

Heads Up

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FASB Continues Deliberations on Financial Instruments and Decides on Presentation.

by Magnus Orrell and Ana Zelic, Deloitte & Touche LLP

Background

As we reported in our [July 27, 2009, Heads Up](#), the accounting for financial assets and financial liabilities may soon change. In its project *Accounting for Financial Instruments* (AFI) (formerly *Financial Instruments: Improvements to Recognition and Measurement* — including *Accounting for Hedging Activities Project*), the FASB has tentatively agreed that all financial assets and financial liabilities (except for an entity's own debt in certain circumstances) should be measured at fair value on the balance sheet, with changes in fair value recognized in either net income or other comprehensive income (OCI). On August 13, 2009, the FASB met to continue its discussions about the presentation of financial instruments in financial statements. This *Heads Up* summarizes the tentative decisions reached by the FASB on the AFI project at its August 13 Board meeting.¹

The FASB expects to issue an Exposure Draft (ED) on classification, measurement, impairment, and presentation of financial instruments as well as hedge accounting by the end of this year or early 2010. Before issuing this ED, the FASB will continue to deliberate various issues, including the scope, effective date, and transition requirements as well as impairment of financial assets and hedge accounting.

[Appendix A](#) of this *Heads Up* gives an overview of the FASB's decisions to date about financial statement presentation of financial instruments, and [Appendix B](#) summarizes the FASB's other decisions in this project to date.

Separate Balance Sheet Presentation

At its August 13 meeting, the FASB decided that financial instruments for which changes in fair value are recognized in net income should be presented on the balance sheet separately from financial instruments for which fair value changes are recognized in OCI.²

Presentation of Financial Instruments for Which Changes in Fair Value Are Recognized in Net Income

Balance Sheet

Back in July, the FASB tentatively decided that for financial instruments measured at fair value and for which fair value changes are recognized in OCI, amortized cost should be displayed on the balance sheet along with the adjustment made in arriving at fair value. On August 13, the FASB discussed whether to extend that presentation approach to financial instruments for which changes in fair value are recognized in net income. The

¹ The following summary of the FASB's approach is based on preliminary and unofficial notes taken by Deloitte observers of the FASB's deliberations.

² Note that interest accruals, credit losses, and realized gains and losses would be reported in net income for financial instruments for which fair value changes are recognized in OCI.

FASB agreed to require only presentation of fair value on the balance sheet for these financial instruments, with the exception of the entity's own debt, whose amortized cost would also have to be presented on the balance sheet. However, entities would not be prohibited from presenting on the balance sheet, or disclosing in the notes to the financial statements, amortized cost and a reconciliation to fair value for financial instruments for which changes in fair value are recognized in net income.

Net Income

In July, the FASB agreed that for financial instruments for which changes in fair value are recognized in OCI, interest income and interest expense, realized gains and losses, and credit-related impairments would be recognized and separately presented within net income. At its August 13 meeting, the FASB considered whether to require similar separate presentation for financial instruments for which changes in fair value are recognized in net income. The FASB decided not to require separate presentation of interest accruals and credit losses for these financial instruments, although an entity would not be precluded from separately presenting those items in the income statement. The FASB did decide, however, to require entities to separately present realized and *unrealized* gains (or losses), in the aggregate, on the face of the income statement for financial instruments for which changes in fair value are recognized in net income.

The FASB decided to require separate income statement presentation of interest accruals and any realized gains or losses on an entity's own debt for which the amortized cost option is elected.

Presentation of Financial Instruments for Which Changes in Fair Value Are Recognized in OCI

Balance Sheet Presentation of Cumulative Credit Losses

At its August 13 meeting, the FASB concluded that for financial assets for which fair value changes are recognized in OCI, entities should be required to present cumulative credit losses as a separate line item on the face of the balance sheet. This amount would be presented separately from the remainder of the fair value adjustment that reconciles the amortized cost to the fair value of the financial asset. The separate presentation of the cumulative credit losses on the face of the balance sheet would provide information complementary to the separate presentation within net income of any credit losses incurred during the period.

Foreign Currency Transaction Gains/Losses

The FASB discussed whether to require entities to separate and recognize in net income foreign currency transaction gains or losses on a foreign-currency-denominated financial instrument measured at fair value with changes in fair value recognized in OCI. However, in a manner consistent with the current approach for foreign-currency-denominated available-for-sale debt securities that are not other-than-temporarily impaired (under ASC 830³), the FASB decided that foreign currency gains and losses on financial instruments measured at fair value with changes in fair value recognized in OCI should not be separated and recognized in net income. Instead, those changes in fair value would be reported in OCI along with other changes in fair value recognized in OCI.

Disaggregation of Other Changes in Fair Value

The FASB agreed not to propose additional disaggregation of fair value changes for financial instruments for which fair value changes are recognized in OCI (as discussed above).

