

# FASB FLASH REPORT

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## FASB Clarifies the Interaction of Accounting Standards for Equity Securities, Equity Method Investments and Derivatives

The FASB issued ASU 2020-01<sup>1</sup> ("Update") to clarify the interaction among the accounting standards for equity securities, equity method investments and certain derivatives. The new ASU is available [here](#) and becomes effective for public entities for fiscal years beginning after December 15, 2020 and all other entities for fiscal years beginning after December 15, 2021. Early adoption is permitted.

In 2016, the FASB made targeted improvements<sup>2</sup> to the accounting for financial instruments. As part of those changes, an entity may elect to measure equity securities without a readily determinable fair value at historical cost, less impairment charges if applicable. However, if the entity identifies observable price changes in orderly transactions for identical or similar instruments of the same issuer, then it must remeasure the equity security at fair value as of the date that the observable transaction occurred. In applying this measurement alternative, stakeholders questioned the interaction of this guidance with the guidance in Topic 323 governing equity method investments, specifically whether an equity investment should be remeasured based on transactions that triggered either the application of or the discontinuance of the equity method.

Additionally, stakeholders raised questions about the interaction of Topic 321, *Investments*, Topic 323, *Investments — Equity Method and Joint Ventures*, and Topic 815 *Derivatives and Hedging* when determining the accounting treatment of forward contracts and purchased options for securities that will be accounted for under the equity method of accounting upon settlement or exercise.

<sup>1</sup> Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): *Clarifying the Interactions between Topic 321, Topic 323, and Topic 815*

<sup>2</sup> Accounting Standards Update No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities*

## MAIN PROVISIONS

The amendment clarifies two issues, which are summarized below.

- ▶ **Issue 1: Application of the Measurement Alternative for Certain Equity Securities.** The Update states that an entity is required to evaluate observable transactions that necessitate applying or discontinuing the equity method of accounting, when applying the measurement alternative in Topic 321. This evaluation occurs prior to applying or upon ceasing the equity method. Thus, if those transactions are considered price changes in orderly transactions for an identical or a similar instrument of the same issuer, then the existing investment must be remeasured at fair value as of the date that the observable transaction occurred.
- ▶ **Issue 2: Scoping Assessment for Forward Contracts and Purchased Options on Certain Securities.** The Update states that when applying paragraph 815-10-15-141(a) for forward contracts and purchased options, an entity is not required to assess whether the underlying securities will be accounted for under the equity method in accordance with Topic 323 or fair value method under Topic 825 upon settlement or exercise. However, an entity is required to assess the accounting for these arrangements under the remaining characteristics in paragraph 815-10-15-141(b) through 151-141(d):
  - “b. The contract is not a derivative instrument otherwise subject to this Subtopic.
  - c. The contract is not a derivative instrument otherwise subject to this Subtopic.
  - d. The contract, if a purchased option, has no intrinsic value at acquisition.”

Such contracts meeting these four criteria are generally subject to fair value accounting under Topic 321.

## EFFECTIVE DATE AND TRANSITION REQUIREMENTS

For public entities, the Update is effective for fiscal years beginning after December 15, 2020 and for interim periods therein. All other entities have an effective date for fiscal years beginning after December 15, 2021 and interim periods therein. Early adoption is permitted, including in interim periods for which financial statements have not been issued or made available for issuance.

The Update should be applied prospectively as of the first day of the interim period that contains the adoption date.

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