

Heads Up

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The More Things Change, the More They Stay the Same

Update on FASB's Project on Classifying and Measuring Financial Instruments

by Magnus Orrell and Jason Nye, Deloitte & Touche LLP

Introduction

This *Heads Up* addresses classification and measurement, a key component of the FASB's project on accounting for financial instruments. With redeliberations nearly complete, the FASB's tentative decisions to date¹ describe a fairly complete model and give clues regarding what application issues may arise if the FASB amends U.S. GAAP on the basis of these decisions.

The body of this *Heads Up* gives an overview of the tentative decisions. The appendixes contain detailed information on more specific aspects of this topic:

- [Appendix A](#) discusses the cash flow characteristics and business model assessments in the FASB's tentative model.
- [Appendix B](#) describes other components of the tentative model.
- [Appendix C](#) provides an overview of the FASB's tentative presentation and disclosure requirements.
- [Appendix D](#) illustrates classification of common instruments under both current U.S. GAAP and the FASB's tentative approach.
- [Appendix E](#) compares current U.S. GAAP with the FASB's tentative approach.
- [Appendix F](#) compares IFRS 9² with the FASB's tentative approach.

Overview

The FASB has tentatively decided that financial assets should be classified at initial recognition into one of three categories: (1) fair value through net income (FV-NI), (2) fair value through other comprehensive income (FV-OCI), or (3) amortized cost. Classification of financial assets would be based on two factors: (1) the cash flow characteristics of the financial instrument and (2) the entity's business model for managing the instrument. Financial liabilities would be classified as amortized cost unless (1) the obligation is a derivative, (2) the liability is a short sale, or (3) the entity will subsequently transact at fair value.

¹ Decisions include those made as of the FASB's September 5, 2012, Board meeting. Because decisions are tentative, they could change before new requirements are finalized.

² IFRS 9, *Financial Instruments*.

The more significant changes that the FASB's tentative model would make to U.S. GAAP include the following:

- Investments in equity securities must be accounted for at FV-NI unless (1) the entity's investment qualifies for the equity method of accounting or (2) the entity elects, at initial recognition, to use a practicability exception.
- Equity investments that otherwise qualify for the equity method of accounting must be accounted for at FV-NI if they are held for sale.
- Entities are permitted to measure nonmarketable equity investments by using a new measurement approach under which the cost basis is adjusted for observable price changes.
- Equity method investments that are not accounted for at FV-NI are evaluated for impairment under a single-step approach, eliminating the other-than-temporary impairment recognition threshold.
- The classification of debt-instrument financial assets (e.g., loans, receivables, and investments in debt securities) is based on an entity's assessment of the cash flow characteristics of the instrument and its business model for managing instruments rather than management's intentions with a specific instrument (e.g., to trade or to hold an individual instrument until its maturity).
- FV-OCI is no longer a default measurement category. Instead, FV-NI is a "residual" category, applicable to investments in debt-instrument financial assets that are not held within a business model consistent with either amortized cost or FV-OCI classification.
- Loans that are held for sale cannot be measured at the lower of cost or market but will generally be accounted for at FV-NI.
- Reclassifications between categories occur only when there has been a change in business model and are expected to be rare.
- Embedded derivatives are not bifurcated from hybrid financial asset hosts.
- Foreign-currency gains and losses on debt instruments classified as FV-OCI are recognized in net income.
- The fair value option (FVO) is available only when specific eligibility criteria are met.

The FASB's redeliberations on the classification and measurement of financial instruments are nearly complete. Many of the Board's decisions regarding the FASB's tentative model have been more in line with current U.S. GAAP and IFRSs than with the Board's May 2010 exposure draft (ED),³ which proposed a significant expansion of fair value accounting. The FASB still plans to deliberate scope and specialized industry guidance (e.g., for broker-dealers and investment companies). Any amendments to the *FASB Accounting Standards Codification* that will be proposed as a result of this work will be exposed for public comment.⁴ The FASB currently expects to issue an ED on this topic in the fourth quarter of 2012.

Editor's Note: We believe, given the remaining items to be deliberated and the volume of potential changes to U.S. GAAP, that a revised exposure draft will not be issued before January 2013.

³ FASB Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*.

⁴ According to the FASB's current technical plan.

Classification and Measurement of Investments in Equity Securities

Investments in both marketable and nonmarketable equity securities are classified as FV-NI under the FASB's tentative model with two exceptions: (1) equity method investments not held for sale at the moment significant influence is established and (2) nonmarketable equity securities for which entities may elect a "modified-cost" measurement.⁵

Equity Method of Accounting

In a change from current U.S. GAAP, the FASB tentatively decided that an equity investment that otherwise qualifies for the equity method of accounting must be classified as FV-NI if the investment is held for sale at the moment significant influence is established. The following would be determinative indicators that an equity method investment is held for sale:

- "The entity has specifically identified potential exit strategies."
- "The entity has defined the time at which it expects to exit the investment."⁶

The FASB's tentative model would also require entities to apply an impairment approach to equity method investments, whereby entities perform a qualitative assessment to determine whether the investment is impaired, then measure and recognize the impairment loss, if any.

Practicability Exception for Measuring Nonmarketable Securities

Under the FASB's tentative model, an entity may elect at initial recognition to measure nonmarketable securities at cost adjusted for:

- Any recognized impairment loss.
- Observable price changes (upward or downward) in orderly transactions involving identical or similar equity securities of the same issuer.

Entities using the exception would be required to recognize an impairment loss equal to the difference between the fair value of a nonmarketable equity security and its carrying amount if qualitative factors indicate that it is more likely than not that the investment is impaired.

Classification and Measurement of Debt Instruments

Debt Instruments Held as Assets

Under the FASB's tentative model, an entity classifies a debt instrument held as an asset (e.g., a debt security, loan, or receivable) by considering (1) the cash flow characteristics of the instrument and (2) its business model for managing the instruments. This assessment is made at initial recognition. Hybrid financial assets would be classified in their entirety and would not be bifurcated.

Contractual Cash Flow Characteristics Assessment

Debt-instrument financial assets (e.g., investments in debt securities, loans, and receivables) with contractual terms that "give rise on specified dates to cash flows that are solely payments of principal and interest"⁷ (SPPI) are eligible for a category other than FV-NI.

Under the cash flow characteristics criterion, (1) interest is consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period and (2) principal is the amount transferred by the holder on initial recognition.

⁵ The Board's tentative decisions on equity securities do not apply to entities subject to specialized industry accounting guidance, such as broker-dealers, investment companies, sponsors of defined benefit plans, and insurance companies. The Board will address specialized industry accounting at a later date.

⁶ FASB's August 9, 2012, "Summary of Decisions Reached to Date During Redeliberations."

⁷ See footnote 6.

Investments in debt securities, loans, and receivables that do not pass the cash flow characteristics assessment would be classified as FV-NI. Those that pass the assessment would be classified — on the basis of the entity’s business model — as amortized cost or FV-OCI.