Presentation of Financial Liabilities for Which the Amortized Cost Option Is Elected

In July, the FASB agreed that an entity should have the option to elect to carry its own debt at amortized cost if (1) it meets certain eligibility criteria related to management's intent/business model as well as to the cash flow variability of the instrument and (2) such designation addresses an accounting mismatch. At its August 13 meeting, the FASB decided to require separate income statement presentation of interest accruals and any realized gains or losses on an entity's own debt for which the amortized cost option is

³ FASB Accounting Standards Codification Topic 830, *Foreign Currency Matters*.

Appendix A

The table below summarizes the tentative decisions the FASB has made to date (as of August 13, 2009) regarding the financial statement presentation of financial instruments. Note that the FASB has not made any final decisions and that the description of the FASB's tentative decisions is based on preliminary and unofficial notes taken by Deloitte observers of the FASB's deliberations.

Classification	Balance Sheet	Income Statement
Fair value through net income	<p>An entity would be required to present fair value on the face of the balance sheet.</p> <p>For own debt measured at fair value through net income, an entity would also be required to show amortized cost on the face of the balance sheet.</p>	<p>Separate line items within net income for realized and unrealized gains and losses (in the aggregate).</p> <p>For investments in equity instruments, dividend accruals would be shown separately within net income.</p> <p>No requirement to separately present interest accruals or credit losses.</p>
Fair value through OCI	<p>Separate presentation on the face of the balance sheet of:</p> <ul style="list-style-type: none"> • Amortized cost. • Cumulative credit losses. • Adjustments to arrive at fair value. • Fair value. 	<p>Separate line items within net income for:</p> <ul style="list-style-type: none"> • Interest income. • Interest expense. • Credit losses. • Realized gains and losses. <p>Foreign currency gains or losses would not be separated (they would be recognized in OCI).</p>
Amortized cost	<p>Amortized cost would be shown on the face of the balance sheet.</p>	<p>Separate line item within net income for:</p> <ul style="list-style-type: none"> • Interest expense. • Realized gains and losses.

In addition, note the following:

- One performance statement would be required, with a total for comprehensive income and a subtotal for net income.
- An entity would continue to be required to present basic and diluted earnings per share on the basis of net income.

Appendix B

The table below summarizes the tentative decisions the FASB has reached to date on the AFI project regarding the classification and measurement of financial instruments. Note that the FASB has not made any final decisions and that the description of the FASB's tentative decisions is based on preliminary and unofficial notes taken by Deloitte observers of the FASB's deliberations.

Subject	FASB's Tentative Decisions
Categories of financial assets and financial liabilities	<p>Effectively, three categories:</p> <ol style="list-style-type: none"> 1. Fair value through net income. 2. Fair value through OCI (FVTOCI). 3. Amortized cost (option for own debt). <p>All financial assets and financial liabilities would be measured at fair value on the balance sheet, with an optional exception for an entity's own debt, which may be recorded at amortized cost if it meets certain criteria.</p> <p>This would eliminate the available-for-sale and held-to-maturity categories in ASC 320⁴ (formerly Statement 115⁵) and the held-for-sale and held-for-investment categories of loans under ASC 948⁶ (formerly Statement 65⁷) and ASC 310⁷ (formerly SOP 01-6⁹).</p>
Criteria for FVTOCI	<p>An entity is permitted to measure a financial asset or financial liability at fair value, with changes in fair value recorded in OCI, if it meets the following two criteria:</p> <ol style="list-style-type: none"> 1. The financial instrument has no or little cash flow variability (the financial instrument (1) has a stated maturity date, (2) cannot be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its initial investment, and (3) is not a derivative or a hybrid instrument containing embedded derivatives that requires bifurcation under ASC 815¹⁰ (formerly Statement 133¹¹), or an equity security). 2. Such classification is consistent with management's intent and business model (i.e., the financial instruments in a portfolio of financial instruments are predominantly held for collection or payment of the contractual cash flows, and it is more likely than not that management will not be required to sell or repurchase the instruments before their maturity).
Criteria for amortized cost measurement	<p>An entity has the option to elect to carry its own debt at amortized cost if it meets the criteria for FVTOCI and such designation addresses an accounting mismatch.</p>
Recycling of accumulated OCI to net income	<p>Amounts in accumulated OCI are recycled to net income upon realization or impairment.</p>
Equity investments	<p>All measured at fair value. Unlike current U.S. GAAP, the FASB's tentative decisions do not allow an exception for nonmarketable equity securities.</p>
Embedded derivatives in financial hybrid contracts	<p>Hybrid financial contracts with an embedded derivative, which currently must be bifurcated under ASC 815 (formerly Statement 133), would instead be measured at fair value in their entirety.</p>
Reclassification	<p>Not permitted.</p>

⁴ FASB Accounting Standards Codification Topic 320, *Investments — Debt and Equity Securities*.

⁵ FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

⁶ FASB Accounting Standards Codification Topic 948, *Financial Services — Mortgage Banking*.

⁷ FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*.

⁸ FASB Accounting Standards Codification Topic 310, *Receivables*.

⁹ AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*.

¹⁰ FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging*.

¹¹ FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

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