

THOUGHT LEADERSHIP FROM THE BDO NATIONAL ASSURANCE  
AND TAX PRACTICES

# BDO KNOWS:

## FASB



### SUBJECT

## FASB ISSUES TARGETED AMENDMENTS TO THE RECOGNITION AND MEASUREMENT GUIDANCE FOR FINANCIAL INSTRUMENTS

### SUMMARY

The FASB recently issued ASU 2016-01 which requires an entity to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in OCI the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of AFS debt securities in combination with other deferred tax assets. The Update provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The Update also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. The new standard takes effect in 2018 for public companies and is available [here](#). Early adoption is only permitted for the provision related to instrument-specific credit risk and the fair value disclosure exemption provided to nonpublic entities.

### DETAILS

ASU 2016-01<sup>1</sup> (the “Update”) includes amendments on recognition, measurement, presentation and disclosure of financial instruments, which are discussed below.

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<sup>1</sup> *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities*

### ***Investments in Equity Securities***

The Update requires an entity to measure investments in equity securities, except for those that result in consolidation or are accounted for under the equity method of accounting, at fair value with changes in fair value recognized through net income. The Update also provides a “practicability election” to measure equity investments without a readily determinable fair value that do not qualify for the NAV practical expedient under Topic 820<sup>2</sup>, “*Fair Value Measurement*”, at its cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. This election shall be made for each investment separately and once selected shall continue to be applied until the equity security no longer qualifies for this exception. The Update provides implementation guidance on identifying observable price changes and whether a security issued by the same issuer is similar to the equity security held. The Update also requires that the observable price of a similar security be adjusted for the different rights and obligations to determine the amount that should be recorded as an upward or downward adjustment in the carrying value of the security measured to reflect the current fair value of that security.

### ***Impairment of Equity Securities without Readily Determinable Fair Values***

A nonmarketable equity security measured under the practicability election shall be written down from book value to its fair value if a qualitative assessment indicates that the investment is impaired. The Update requires an entity to perform a qualitative assessment each reporting period considering, but not limited to, certain specified impairment indicators. That impairment assessment is similar to the qualitative assessment for long-lived assets, goodwill, and indefinite lived intangible assets. The Update also requires disclosure of the carrying amount of those equity securities and adjustments made because of observable price changes (including information it considered in developing them), as well as impairment charges during the reporting period.

### ***Liabilities Measured Using the Fair Value Option***

The Update requires an entity to present separately in OCI the portion of the total change in the fair value of financial liabilities resulting from a change in the instrument-specific credit risk when the entity has elected the fair value option. The entity may consider the portion of the total change in fair value that excludes the amount resulting from a change in a base market risk, such as a risk-free rate or a benchmark interest rate, to be the result of a change in instrument-specific credit risk. Alternatively, an entity may use another method that faithfully represents the portion of the total change in fair value resulting from a change in instrument-specific credit risk. The entity shall apply the method consistently to each financial liability. Upon derecognition, the cumulative amount of the gain or loss on the financial liability that resulted from changes in instrument-specific credit risk would be included in net income.

### ***Presentation of Financial Assets and Financial Liabilities***

The Update requires separate presentation of financial assets and financial liabilities by measurement category (e.g. fair value through net income, fair value through OCI, amortized cost) and form of financial asset (that is, securities or loans and receivables) on the balance sheet or in the notes to the financial statements.

### ***Deferred Tax Assets***

The Update clarifies that an entity should assess the need for a valuation allowance on a deferred tax asset related to unrealized losses of investments in debt instruments recognized in OCI in combination with the entity’s other deferred tax assets. Prior to this Update, the alternative approach used in practice evaluated the need for a valuation allowance for a deferred tax asset related to unrealized losses on debt instruments recognized in other comprehensive income separately from other deferred tax assets. This alternative approach will no longer be acceptable.

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<sup>2</sup> Paragraph 820-10-35-59

### ***Disclosures for Financial Instruments Measured at Amortized Cost***

For entities other than public business entities, the Update eliminates the requirement under Topic 825, “*Financial Instruments*”, to disclose the fair values of financial assets and financial liabilities measured in the financial statements at amortized cost. While public business entities will still be required to provide those fair value disclosures either on the face of the balance sheet or in the notes, along with the level within which the fair value measurement is categorized (Level 1, 2 or 3), they will no longer have to disclose the method(s) and significant assumptions used in estimating those fair values. Further, this Update excludes receivables and payables due in one year or less, deposit liabilities with no defined or contractual maturities and nonmarketable equity securities accounted for under the practicability election from this disclosure requirement. The Update also requires public business entities to measure the fair value using the exit price notion consistent with Topic 820 when disclosing fair value of financial instruments measured at amortized cost. This change to existing GAAP eliminates the entry price method previously used by some entities for disclosure purposes for some financial instruments.

## **EFFECTIVE DATE AND TRANSITION**

The amendments are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019 with early adoption permitted for fiscal years beginning after December 15, 2017 including interim periods within those years.

Early application to financial statements of fiscal years or interim periods that have not yet been issued (or not been made available for issuance) of either or both of the following amendments is permitted as of the beginning of the fiscal year of adoption:

1. Separate presentation in OCI of the portion of the total change in the fair value resulting from a change in the instrument-specific credit risk of a liability measured using the fair value option.
2. Elimination of the requirement by entities other than public business entities to disclose the fair values of financial instruments carried at amortized cost.

As such, entities may wish to consider early adopting these provisions for 2015 year-end financial statements.

Except for the early application guidance discussed above, early adoption of the amendments in this Update is not allowed. An entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption of the Update.

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