Business Model Assessment

Although an entity would assess the cash flow characteristics of each debt-instrument financial asset individually, it would assess the business model at a higher level of aggregation and would not be prevented from classifying identical or similar financial assets differently if those assets are managed within different business models. The assessment is performed at origination or acquisition of the financial asset(s) by “key management personnel on the basis of how the asset(s) will be managed together with other financial assets within a distinct business model.”⁸ The business model assessments can be summarized as follows (see [Appendix A](#) for more information):

- To classify debt instruments that pass the contractual cash flow characteristics assessment as amortized cost, an entity must manage the instrument within a business model “whose objective is to hold the assets in order to collect contractual cash flows.”
- To classify eligible debt instruments as FV-OCI, an entity must manage the instruments within a business model “whose objective is both to hold the financial assets to collect contractual cash flows and to sell the financial assets.”

Debt-instrument financial assets that do not pass the contractual cash flow characteristics assessment or that fail to meet the amortized cost or FV-OCI business model assessments are accounted for at FV-NI.

For foreign-currency-denominated debt instruments classified as FV-OCI, an entity would separately calculate changes in fair value attributable to changes in foreign exchange rates and record those in net income. Further, entities would measure such gains and losses by using a method based on the fair value of the debt instrument. One acceptable method would be to multiply the end-of-period fair value of the debt instrument in the foreign currency by the difference between the end-of-period spot exchange rate and the beginning-of-period spot exchange rate. The entity would consistently apply the method selected, though investment companies would continue to apply the method described in ASC 946-830.⁹

Editor’s Note: The FASB also tentatively decided to provide application guidance that:

- Describes the types of business activities that are consistent with the “hold-to-collect” business model assessment for amortized cost and the frequency and nature of sales that would prohibit financial assets from qualifying for amortized cost.
- Describes the types of business activities that would qualify for the FV-OCI business model.

Debt Instruments That Are Liabilities

Under the FASB’s tentative model, an entity accounts for financial liabilities at amortized cost except derivative liabilities, short sales, and those that will be subsequently transacted at fair value. An entity would first determine whether any feature within the liability contract represents an embedded derivative that should be separately accounted for under the guidance in ASC 815-15. In such cases, an entity would classify a separated host contract financial liability in the amortized cost category.

⁸ See footnote 6.

⁹ For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte’s “[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#).”

As an exception, in circumstances in which financial assets will be used to settle nonrecourse financial liabilities, those financial liabilities would be accounted for on the same basis as the related financial assets.

Other Components of the Model

Fair Value Option

Under the FASB's tentative decisions, the circumstances under which the FVO could be elected would be narrower than those under existing U.S. GAAP. At initial recognition, an entity could irrevocably elect to account for the following instruments at FV-NI:

- A group of financial assets and financial liabilities (which may be derivative instruments) if the entity (1) manages the net exposure for the group on a fair value basis and (2) provides information on that fair value basis to the reporting entity's management.
- A hybrid financial liability unless (1) the embedded derivative or derivatives do not significantly modify the cash flows of the contract or, (2) after the entity performs little to no analysis, it is clear that separate accounting for the derivative(s) is prohibited.

Changes in the fair value of a financial liability for which the FVO has been elected are presented separately in other comprehensive income (OCI) rather than in net income (NI) if they result from a change in the reporting entity's own credit risk. Cumulative gains and losses recognized in OCI that are associated with changes in an entity's own credit risk are recognized in NI upon the settlement of the liability.

Reclassification and Sales

Under the FASB's tentative model, financial assets **must** be reclassified "when (and only when) the business model changes."¹⁰ Such changes are expected to be infrequent and "must be (1) determined by an entity's senior management as a result of external or internal changes, (2) significant to an entity's operations, and (3) demonstrable to external parties"¹¹ to trigger reclassification. Although the change in business model may occur as of an interim date, an entity would recognize the reclassification as of the last day of the interim period during which the change in business model occurs.

When an entity decides, after initial recognition, that a financial asset accounted for at amortized cost will be sold and the entity's business model does not change, the entity still measures the instrument at amortized cost subject to impairment until the instrument is sold. In such cases, an entity measures the impairment loss by calculating the entire difference between the instrument's fair value and amortized cost, which is then recognized in net income. Entities are also required to present financial assets originally accounted for at amortized cost and subsequently identified for sale in a separate line item in the statement of financial position and provide related disclosures.

Presentation and Disclosure

The FASB has tentatively decided to expand the presentation and disclosure requirements for financial instruments. Notably, an entity would be required to separately present financial assets and financial liabilities on the balance sheet by classification and measurement category (i.e., FV-NI, FV-OCI, and amortized cost). In addition, public entities would be required to parenthetically present fair value measurements on the face of the balance sheet for financial instruments accounted for at amortized cost. Nonpublic entities would not be required to present or disclose fair value measurements for financial instruments accounted for at amortized cost.

Moreover, the FASB has proposed a package of new disclosure requirements for liquidity and interest rate risk related to financial instruments. See Deloitte's July 3, 2012, [Heads Up](#) for more information.

¹⁰ See footnote 6.

¹¹ See footnote 6.

U.S. Income Tax Considerations¹²

The accounting for financial instruments for tax purposes can be quite complex. Entities must consider differences in the character of gains and losses (capital vs. ordinary) and the timing of recognition based on appropriate tax-basis measurement attributes (e.g., mark to market vs. cost). An entity would determine at inception whether instruments will be measured at fair value or cost for tax purposes on the basis of that entity's industry and the business activities performed when purchasing, managing, and selling the underlying investment (i.e., whether the entity's activities are consistent with definitions for dealers, investors, or hedgers). Further, this determination is made on a security-by-security basis and, under certain conditions, an entity can elect to measure its investments at fair value for tax purposes even though the investments might otherwise be measured at cost for financial statement purposes. Other considerations include:

- Gains are taxed as ordinary income or at capital gains rates depending on the tax classification (differences in character).
- The classification or measurement attribute applied to AFI for book purposes may be indicative, but not determinative, of the tax treatment, and differences are common.
- Fair value measurement requirements under the Internal Revenue Code (IRC) (e.g., IRC Sections 475 and 1256) differ from the fair value requirements under ASC 820.

Such tax matters may be complex, but the FASB's project on the classification and measurement of financial instruments will most likely not result in a change to the related rules under the IRC.

With any change in the accounting principles governing financial reporting, there is the potential for changes in the magnitude, if not the nature, of book-tax differences. Entities often make elections under the IRC to achieve consistent treatment for book and tax purposes. For example, smaller banks may classify investments at cost in accordance with IRC Section 475(b) but may make fair value elections pursuant to IRC Section 475(f) to eliminate book-tax mismatches. Along with understanding the changes that may result from the FASB's tentative decisions, management will want to consider (1) what tax elections should be made, (2) whether to reduce complexity and book-tax differences, and (3) how to effectively manage the entity's tax obligations.

¹² Jeff Callender, Deloitte Tax LLP, contributed to this section.

Appendix A — Cash Flow Characteristics and Business Model Assessments

This appendix discusses the cash flow characteristics and business model assessments, which an entity would perform to determine the classification and measurement of financial assets.¹³

Cash Flow Characteristics Assessment — Solely Principal and Interest

“A financial asset would be eligible for a measurement category other than FV-NI (depending on the business model within which it is held) if the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding [(SPPI)].

