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FASB FLASH REPORT

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FASB Issues Codification Improvements to Financial Instruments

Summary: The FASB issued ASU 2020-03[1] ("ASU"), which makes narrow-scope improvements to various financial instruments Topics, including the current expected **credit losses** (CECL) standard. The new ASU is available **here**, and the amendments have various effective dates.

BACKGROUND

The ASU is part of the FASB's ongoing Codification improvement project aimed at clarifying specific areas of accounting guidance to help avoid unintended application. The items in this project are generally narrow in scope and are not expected to significantly affect current accounting practice or create a significant administrative cost for most entities.

1 Codification Improvements to Financial Instruments.

MAIN PROVISIONS

The ASU clarifies the following issues:

- **Issue 1:** Fair Value Option Disclosures

  Accounting Standards Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities*, provided entities other than public business entities with relief from the requirement to disclose the fair values of financial instruments measured at amortized cost basis. Questions were raised about whether that relief also applied to the fair value option disclosures in ASC 825-10-50-24 through 50-32. The ASU clarifies that all entities, including nonpublic entities, are subject to the fair value option disclosures. Financial instruments where the fair value option has been elected are measured at fair value rather than amortized cost, so the fair value option disclosures are required.

- **Issue 2:** Applicability of the Portfolio Exception in Topic 820 to Nonfinancial Items

  Topic 820, *Fair Value Measurement*, provides an exception that permits fair value measurement on a portfolio basis under certain circumstances. Stakeholders noted that the wording of certain paragraphs in ASC 820-10-35 was not updated to reflect the fact that nonfinancial items accounted for as derivatives under Topic 815 can be included as part of the portfolio. The ASU amends these paragraphs to clarify the applicability of the portfolio exception to those items.

- **Issue 3:** Disclosure for Depository and Lending Institutions

  Topic 942, *Financial Services – Depository and Lending Institutions*, requires disclosure of the fair value of debt securities by maturity grouping (ASC 942-320-50-3), whereas Topic 320, *Investments – Debt and Equity Securities*, requires disclosure of the fair value of debt securities by maturity grouping but allows securities not due at a single maturity date, such as mortgage-backed securities, to be presented separately rather than allocated over the maturity groupings (ASC 320-10-50-3). The ASU clarifies that the disclosure requirements in ASC 320 apply to the disclosure requirements in ASC 942 for depository and lending institutions.

- **Issue 4:** Cross-Reference to Line-of-Credit or Revolving Debt Arrangements Guidance in Subtopic 470-50

  ASC 470-50-40-17 through 40-18 describe the accounting for lender fees and third-party costs directly related to exchanges or modifications of debt instruments and ASC 470-50-40-21 describes the accounting for these fees and costs for modifications to or exchanges of line-of-credit or revolving-debt arrangements. To improve the understandability of the guidance, cross-references have been added to these paragraphs.

- **Issue 5:** Cross-Reference to Net Asset Value Practical Expedient in Subtopic 820-10

  ASC 820-10-50-2 includes disclosure requirements for each class of assets and liabilities that are measured at fair value after initial recognition; however, these disclosure requirements were not intended to apply to investments in entities for which fair value is measured using net asset value per share (or its equivalent) as a practical expedient. The ASU clarifies that these disclosure requirements do not apply to investments measured at fair value using net asset value per share (or its equivalent).

- **Issue 6:** Interaction of Topic 842 and Topic 326

  The contractual term of a net investment in a lease determined in accordance with Topic 842, *Leases*, considers both the contractual lease term, as well as the time period beyond the lease term when there is an option to extend the lease that is reasonably certain to be exercised. The contractual term for measuring expected credit losses under Topic 326, *Financial Instruments – Credit Losses*, considers only the contractual maturity of the lease unless there is a reasonable expectation of a troubled debt restructuring. To address this inconsistency, the ASU clarifies that when measuring expected credit losses on a net investment in a lease, the lease term determined in accordance with Topic 842 should be used as the contractual term.

- **Issue 7:** Interaction of Topic 326 and Subtopic 860-20

  When a transferor regains control of financial assets sold, ASC 860-20-25-13 precludes recognition of a loan loss allowance for loans that do not meet the definition of a security when they are re-recognized. Topic 326 requires immediate recognition of expected credit losses when financial assets are initially recognized, creating an inconsistency in the guidance. The ASU clarifies that when an entity regains control of financial assets sold, an allowance for credit losses should be recorded in accordance with Topic 326.

EFFECTIVE DATES AND TRANSITION

The amendments related to Issues 1,2,4 and 5 are effective for public business entities upon issuance of the ASU. For all other entities, these amendments are effective for fiscal years beginning after December 15, 2019, and interim periods for fiscal years beginning after December 15, 2020. Early application is permitted.

The amendment related to Issue 3 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.

The amendments related to Issue 6 and Issue 7 affect the guidance in ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. For entities that have adopted the guidance in ASU 2016-13, these amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For those entities, the amendments should be applied on a modified-retrospective basis by means of a cumulative-effect adjustment to opening retained earnings as of the adoption date. For entities that have not yet adopted the guidance in ASU 2016-13, the effective dates and the transition requirements for these amendments are the same as those in ASU 2016-13.

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