented from deriving a discount rate that more faithfully represents the characteristics of its different insurance products or markets if it is willing to work through the practical challenges. Although providing an election to insurers could raise concerns about maintaining comparability in insurers’ financial reporting, the Board could address such concerns by requiring insurers that elect to derive their discount rates to provide additional disclosures that would enable financial statement users to understand the financial effects of using discount rates that differ from the proxy.

Question 5 — Discount rate assumption update method and presentation: *Do you agree that the effect of updating discount rate assumptions should be recognized immediately in other comprehensive income? If not, what other approach or approaches do you recommend and why?*

We agree that an insurer should immediately recognize the effect of updating discount rate assumptions in other comprehensive income. Such an approach will more closely align the accounting for the effects of interest rate changes on (1) insurance liabilities and (2) assets classified as available for sale that may fund those liabilities.

Question 6 — Discount rate assumption update frequency: *Do you agree that discount rate assumptions should be updated at each reporting date? If not, what other approach or approaches do you recommend and why?*

We agree that an insurer should update its discount rate assumptions as of each reporting date.

Liability for Future Policy Benefits — Participating Contracts

Question 7 — Scope (participating contracts): *Do you agree with the scope of the proposed amendments on the accounting for the liability for future policy benefits for participating contracts, including closed block contracts issued by a demutualized insurance entity? If not, what types of contracts, contract features, or transactions should be included in or excluded from the scope and why?*

It does not appear as though the proposal’s accounting model for participating contracts would fully reflect the manner in which discretionary policyholder dividends are managed. The proposal would require an insurer to include anticipated policyholder dividends in the computation of the net premium ratio; however, the model ignores that an insurer expects to establish future policyholder dividends through a combination of premium received, mortality and expense experience, and investment returns. The proposal’s

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mechanism for computing the liability for future policy benefits does not provide a means of incorporating investment returns that affect the dividend scales in the net premium ratio computation. Essentially, future changes in the dividend scales that occur as a result of varying (increasing or decreasing) asset portfolio returns are expected to be funded from a portion of the gross premium in the proposed accounting model for participating contracts, although this assumption contradicts the product design and the economics of such contracts.

In its redeliberations, the Board should (1) develop a mechanism to incorporate investment returns into the computation of the net premium ratio for participating contracts, (2) exclude anticipated policyholder dividends from the net premium ratio computation and require insurers to record a separate liability for such dividends, or (3) exclude participating contracts from the targeted improvements (and potentially retain existing DAC accounting for such contracts). If the Board concludes that participating contracts should be removed from the scope of the targeted improvements, it should require insurers to provide more transparent disclosure about their closed blocks of contracts and the possibility of shortfalls in closed block assets.

Question 8 – Cash flow assumption update method and presentation (participating contracts): *Do you agree that the effect of updating cash flow assumptions should be calculated and recognized on a retrospective basis in net income? If not, what other approach or approaches do you recommend and why?*

If the Board elects to move forward with the current scope of the targeted improvements and include participating contracts within the scope of the amendments, we support the adoption of a prospective method of application for the same reasons cited in our response to Question 2 above.

Question 9 – Cash flow assumption update frequency (participating contracts): *Do you agree that cash flow assumptions should be updated on an annual basis, at the same time every year, or more frequently if actual experience or other evidence indicates that earlier assumptions should be revised? If not, what other approach or approaches do you recommend and why?*

If the Board elects to move forward with the current scope of the targeted improvements and include participating contracts within the scope of the amendments, we would share the same observations about the proposed frequency of assumption updates for participating contracts as discussed in our response to Question 3 above.

Question 10 – Discount rate assumption (participating contracts): *Do you agree that expected future cash flows should be discounted on the basis of a high-quality fixed-income instrument yield that maximizes the use of current market observable inputs? If not, what other approach or approaches do you recommend and why?*

If the Board elects to move forward with the current scope of the targeted improvements and include participating contracts within the scope of the amendments, we would share the same observations about the discount rate that an insurer should use to determine the participating insurance contract liability for future policy benefits as discussed in our response to Question 4 above.

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Question 11 — Discount rate assumption update method and presentation (participating contracts): *Do you agree that the effect of updating discount rate assumptions should be recognized immediately in other comprehensive income? If not, what other approach or approaches do you recommend and why?*

We agree that if the Board elects to move forward with the current scope of the targeted improvements and include participating contracts within the scope of the amendments, an insurer should immediately recognize the effect of updating discount rate assumptions for participating contracts in other comprehensive income. Such an approach will more closely align the accounting for the effects of interest rate changes on (1) insurance liabilities and (2) assets classified as available for sale that may fund those liabilities.