1. If the financial asset contains a component other than principal and the consideration for the time value of money and the credit risk of the instrument [(i.e., SPPI)], the financial asset must be measured at [FV-NI].
2. If the financial asset only contains [SPPI] but the relationship between them is modified (for example, the interest rate is reset and the frequency of reset does not match the tenor of the interest rate), an entity must consider the effect of the modification when assessing whether the cash flows on the financial asset are still consistent with the [SPPI principle].
3. If the financial asset only contains [SPPI components] and the relationship between them is not modified, the financial asset could be eligible for a measurement category other than [FV-NI] (depending on the business model within which it is held).”

Contingent Cash Flows

“A contractual term that changes the timing or amount of payments of principal and interest would not preclude the financial asset from a measurement category other than [FV-NI] as long as any variability only reflects changes in the time value of money and the credit risk of the instrument.”

“The probability of contingent cash flows that are not [SPPI] should not be considered. Financial assets that contain contingent cash flows that are not [SPPI] must be measured at [FV-NI]. An exception, however, [would apply to] extremely rare scenarios.”

Assessment of Economic Relationship

“An entity would need to compare the financial asset under assessment to a benchmark instrument that contains cash flows that are [SPPI] to assess the effect of the modification [on] the economic relationship between P&I. An appropriate benchmark instrument would be a contract of the same credit quality and with the same terms, except for the contractual term under evaluation.”

“If the difference between the cash flows of the benchmark instrument and the instrument under assessment is more than insignificant, the instrument must be measured at FV-NI because its contractual cash flows are not [SPPI].”

Prepayment and Extension Options

“A prepayment or extension option, including one that is contingent, does not preclude a financial asset from a measurement category other than [FV-NI] as long as these features are consistent with the [SPPI principle].”

Editor’s Note: The cash flow characteristics assessment tentatively adopted by the FASB is based largely on IFRS 9. The FASB has not indicated whether it will also adopt the implementation guidance and examples from IFRS 9 that are associated with this assessment, although we expect the Board to provide some application guidance. The following are some considerations related to the FASB’s cash flow characteristics assessment:

- Many receivables, loans, and debt securities would pass the cash flow characteristics assessment, whereas equity securities and financial derivatives would not. These would be accounted for at fair value, with changes in fair value recognized in NI, except derivatives designated as the hedging instrument in a cash flow hedge or a hedge of a net investment in a foreign operation.
- Principal would be considered the amount transferred by the holder at the time of initial recognition. We believe that the FASB intends auto loans, trade receivables, and other receivables obtained in exchange for goods or services to pass the cash flow characteristics assessments even though an amount of cash was not transferred at inception.
- Interest is defined as compensation for the time value of money and credit risk. In the case of a debt instrument that is contingently prepayable at par and acquired at a significant premium, the potential loss of initial investment (or a portion thereof) when the instrument is prepaid early would not represent compensation for the time value of money or credit risk. It is not clear whether an instrument prepayable at par and acquired for a premium could qualify for a category other than FV-NI.

¹³ Unless otherwise noted, the quoted text in the appendixes of this *Heads Up* is from the FASB’s August 9, 2012, “Summary of Decisions Reached to Date During Redeliberations” or August 29 Summary of Board Decisions.

- The FASB has not indicated whether it will permit or require an entity to “look through” to underlying assets when classifying investments in structured notes that represent beneficial interests in securitized financial assets. IFRS 9 requires entities to look through to the underlying assets that generate the cash needed to settle the related liability in evaluating whether the instrument meets the cash flow characteristics criterion. Without such look-through guidance, an entity may be forced to conclude that the investment in the structured note does not pass the cash flow characteristics assessment.

Business Model Assessment

“The business model assessment only applies to financial assets that pass the contractual cash flow characteristics assessment. . . . Financial assets that fail [this] assessment are classified and measured at [FV-NI].”

Editor’s Note: On the basis of past tentative decisions, informal discussions with the FASB staff, and the guidance in IFRS 9, we understand that the business model assessment is not performed at the individual instrument level but at a more aggregated level. However, it may not always be clear whether the assessment should be performed at the level of individual investment portfolios, business units, or divisions within a subsidiary.

Amortized Cost

“Financial assets would qualify for amortized cost if the assets are held within a business model whose objective is to hold the assets in order to collect contractual cash flows.”

“The Board [tentatively] decided that the application guidance to be included in the proposed standard should incorporate . . . [e]xamples of types of business activities that would be consistent with an amortized cost classification.”

“Sales of financial assets as a result of significant credit deterioration would be consistent with the objective of amortized cost classification if such sales are to maximize the collection of contractual cash flows through sales rather than through cash collection. Sales for other reasons should be very infrequent.”

“Sales of financial assets that result from managing the credit exposure due to concentration of credit risk would not be consistent with the primary objective of amortized cost classification.”

Fair Value Through Other Comprehensive Income

“Financial assets would qualify for classification and measurement at [FV-OCI] if they are managed within a business model whose objective is both to hold the financial assets to collect contractual cash flows and to sell the financial assets.

The proposed standard will also include “[e]xamples of types of business activities that would be consistent with [an FV-OCI] classification.”

“Financial assets classified as [FV-OCI] may be held for collection of contractual cash flows or sold. That is, management may hold the assets for an unspecified period of time or sell the assets to meet certain objectives.”

Editor’s Note: Questions have arisen about certain elements of the business model for FV-OCI classification. Such questions have included the following:

- How would an entity demonstrate that it is managing its instruments within a business model whose objective is **both to hold and to sell** the assets?
- Could the business model reflect management’s intentions relative to market conditions, changes in the entity’s objectives for maintaining a particular relationship, or other factors?
- Should the business model assessment ignore management’s “intentions” to either hold or sell specific financial instruments?

Fair Value Through Net Income

“[FV-NI] is the residual category, that is, financial assets that fail the amortized cost and [FV-OCI] business model assessment will be measured at FV-NI.”

“Financial assets that are held for sale at initial recognition would not be consistent with the primary objective of amortized cost or [FV-OCI].”

Editor’s Note: During the Board’s discussion of business activities that are not consistent with the amortized cost and FV-OCI business model assessments and that are therefore classified in FV-NI, one board member noted that he did not believe the FV-NI category would be limited to financial assets that are classified as trading under current U.S. GAAP (i.e., ASC 320). Four other board members agreed.

At this time, it is unclear whether the Board will expand entities’ ability to classify financial assets at FV-NI to align the application of the business model assessment with the view expressed by these board members.

Financial Liabilities

A different business model assessment applies to financial liabilities. “An entity would measure financial liabilities . . . at amortized cost unless *either* of the following conditions applies:

- Financial liabilities for which an entity’s business [model for managing the liability] at acquisition, issuance, or inception, is to subsequently transact at fair value.
- Financial liabilities that are short sales.”

Financial liabilities that meet either of the conditions above would be classified as FV-NI.

“In circumstances in which financial assets will be used to settle nonrecourse financial liabilities, an entity should measure the financial liabilities consistently with the measure of the related financial assets, taking into account the same factors determining each amount. For example, if both the assets and the liabilities are measured at amortized cost and the reported amount of the assets is reduced by a credit impairment, the reported amount of the nonrecourse liabilities should include the same reduction.”

