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AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO **FLASH** REPORT

FASB

SUBJECT

FASB ISSUES TECHNICAL CORRECTIONS & IMPROVEMENTS TO ITS RECENT FINANCIAL INSTRUMENTS GUIDANCE

SUMMARY

The FASB issued ASU 2018-03 [1] to address questions raised about its recent standard on financial instruments, ASU 2016-01[2]. The new ASU is available **here**, and takes effect in 2018 for public business entities. All other entities will apply these amendments under the original transition requirements in ASU 2016-01. Early adoption is permitted as long as the entity has adopted ASU 2016-01.

DETAILS

Background

ASU 2016-01 made targeted improvements to the accounting and disclosure requirements for financial instruments and takes effect in Q1 2018 for public companies. Specifically, it 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 available-for-sale (AFS) debt securities in combination with other deferred tax assets. It provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment, as adjusted for certain observable price changes. That ASU also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements.

CONTACT

BRAD BIRD
National Assurance Partner
312-730-1294 / bbird@bdo.com

GAUTAM GOSWAMI
National Assurance Partner
312-856-9100/ggoswami@bdo.com

ANGELA NEWELL
National Assurance Partner
214-689-5669 / ajnewell@bdo.com

ADAM BROWN
National Director of Accounting
214-665-0673 / abrown@bdo.com

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1 Technical Corrections and Improvements to Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities

2 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities

Main Provisions

The amendments included in ASU 2018-03 are technical corrections and improvements to ASU 2016-01.

Equity Securities without a Readily Determinable Fair Value – Discontinuation

An entity that elects to use the measurement alternative ASC 321-10-35-2 for equity securities without a readily determinable fair value may change its measurement approach to fair value in accordance with Topic 820[3] through an irrevocable election. When an entity makes this election it not only applies to that security but also all identical or similar investments of the same issuer, including future purchases of identical or similar investments. Otherwise, the entity must continue applying the measurement alternative until either the investment has a readily determinable fair value or becomes eligible for the net asset value practical expedient.

Equity Securities without a Readily Determinable Fair Value – Adjustments

ASC 321-10-55-9 was amended to clarify that the Board intended to remeasure a security under paragraph 321-10-35-2 based on the date of an observable transaction for a similar security, rather than as of the current balance sheet date.

Forward Contracts and Purchased Options on Securities That Lack a Readily Determinable Fair Value

When applying the measurement alternative in ASC 815-10-35-6, the amendments require entities to update all of the inputs to the fair value calculation, not just the inputs related to the change in value of the underlying security.

Presentation Requirements for Certain Fair Value Option Liabilities

This Update clarifies that the presentation guidance for instrument-specific credit risk in ASC 825-10-45-5 should be applied when an entity has elected the fair value option, regardless of whether the election was made pursuant to ASC 815-15[4] or ASC 825-10.

Fair Value Option Liabilities Denominated in a Foreign Currency

For entities that have elected the fair value option, the amount of change in fair value related to instrument-specific credit risk should first be separated from the total change in the fair value of the financial liability using the currency of denomination. Subsequently, the cumulative amount of instrument-specific credit risk should be remeasured into the functional currency of the reporting entity using end-of-period spot rates and presented in accumulated other comprehensive income.

Transition Guidance for Equity Securities without a Readily Determinable Fair Value

The transition guidance in ASU 2016-01 generally requires a modified retrospective transition approach; however, equity securities without a readily determinable fair value require a prospective approach. In response to stakeholder feedback asking whether a prospective transition approach would be acceptable for those equity securities without a readily determinable fair value where the measurement alternative was not applied, the Board clarified it was not. Rather, the prospective transition approach was intended only for instances where the measurement alternative was applied.

Additionally, clarification was made that insurance entities subject to the guidance in Topic 944 [5], should use the prospective transition approach for the entity's entire population of equity securities for which the measurement alternative was elected.

EFFECTIVE DATE AND TRANSITION

For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Public business entities with fiscal years beginning between December 15, 2017, and June 15, 2018, are not required to adopt these amendments until the interim period beginning after June 15, 2018, and public business entities with fiscal years beginning between June 15, 2018, and December 15, 2018, are not required to adopt these amendments before adopting the amendments in Update 2016-01.

For all other entities, the effective date is the same as the effective date in Update 2016-01.

All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted Update 2016-01.

3 Fair Value Measurement
4 Derivatives and Hedging—Embedded Derivatives
5 Financial Services – Insurance