Question 12 — Discount rate assumption update frequency (participating contracts): *Do you agree that discount rate assumptions should be updated at each reporting date? If not, what other approach or approaches do you recommend and why?*

We agree that if the Board elects to move forward with the current scope of the targeted improvements and include participating contracts within the scope of the amendments, an insurer should update its discount rate assumptions for participating contracts as of each reporting date.

Market Risk Benefits

Question 13 — Scope: *Do you agree with the scope of the proposed amendments on the accounting for market risk benefits? If not, what types of contracts or contract features should be included in or excluded from the scope and why?*

We agree that the scope of the proposed amendments on the accounting for market risk benefits is appropriate; however, we believe that the proposed transition provisions for such benefits should be revisited. For a discussion of our concerns, see our response to Question 21 below.

Question 14 — Measurement: *Do you agree that all market risk benefits should be measured at fair value, with fair value changes attributable to a change in the instrument-specific credit risk recognized in other comprehensive income? If not, what other alternative or alternatives do you recommend and why?*

We agree that an insurer should (1) measure all market risk benefits at fair value and (2) recognize fair value changes attributable to a change in the instrument-specific credit risk in other comprehensive income.

However, the Board should clarify whether an insurer would be required to apply the hierarchy discussed in ASC 944-40-25-25B at inception only or in each subsequent reporting period. For example, when an underlying account value is exhausted on a guaranteed minimum withdrawal benefit for life, the benefit feature effectively reflects an in-benefit payout annuity and would no longer meet the definition of a market risk benefit.

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Deferred Acquisition Costs

Question 15 — Scope: *Should the scope of the proposed amendments be expanded to include investment contract acquisition costs currently amortized using the interest method in Subtopic 310-20, Receivables — Nonrefundable Fees and Other Costs?*

We agree with the current scope of the targeted improvements and do not believe that it should be expanded to include investment contract acquisition costs currently amortized using the interest method.

Question 16 — Amortization: *Do you agree with the proposed amendments that would simplify the amortization of deferred acquisition costs? If not, what other simplified and reasonably estimable amortization approach or approaches do you recommend and why?*

We agree with the proposed amendments that would simplify the amortization of deferred acquisition costs.

Question 17 — Impairment: *Do you agree that deferred acquisition costs should not be subject to impairment testing? If not, what alternative or alternatives do you recommend and why?*

The proposal would require an insurer to continue to amortize deferred acquisitions costs over the expected life of an insurance contract even when the anticipated future gross premiums would not be sufficient to recover the total of the future policy benefits and the unamortized DAC. We support an impairment test that would transparently portray the underlying economics of such a contract to financial statement users. The Board and its staff should conduct additional outreach to develop a DAC impairment test based on product cash flows at a disaggregated level. For example, assessing impairment by applying a gross premium valuation test might achieve this objective.

Additional benefits of requiring a DAC impairment test include the following:

- DAC would be treated the same as other long-lived assets that are subject to periodic impairment tests under U.S. GAAP.
- DAC accounting for long-duration contracts would be more closely aligned with the accounting for short-duration contracts.

Presentation and Disclosure

Question 18 — Proposed requirements: *Do you agree that the presentation and disclosure requirements included in the proposed amendments would provide decision-useful information? If not, which presentation and/or disclosure requirement or requirements would you change and why?*

We agree that the presentation and disclosure requirements included in the proposed amendments would provide decision-useful information to financial statement users, and we support the enhanced disclosure requirements for annual periods. However, we believe that the final ASU should provide additional guidance to clarify some of these requirements.

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Specifically, the Board should clarify the requirement to disclose weighted average mortality and lapse rates. The proposal does not clearly define the method that an insurer would use to determine the rates that must be disclosed; accordingly, without further clarification, there is a risk that these disclosures will not provide comparable and decision-useful information to financial statement users.

The final ASU should also (1) indicate how insurers would reflect the effects of changes in foreign currency exchange rates in the rollforward disclosures and (2) incorporate such exchange rate changes into at least some of the illustrative examples.

We understand that some preparers are concerned about their ability to prepare all of the disclosures required for interim reporting in the compressed interim reporting time frames. They have also expressed concern about whether the costs of providing such disclosures will outweigh the benefits to financial statement users, particularly in circumstances in which there have been no significant changes from the information disclosed in the annual financial statements. In its redeliberations, the Board should consider constituent feedback regarding the relative costs and benefits of providing the disclosures in both interim and annual periods. However, we recommend not requiring the interim disclosures unless changes from the previous annual period are material.