Editor’s Note: For nonrecourse liabilities, there is an unanswered question about how the FASB’s principle applies to a structured note for which (1) contractual terms do not explicitly limit recourse and (2) the only assets held by the investment vehicle are those being used to settle its liability (e.g., when the value of these assets does not exceed the value of the liability and investors are limited to those assets when trying to recover their investment in the event that payment is not made on the liability). On the basis of informal discussions with the FASB staff, we believe that the Board’s intent is to limit the guidance on nonrecourse liabilities to arrangements that (1) establish a contractual link between the liabilities and underlying asset and (2) contractually stipulate the holder’s recourse in the event that default is limited to the value of the underlying assets, which may be zero.

Appendix B — Other Components of the Model

Initial Measurement

The initial measurement of a financial instrument depends on its classification under the FASB's tentative model. Financial instruments classified as FV-NI are initially measured at fair value, and financial instruments classified as either FV-OCI or amortized cost are initially measured at the transaction price. However, entities must evaluate the transaction price or consideration transferred for instruments classified at FV-OCI or amortized cost to identify elements unrelated to the financial instrument.

This measurement principle results in differing treatment of transaction costs. Such costs are expensed when incurred for the acquisition or issuance of financial instruments initially measured at fair value but included in the amount initially recognized when an instrument is initially measured at the transaction price.

Editor's Note: Deloitte held informal discussions with the FASB staff about the requirement to evaluate the transaction price at initial recognition to identify elements unrelated to the financial instrument. During these discussions, the FASB staff suggested that entities would be required to initially measure a financial instrument at fair value, regardless of classification, if there is a difference related to explicit incentives or concessions between the transaction price and fair value at initial recognition. The difference would be recognized in earnings unless another Codification topic would permit an entity to recognize the difference in the statement of financial position. However, the incentive or concession would have to result in unreasonable terms in light of other observable market data for similar instruments.

An entity may be more likely to conclude that some part of the consideration given or received is for something other than the financial instrument if the terms of the agreement are significantly off-market.

The Board may provide application guidance to clarify the general principle for the initial measurement of financial instruments. Specific questions that we hope to see answered include:

- Does the guidance require recognition of differences between fair value and transaction price (e.g., as an up-front fee) for (1) credit card receivables with teaser rates (e.g., an explicit incentive to transfer balances), (2) mortgage loans purchased at a premium to build market share, or (3) small business loans with multiple counterparties bundled together and offered at rates below market. During our discussions with the FASB staff, it was suggested that the Board does not intend to require the recognition of such up-front differences unless the terms are unreasonable in light of other observable market data for similar transactions.
- Could an entity view a concession as being analogous to a loan origination fee or direct loan origination costs, which are deferred under ASC 310-20-25-2?

Equity Method of Accounting

The FASB's tentative model retains the equity method investments guidance in ASC 323. Under ASC 323-10-25-1, an investor is required to apply the equity method of accounting when its investment in voting stock gives it "the ability to exercise significant influence over operating and financial policies of [a corporate] investee." Significant influence is established when an investor holds 20 percent or more of the investee's outstanding voting rights, although other factors may indicate that an investor holds significant influence over an investee. Investments that qualify for the equity method of accounting are measured at cost, with adjustments for the investor's proportionate share of the investee's NI (or net loss) after the date of acquisition.

The Board has tentatively decided to require entities to measure investments otherwise eligible for the equity method of accounting at FV-NI if they are "held for sale" when the investment initially becomes eligible for the equity method of accounting. The following two indicators are determinative that an investment is held for sale:

1. "The entity has specifically identified potential exit strategies even though it may not yet have determined the specific method of exiting the investment.
2. The entity has defined the time at which it expects to exit the investment, which may be either an expected date or range of dates; a time defined by specific facts and circumstances, such as achieving certain milestones; or the investment objectives of the entity."

Entities would measure and record potential impairment losses on equity method investments when a qualitative assessment of relevant factors indicates that the investments are impaired. Recognized impairment losses may not be reversed.

Editor's Note: In the FASB's tentative decision on the held-for-sale indicators, it is not clear whether both indicators must be present or one alone would be sufficient to require an equity investment otherwise eligible for the equity method of accounting to be classified as FV-NI. We believe that the FASB's intention is that the presence of one indicator is sufficient to require classification of the equity investment as FV-NI but that other factors or indicators may also be taken into consideration.

Some have questioned whether this tentative decision effectively provides a FVO for equity method investments given the potential ease with which an entity might assert that one or both indicators are present. For example, an entity would not be required to determine the specific strategy to exit the investment. Further, there is no explicit requirement that such strategies be consistent for similar investments or that the strategy be included in investment strategy documents. In addition, the time at which an entity expects to exit the investment may be based on a range of dates or the occurrence of a contingent event such as the achievement of specific milestones or investment objectives. Further, there is no apparent limit on how far in the future management may assert that it plans to exit the investment.

At the same time, on the basis of the current language, others are concerned that FV-NI may be required even for longer-term investments. For example, management may discuss a range of strategies when making its initial investment or when subsequently establishing significant influence over the investee. If management discusses potential exit strategies but ultimately selects a strategic alternative that shows its commitment to a longer-term relationship with the investee, the investment might be forced into FV-NI. It may be helpful if the FASB were to clarify this by refining the indicators or providing implementation guidance.

Practicability Exception for Nonmarketable Equity Securities

Entities holding nonmarketable equity securities may elect, at initial recognition, to measure such investments at cost adjusted for (1) any impairment loss if qualitative factors indicate it is more likely than not that the instrument is impaired and (2) observable price changes (upward or downward) in orderly transactions involving identical or similar equity securities of the same issuer.

Editor's Note: During discussions with the FASB, staff members noted that the qualitative factors an entity would use to determine whether a nonmarketable equity security is more likely than not impaired might be based on the factors in ASC 320-10-35-27, which include:

- a. A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
- b. A significant adverse change in the regulatory, economic, or technological environment of the investee
- c. A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
- d. A bona fide offer to purchase (whether solicited or unsolicited), an offer by the investee to sell, or a completed auction process for the same or similar security for an amount less than the cost of the investment
- e. Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.

The impairment approaches that would be applied to equity method investments and nonmarketable equity securities measured under the "adjusted-cost" practicability exception are "single-step" approaches. Under the FASB's tentative model, an entity would not be required to determine whether a potential impairment loss is other than temporary.

Fair Value Option

According to the FASB's August 9, 2012, "Summary of Decisions Reached to Date During Redeliberations," an entity may irrevocably elect at initial recognition to account for the following instruments at FV-NI:

1. A group of financial assets and financial liabilities (which may be derivative instruments) if the entity (a) "manages the net exposure" for the group on a fair value basis and (b) "provides information on that basis to the reporting entity's management."
2. A hybrid financial liability unless (a) the embedded derivative(s) does "not significantly modify the cash flows" of the contract or (b) "[i]t is clear with little or no analysis" that separately accounting for the derivative(s) is prohibited.

Editor’s Note: On the basis of informal discussions with the FASB staff, we understand that the first condition is intended to capture financial instruments such as those that are managed as part of matched repo books or structured notes that are being managed with interest-rate derivatives, but not a commercial bank’s asset-liability management activities involving loans and customer deposits.

The conditional FVO under the FASB’s tentative model, in conjunction with the FASB’s other tentative decisions (including those related to investments otherwise qualifying for the equity method of accounting and loan commitments), is intended to allow for FV-NI classification for most instruments that are currently accounted for at FV-NI through the exercise of the FVO in ASC 825. The FASB has not proposed eliminating the FVO for rights and obligations under insurance contracts or warranties.

Reclassifications

Under the FASB’s model, reclassifications between categories would be accounted for as follows:

- For reclassifications from FV-OCI to FV-NI, amounts accumulated in OCI are “recycled” (recognized in net income) and the financial asset continues to be measured at fair value.
- For reclassifications from FV-NI to FV-OCI, changes in fair value occurring after the reclassification date are recognized in OCI and the financial asset continues to be measured at fair value. On the date a reclassification is recognized, an entity should calculate an effective interest rate (EIR) on the basis of its current carrying amount (i.e., fair value on the reclassification date) to determine the amounts of interest and amortization it should recognize in net income going forward.
- For reclassifications from amortized cost to FV-OCI, the financial asset is remeasured at fair value on the reclassification date and any difference between amortized cost and fair value is recognized in OCI.
- For reclassifications from FV-OCI to amortized cost, amounts accumulated in OCI are derecognized, with an offsetting entry to the financial asset’s carrying amount (i.e., the new carrying amount is determined as though the asset had always been classified at amortized cost).
- For reclassifications from FV-NI to amortized cost, the fair value of the financial instrument becomes the amortized cost on the reclassification date and an entity would calculate the EIR on the basis of this new carrying amount.

For reclassifications from amortized cost to FV-NI, an entity remeasures the asset at fair value and recognizes the difference between amortized cost and fair value in net income.

Assets to Be Sold Not Yet Identified

Because the classification of a financial instrument occurs at initial recognition, situations naturally arise in which an entity originates or purchases a pool of financial assets (such as loans), anticipating that some assets will be sold while others will be managed through its business model for collecting contractual cash flows (i.e., amortized cost business model). At the time the assets are originated or purchased, however, the entity may not know which specific assets will be sold. In this case, an entity would still classify all the assets into one of the three categories at initial recognition in accordance with the FASB’s tentative model.

Editor’s Note: On the basis of informal discussions with the FASB staff, we understand that an entity may estimate a portion of the portfolio that management expects to sell even when the entity has not identified, at initial recognition, which assets will be sold. The portion expected to be measured at fair value (i.e., accounted for at either FV-NI or FV-OCI), and the remaining portfolio would be accounted for at amortized cost. However, significant differences between the portion ultimately sold and the original estimate may call into question an entity’s initial classification or estimate (i.e., there may be an error).

Specific Instruments

During redeliberations, the FASB made a number of tentative decisions relating to other types of financial instruments.

- *Hybrid financial instruments* — The FASB has tentatively decided to retain the bifurcation requirements in ASC 815-15 for embedded derivatives in hybrid financial liabilities. This is a change from the guidance in the FASB’s original ED, which would have eliminated the bifurcation requirements for embedded derivatives altogether.
- *Certain convertible debt instruments* — From the issuer’s perspective, convertible debt instruments (1) in which the conversion feature is not required to be bifurcated as an embedded derivative, because it is indexed to and settled in an entity’s own equity instruments, and (2) that do not contain a beneficial conversion feature would be accounted for at amortized cost in their entirety. This decision retains current U.S. GAAP and does not apply to the holder of such instruments.

- *Loan commitments and standby letters of credit* — If an entity expects to manage the funded loan within a business model that is inconsistent with the amortized cost and FV-OCI assessments (i.e., the loan will be accounted for at FV-NI), the entity would be required to classify the related loan commitment (including a loan commitment for a revolving line of credit) or standby letter of credit as FV-NI. However, if the funded loan will be managed within an amortized cost or FV-OCI business model, the entity would need to assess whether the likelihood to fund the potential loan was “remote.” If so, the entity would account for the fees earned (i.e., commitment fees) as fee income. If the likelihood was not remote, the commitment fee would be treated as a yield adjustment and recognized over the life of the funded loan. The contractual cash flows characteristics assessment does not apply to loan commitments and standby letters of credit.

FASB and IASB Convergence Efforts

The IASB decided in late 2011 to revise the classification and measurement approach in IFRS 9 to (1) align the guidance with decisions reached as part of the joint project on insurance contracts, (2) address application issues, and (3) work with the FASB to converge some of the requirements in IFRS 9 and the FASB’s tentative model. Converged elements are noted below:

- *Cash flow characteristics assessment* — The FASB adopted the SPPI assessment from IFRS 9, and both boards tentatively agreed on a principle for assessing modifications to the economic relationship between principal and interest. This principle addresses IFRS 9 application issues raised by some constituents, including questions about the application of this test to debt instruments with interest rate reset provisions that refer to rates that do not match the remaining maturity of the instrument.
- *Business model assessment* — The FASB and IASB agreed on the business model criteria for amortized cost and FV-OCI. The boards also agreed to define the FV-NI category as a residual category (i.e., applicable when an instrument or instruments do not pass the amortized cost or FV-OCI business model assessments). In converging the business model assessments, the IASB tentatively decided to permit investments in certain debt instruments to be accounted for at FV-OCI, which is a significant change to IFRS 9.
- *Bifurcation* — The FASB tentatively agreed to prohibit bifurcation of hybrid financial assets while requiring bifurcation of hybrid financial liabilities when ASC 815-15 requires it. This approach is similar to the requirements in IFRS 9.
- *Reclassifications* — Similarly to the IASB in IFRS 9, the FASB agreed to require reclassifications when an entity’s business model changes.

The IASB decided not to include the following topics in its project to amend IFRS 9:

- The scope or mechanics of the option under IFRS 9 to measure investments in equity instruments that are not held for trading at FV-OCI.
- The requirement to measure nonmarketable equity investments at fair value. Nevertheless, the IASB tentatively decided to develop educational material for IFRS 13¹⁴ to clarify the fair value measurement principles applicable to equity instruments for which it is difficult to measure fair value or for which limited information is available that could be used in such a measurement.

The FASB’s tentative model does not permit equity instruments to be classified as FV-OCI, but it does provide a practicability exception from fair value for entities holding nonmarketable equity securities.

¹⁴ IFRS 13, *Fair Value Measurement*.

Appendix C — The FASB's Tentative Presentation and Disclosure Requirements

The FASB has tentatively decided to expand certain presentation requirements for financial instruments. Specifically, public entities would be required to:

- Present parenthetical fair value information (determined in accordance with ASC 820) on the face of the balance sheet for financial assets and financial liabilities measured at amortized cost except demand deposit liabilities and short-term receivables and payables.
- Disclose a present value amount for demand deposit liabilities in the notes to the financial statements. (Note that the Board requested the staff to further develop this present value measurement attribute.)

Nonpublic entities would not be required to present or disclose fair value measurements for financial instruments measured at amortized cost. The FASB has not addressed whether nonpublic entities would be required to disclose a present value amount for demand deposit liabilities.

Editor's Note: This tentative decision would be a change in U.S. GAAP for nonpublic entities with (1) total assets equal to or greater than \$100 million or (2) less than \$100 million in total assets that account for certain of their instruments as derivatives. Such nonpublic entities would no longer be required to disclose fair value measurements for financial instruments measured at amortized cost.