Question 19 — Additional requirements: *Are there any additional presentation or disclosure requirements that would provide decision-useful information? If so, please describe them and explain why.*

Other than those included as part of our recommendations for the prospective updating model, participating contracts, and discount rate assumption changes discussed above, we have not identified any additional presentation requirements or disclosures that would provide decision-useful information to financial statement users.

Effective Date and Transition

Question 20 — Implementation date: *The Board is interested in understanding the key drivers affecting the timing of implementation. What are those key drivers, and how do they affect the time it will take to implement the proposed amendments? Should the effective date be the same for both public entities and nonpublic entities?*

The transition from a long-duration insurance accounting model with locked-in assumptions to an accounting model that requires regular and frequent assumption updates is likely to be a significant undertaking for market participants. The proposed amendments to the accounting models for participating contracts and market risk benefits may also require significant effort to implement. These changes may require insurers to update and enhance their actuarial systems and identify and gather historical data not previously accumulated. Although we defer to preparer feedback regarding the amount of time required to implement the targeted improvements, we understand that many market participants expect that it would take them several years to implement the proposed amendments.

We would not object to granting entities other than public business entities an additional year to implement the guidance in the final ASU if they believe that such additional time is necessary.

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Question 21 — Transition methods: *Are the proposed transition provisions operable and do they provide decision-useful information? If not, what would you recommend and why?*

We agree that if the Board adopts the retrospective approach, the proposed transition provisions would provide decision-useful information.

However, as noted in our response to Question 2, we support a prospective approach. In a manner consistent with that approach, an insurer would apply an updated net premium ratio as of the beginning of the earliest period presented. Accordingly, all periods presented in the financial statements would reflect a consistent application of prospective unlocking.

We also believe that the market risk benefit transition provisions in the final ASU should provide a practical expedient in certain circumstances. The proposal's transition provisions would require an insurer to determine the fair value of market risk benefits at contract inception. However, the mechanics of the fair value calculation would require an insurer to determine the fee that it should have ascribed to the market risk benefit, which is based on the risk margin, policyholder behavior, and expected future market performance expectations that should have been used, reflecting the market conditions that existed at contract inception. If this information was not recorded or captured at contract issuance, the insurer is likely to have difficulty re-creating or determining it without the effects of hindsight. Accordingly, we believe that the Board should provide a practical expedient for circumstances in which an insurer is unable to determine the fair value of market risk benefits at contract inception without undue effort or the use of hindsight.

We are aware of alternative approaches that might be used as an expedient and would be pleased to discuss them in greater detail with the Board and its staff.

We also acknowledge that given the significant change in reporting for future policy benefits, an entity may wish to elect fair value accounting for some of its insurance liabilities by using the fair value option available under ASC 825. Accordingly, the Board should provide a one-time exception that allows an insurer to irrevocably elect to apply a fair value option to a specified portfolio of insurance contracts at transition.

Question 22 — Transition disclosure: *Do the proposed transition disclosure requirements provide decision-useful information? If not, what would you recommend and why?*

We have identified that ASC 944-40-65-2(f)(1) would require disclosures consistent with ASC 250-10-50-1 to be provided at the level of disaggregation required under ASC 944-40-55-13F through 55-13H. We suggest that the Board revisit the need for this level of disclosure upon transition since the disclosure detail that ASC 944-40-55-13F through 55-13H would require has not been presented in the past. In light of this, disclosures consistent with ASC 250-10-50-1 at a financial statement level or segment level may better meet the disclosure objectives and would not result in excessive information.

Costs and Complexities

Question 23 — Costs and complexities: *Describe the nature of the incremental costs of adopting the proposed amendments, distinguishing between one-time costs and ongoing costs. Explain which aspects of the proposed amendments are driving those costs and include ideas to make the proposals more cost effective.*

Although we generally defer to preparer feedback regarding anticipated adoption costs, we understand that adoption of the proposed ASU may result in significant one-time costs for preparers and could involve costs associated with:

- Creating or modifying information systems for implementation, as well as for tracking and storing historical data needed to identify “historical adjustments.”
- Modifying actuarial systems for the modified reserve calculations.
- Establishing or modifying internal control systems.
- Computing the transition adjustment under the retrospective method.
- Preparing the required disclosures on an ongoing basis.
- Providing adequate training to preparers and other users of the financial information.

Auditors may incur one-time costs to (1) train their personnel, (2) audit their clients’ transition adjustments, and (3) update their understanding of, and test any new or modified, information technology or internal control systems implemented by their clients.

In addition, preparers and auditors may incur ongoing costs related to the preparation and review of the more extensive interim disclosures.