The Board also tentatively decided to require all public and nonpublic entities to:

- Separately present financial assets and financial liabilities on the balance sheet by classification and measurement category (i.e., FV-NI, FV-OCI, and amortized cost).
- Present amortized cost parenthetically on the face of the balance sheet for an entity's own debt measured at fair value.
- Separately present cumulative credit losses on the face of the balance sheet for financial assets measured at amortized cost.
- Present in NI an aggregate amount of realized and unrealized gains or losses for financial assets classified as FV-NI as well as for financial liabilities classified as FV-NI.
- Separately present the following items in NI for financial assets and financial liabilities accounted for at amortized cost and for financial assets accounted for at FV-OCI:
 - Current-period interest income (financial assets) and expense (financial liabilities).
 - Credit losses for the current period (financial assets).
 - Realized gains and losses (both financial assets and financial liabilities).

Editor's Note: The Board's tentative decision to require public entities to parenthetically present fair value on the basis of an exit price for financial liabilities measured at amortized cost (excluding core deposits), but not to provide a practicability exception, is a change from existing U.S. GAAP. ASC 825-10-50-10(a) requires an entity to disclose "the fair value of financial instruments for which it is practicable to estimate that value."

In addition, some entities have used an entry price instead of the exit price in ASC 820 to comply with this disclosure requirement for loan assets. The guidance often cited to support this approach is Example 1 from the implementation guidance in ASC 825-10-55-3, which provides a sample disclosure for a hypothetical bank. ASC 825-10-55-3 states, in part, "The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities." In short, this is a description of the transaction price associated with a loan issuance occurring at the time of valuation (an entry price). When introducing its presentation questions to the Board, the FASB staff noted that some have expressed operational concerns about presenting loans at fair value on the face of the balance sheet, including that entities may need more time, and may incur additional costs, when moving from an entry price calculation to an exit price calculation. Despite these concerns, the Board tentatively decided that fair value should be determined in accordance with ASC 820 (i.e., an exit price should be used).

When the staff works to develop the present value measurement for demand deposit liabilities, it may be able to start with the core deposit liabilities remeasurement approach outlined in the May 2010 ED. Paragraph 31 of the ED states that "[a]n entity shall measure its **core deposit liabilities** at the present value of the average core deposit amount during the period discounted at the difference between the **alternative funds rate** and the **all-in-cost-to-service rate** over the **implied maturity** of the deposits (the core deposit liabilities remeasurement approach)." Determining the all-in-cost-to-service rate may prove difficult and costly for some entities and may be inconsistent with existing measurement practices. However, it remains to be seen what present value measure the Board would require public entities to disclose.

Appendix D — Classification of Common Instruments Under Both Current U.S. GAAP and the FASB's Tentative Approach

The table below illustrates likely classifications of common types of financial instruments under both current U.S. GAAP and the FASB's tentative approach to the classification and measurement of financial assets and financial liabilities. Note that, depending on facts and circumstances (such as the specifics of an entity's business strategy and the characteristics of a financial instrument), an entity's classification may differ from the listing in this table. Shaded boxes indicate differences between the FASB's tentative approach and current U.S. GAAP.

Instrument	Current U.S. GAAP	FASB's Tentative Approach
Investments in marketable equity securities that are held for trading	FV-NI	FV-NI
Investments in marketable equity securities that are not held for trading and in which the investor does not have significant influence over the investee	FV-OCI	FV-NI
Nonmarketable equity investments (i.e., for which there is not a readily determinable fair value) in which the investor does not have significant influence over the investee	Cost	FV-NI or adjusted cost ¹⁵
Equity investments in which the investor has significant influence over the investee	Equity method (at cost with adjustments for proportionate earnings or losses), though an FVO is available	Equity method; FV-NI is required if held for sale
Investments in debt securities held for trading	FV-NI	FV-NI
Investments in debt securities that are neither held for trading nor held to maturity	FV-OCI	FV-OCI
Investments in debt securities (e.g., bonds) that the entity has the intent and ability to hold to maturity	Amortized cost	Amortized cost
Loans and receivables held for sale	Lower of cost or fair value	FV-NI
Loans and receivables held for investment	Amortized cost	Amortized cost
Hybrid financial assets	Bifurcate embedded derivative if certain conditions are met; FVO available for hybrid in its entirety	FV-NI (i.e., without bifurcation), provided that the feature results in cash flows that are not solely principal and interest
Hybrid financial liabilities	Bifurcate embedded derivative if certain conditions are met; FVO available for hybrid in its entirety	Bifurcate embedded derivative if certain conditions are met; FVO generally available for hybrid in its entirety

¹⁵ Entities holding nonmarketable equity securities may elect at initial recognition to measure such investments at cost less impairment, with adjustments for observable price changes in identical or similar instruments from the same issuer.

Appendix E — Comparison of Current U.S. GAAP With the FASB's Tentative Approach

The following table compares current U.S. GAAP with the FASB's tentative approach for the classification and measurement of financial assets and financial liabilities.

Subject	Current U.S. GAAP	Tentative Approach	What's Changed?
Categories for debt-instrument financial assets	<p>Effectively, multiple categories of financial assets, including:</p> <ul style="list-style-type: none"> • <i>Trading securities</i> — Investments in debt securities bought and held primarily for sale in the near term are accounted for at fair value with changes in fair value recognized in NI. • <i>Available for sale</i> — Investments in debt securities that do not meet the criteria for classification as held to maturity (HTM) or trading are accounted for at fair value with certain changes in fair value recognized in OCI. • <i>Held to maturity</i> — Investments in debt securities that the entity has the positive intent and ability to hold to maturity are recorded at amortized cost. • <i>Loans held for sale</i> — Reported at the lower of cost or fair value. • <i>Loans held for investment</i> — These are loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff. They are recorded at amortized cost less impairments. 	<p>Effectively, three categories of financial assets and financial liabilities:</p> <ul style="list-style-type: none"> • <i>FV-NI</i> — Required for financial assets that fail the cash flow characteristics assessment (e.g., equity instruments, derivatives) and debt instruments that pass the assessment but are not held within a business model consistent with amortized cost or FV-OCI. • <i>FV-OCI</i> — Debt-instrument financial assets that meet the cash flow characteristics assessment and are managed within a business model whose objective is to both collect contractual cash flows and sell assets. • <i>Amortized cost</i> — Debt-instrument financial assets that meet the cash flow characteristics assessment that are managed within a business model whose objective is to hold the assets to collect contractual cash flows. 	<p>For certain assets, the classification and measurement attributes will change.</p> <p>The ability to account for loans held for sale at the lower of cost or fair value would be eliminated.</p> <p>An entity would no longer bifurcate embedded derivatives from hybrid financial assets.</p>
Categories for investments in equity securities	<p>Investments in equity securities with readily determinable fair values (i.e., marketable equity securities) are classified as either trading, and accounted for at FV-NI, or available-for-sale, and accounted for at FV-OCI, on the basis of management's intent.</p> <p><i>Investments in nonmarketable equity securities</i> — Measured at cost (less impairment) unless the investor has significant influence or the FVO has been elected.</p> <p><i>Equity method investments</i> — An equity investor that has significant influence applies the equity method of accounting to the investment unless it has elected to apply the FVO.</p> <p>Impairment losses that are other than temporary are recognized on investments in AFS equity securities, nonmarketable equity securities, and equity method investments.</p>	<p>Marketable and nonmarketable equity securities are generally accounted for at FV-NI.</p> <p><i>Practicability exception</i> — An entity can elect to measure nonmarketable equity securities at cost less impairment plus or minus changes in observable prices.</p> <p><i>Equity method</i> — Investors that have significant influence apply the equity method of accounting unless the investment is held for sale at the moment significant influence is established, in which case FV-NI applies.</p> <p>Entities apply a single-step impairment approach to nonmarketable equity securities measured under the practicability exception and equity method investments.</p>	<p>Marketable equity securities could no longer be classified as available for sale (AFS), with changes in fair value recorded in OCI (instead, gains and losses must be recognized in earnings).</p> <p>The FVO for equity method investments is replaced by an FV-NI requirement for equity investments that are held for sale.</p> <p>Entities would no longer be required to determine whether impairment losses are other than temporary.</p>

Subject	Current U.S. GAAP	Tentative Approach	What's Changed?
Classification and measurement of financial liabilities	<p><i>Financial liabilities</i> — Nonderivative financial liabilities (primarily an entity's own debt) are accounted for at amortized cost unless an entity elects to use the FVO.</p> <p>Derivative financial liabilities and short-sale obligations are measured at fair value.</p>	<p>Financial liabilities are accounted for at amortized cost unless:</p> <ul style="list-style-type: none"> • The business model at acquisition, issuance, or inception is to subsequently transact at fair value. • The financial liability is a derivative or short sale. • The financial liability is a hybrid instrument with an embedded derivative that must be bifurcated under ASC 815, but the entity has elected to apply the FVO to the hybrid <p>For financial liabilities that are accounted for at FV-NI under the fair value option, changes in fair value attributable to changes in an entity's own credit risk will be presented in OCI and recycled to net income upon settlement of a liability.</p>	<p>For financial liabilities that are accounted for at FV-NI under the fair value option, changes in fair value attributable to changes in an entity's own credit risk are no longer presented in net income but in OCI.</p>
Criteria for amortized cost measurement	<p>Loans held for investment, trade receivables, investments in HTM debt securities, and nonderivative financial liabilities are generally measured at amortized cost.</p> <p>Regarding investments in debt securities, use of the HTM category is restrictive because the use of amortized cost must be justified for each individual investment in a debt security. At acquisition, an entity should determine whether it has the positive intent and ability to hold a security to maturity.</p>	<p>A financial asset is carried at amortized cost if it meets (1) the cash flow characteristics assessment and (2) the business model conditions related to amortized cost.</p> <p><i>Cash flow characteristics assessment</i> — A financial asset would be eligible for a measurement category other than FV-NI (depending on the business model within which it is held) if the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI on the principal amount outstanding.</p> <p><i>Business model</i> — Financial assets would qualify for amortized cost if the assets are held within a business model whose objective is to hold the assets to collect contractual cash flows.</p> <p>Nonderivative financial liabilities are accounted for at amortized cost unless they are a short sale or the entity's business model at acquisition, issuance, or inception is to subsequently transact them at fair value.</p>	<p>The process for determining what qualifies for amortized cost has changed.</p> <p>There is no longer a requirement to demonstrate an intent and ability to hold an individual investment in a debt security to maturity to measure it at amortized cost.</p>
Criteria for FV-OCI classification	<p>Investments in debt and marketable equity securities that fall into the AFS category (i.e., that are neither held for trading nor held to maturity) are measured at fair value, with certain changes in fair value recorded in OCI.</p>	<p>A financial asset is classified as FV-OCI if it meets the cash flow characteristics assessment (see above) and the business model assessment for FV-OCI (i.e., it is "managed within a business model whose objective is both to hold the financial assets to collect contractual cash flows and to sell the financial assets").</p>	<p>FV-OCI is no longer a default classification whereby instruments that fail to meet the other two categories are classified as FV-OCI; an instrument must have specific cash flow characteristics and meet certain business model criteria.</p> <p>In addition, investments in equity instruments can no longer be classified as FV-OCI.</p>

Subject	Current U.S. GAAP	Tentative Approach	What's Changed?
Criteria for FV-NI classification	Trading securities and instruments for which the entity has elected the FVO are measured at fair value, with changes in fair value recognized in NI. Loans held for sale are measured at the lower of cost or fair value.	<p>A financial asset is carried at FV-NI if it fails the cash flow characteristics assessment (see above) or fails to meet the business model assessments for amortized cost or FV-OCI (i.e., FV-NI is a residual category).</p> <p>In addition, nonderivative financial liabilities that are short-sale obligations or for which the business strategy is to subsequently transact at fair value at issuance or acquisition would also be accounted for at FV-NI.</p>	<p>The following instruments would be classified as FV-NI under the FASB's proposals but not under current GAAP:</p> <ul style="list-style-type: none"> • Marketable investments in equity securities not held for trading. • Loans held for sale (previously measured at the lower of cost or fair value). <p>This category is now a residual category for debt-instrument financial assets.</p>
Fair value option	ASC 825 provides an unconditional FVO for certain financial instruments.	<p>A conditional FVO is provided for hybrid financial liabilities unless the embedded derivative does not significantly modify the instrument's cash flows or it is clear that bifurcation would be prohibited.</p> <p>A conditional FVO is also available when an entity manages the net exposure of a group of financial assets and financial liabilities on a fair value basis and information is provided to management on that basis.</p> <p>Changes in the fair value of a financial liability for which the FVO has been elected are presented separately in OCI if they "result from a change in a reporting entity's own credit risk."</p>	<p>There is no unconditional FVO. Thus, entities that previously have elected to account for financial instruments under such an option may no longer be able to do so.</p> <p>Further, changes in fair value of an FVO financial liability attributable to a change in the entity's own credit risk is presented separately in OCI rather than in NI.</p>
Foreign currency gains and losses in the FV-OCI category	For AFS debt securities, unrealized foreign currency gains and losses are deferred in OCI in a manner similar to other unrealized gains and losses.	Unrealized foreign currency gains and losses are separately recognized in net income for financial assets classified as FV-OCI.	Unrealized foreign currency gains and losses would no longer be deferred in OCI but would be recognized in net income for financial assets accounted for at FV-OCI.
Reclassification of accumulated OCI to NI	Amounts in accumulated OCI are recycled to NI upon sale, settlement, or when an impairment loss is recognized.	Amounts in accumulated OCI are recycled to NI upon sale, settlement, or when an impairment loss is recognized.	No change.
Embedded derivatives in hybrid financial contracts	<p>An entity is required to bifurcate an embedded derivative from a hybrid financial instrument if it meets the bifurcation criteria in ASC 815-15.</p> <p>An FVO is available for hybrid instruments with embedded derivatives that an entity would otherwise be required to bifurcate under ASC 815.</p>	<p>An entity is required to bifurcate an embedded derivative from a hybrid financial liability if it meets the bifurcation criteria in ASC 815-15 but is prohibited from bifurcating an embedded derivative from a hybrid financial asset.</p> <p>An entity may elect to measure a hybrid financial liability at FV-NI in its entirety unless the embedded derivative does not significantly modify the instrument's cash flows or it is clear with little analysis that the derivative would not be bifurcated.</p>	Hybrid financial assets must be classified in their entirety on the basis of the instrument's cash flow characteristics and business model. Bifurcation is not permitted for hybrid financial assets.
Reclassification	<p>Reclassification is permitted in certain circumstances. Transfers from HTM and transfers into or out of the trading category are expected to be rare.</p> <p>The sale of HTM securities may call into question HTM classification for similar securities and indicate that the entity does not have the intent and ability to hold these securities to maturity, in which case reclassification may be required.</p>	Reclassification is required when there is a change in business model. A change that triggers reclassification "must be (1) determined by an entity's senior management as a result of external or internal changes, (2) significant to an entity's operations, and (3) demonstrable to external parties."	Reclassifications are now required, but only when the business model changes and other conditions are met. Reclassifications are expected to be infrequent.

Appendix F — Comparison of IASB's and FASB's Tentative Approaches

The table below summarizes similarities and differences between the IASB's and FASB's tentative approaches for the classification and measurement of financial assets and financial liabilities.

Subject	IASB's Tentative Approach	FASB's Tentative Approach
Categories of financial assets and financial liabilities	<p>Effectively, four categories of financial assets:</p> <ul style="list-style-type: none"> • <i>Fair value through profit or loss (FVTPL)</i> — Residual measurement category. • <i>FV-OCI with recycling</i> — Financial assets that meet the cash flow characteristics and business model assessments. • <i>FV-OCI without recycling</i> — Optional for equity investments not held for trading. • <i>Amortized cost</i> — Financial assets that meet the cash flow characteristics and business model assessments. <p>Effectively, three categories of financial liabilities:</p> <ul style="list-style-type: none"> • <i>FVTPL</i> — Required for trading and derivative liabilities. • <i>Fair value, with changes attributable to an entity's own credit risk recognized in OCI and other changes recognized in profit or loss</i> — Required for financial liabilities elected under the FVO. • <i>Amortized cost</i> — Required for other financial liabilities. 	<p>Effectively, four categories of financial assets:</p> <ul style="list-style-type: none"> • <i>FV-NI</i> — Applicable to equity investments not subject to the practicability exemption and the residual category for debt instruments. • <i>FV-OCI</i> — Financial assets that meet the cash flow characteristics and business model assessments. • <i>Amortized cost</i> — Financial assets that meet the cash flow characteristics and business model assessments. • <i>Adjusted cost</i> — Optional for nonmarketable equity investments. <p>Effectively, three categories of financial liabilities:</p> <ul style="list-style-type: none"> • <i>FV-NI</i> — Required for derivative liabilities or if the business model at acquisition, issuance, or inception is to subsequently transact the liability at fair value or the liability is a short sale. • <i>Fair value, with changes attributable to an entity's own credit risk recognized in OCI and other changes recognized in profit or loss</i> — Required for financial liabilities elected under the FVO. • <i>Amortized cost</i> — Required for other financial liabilities.
Criteria for amortized cost measurement for financial assets	<p>Under IFRS 9, a financial asset generally must be carried at amortized cost if it meets both of the following criteria:</p> <ul style="list-style-type: none"> • <i>Business model</i> — The objective of the entity's business model is to hold assets to collect the contractual cash flows. • <i>Cash flow characteristics</i> — The asset's contractual cash flows solely represent payments of principal and interest. 	<p>While the language describing the business model and cash flow characteristics assessments under the FASB's tentative model is the same as under IFRS 9, application guidance currently differs, which may result in differences in the application of the two models.</p>
Criteria for FV-OCI classification	<p>Upon initial recognition, an entity has the option to irrevocably elect to classify an equity investment as FV-OCI. For this category, both unrealized and realized gains and losses are recorded in OCI; dividend income is recorded in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment.</p> <p>Financial assets that meet the cash flow characteristics assessment (i.e., SPPI) and the FV-OCI business model criterion (i.e., managed within a business model to collect contractual cash flows and sell the assets) are accounted for at FV-OCI.</p>	<p>Equity investments are not eligible for FV-OCI.</p> <p>Financial assets that meet the cash flow characteristics assessment (i.e., SPPI) and business model assessment (i.e., managed within a business model to collect contractual cash flows and sell the assets) are accounted for at FV-OCI.</p>
Criteria for FV-NI classification for financial assets	<p>FV-NI is a residual category. That is, financial assets that fail the cash flow characteristics assessment and are managed within a business model that is inconsistent with the amortized cost and FV-OCI business models are accounted for at FV-NI.</p> <p>Financial assets for which the FVO is elected (see below) are also accounted for at FV-NI.</p>	<p>FV-NI is a residual category. That is, financial assets that fail the cash flow characteristics assessment or are managed within a business model that is inconsistent with the amortized cost and FV-OCI business models are accounted for at FV-NI.</p> <p>Financial assets for which the FVO is elected are also accounted for at FV-NI.</p>
Reclassification of accumulated OCI to net income	<p>Amounts in accumulated OCI related to debt instruments are recycled to NI when the instrument is derecognized or impaired. Amounts in accumulated OCI related to equity instruments and changes attributable to an entity's own credit risk for financial liabilities for which the FVO has been elected are permanently deferred in equity.</p>	<p>Amounts in accumulated OCI are recycled to NI upon sale, settlement, or impairment.</p>

Subject	IASB's Tentative Approach	FASB's Tentative Approach
Equity investments	<p>Carried at fair value, with changes in fair value recognized in profit or loss, except for investments that an entity irrevocably elects to classify as FV-OCI on initial recognition.</p> <p>Under IAS 28,¹⁶ an entity accounts for investments in equity securities under the equity method when the investor has significant influence over the investee.</p>	<p>Equity instruments (both marketable and nonmarketable) are classified as FV-NI. However, for nonmarketable equity securities, a practicability exception is available. Under the practicability exception, a nonmarketable equity security would be measured at cost less impairments and would be adjusted for any observable changes in price. In addition, equity method investments that are not held for sale are measured at cost with adjustments for the investor's proportionate share of the investee's income and losses.</p>
Embedded derivatives in hybrid financial contracts	<p>Under IFRS 9, the embedded derivative guidance has been eliminated for hybrid financial assets (except for hybrid assets that are outside the scope of the standard). That is, embedded derivatives would never be bifurcated from such assets.</p> <p>The embedded derivative guidance applies to hybrid liabilities (both financial and nonfinancial). That is, embedded derivatives would be bifurcated from such liabilities if they meet the criteria for bifurcation.</p>	<p>Substantially converged with IFRS 9.</p> <p>The embedded derivative guidance in ASC 815-15 applies to hybrid liabilities.</p>
Fair value option	<p>Available for financial assets but only available when a fair value designation eliminates or significantly reduces an accounting mismatch; irrevocable election at initial recognition.</p> <p>Available for financial liabilities when a fair value designation eliminates or significantly reduces an accounting mismatch or an entity manages and evaluates a group of instruments on a fair value basis or the liability contains certain types of embedded derivatives. Changes in fair value are recognized in profit or loss, and an entry should reclassify changes attributable to changes in an entity's own credit from earnings to OCI. Recycling of amounts initially recognized in OCI is prohibited.</p>	<p>A conditional FVO is provided for hybrid financial liabilities unless the embedded derivative does not significantly modify the instrument's cash flows or it is clear that bifurcation would be prohibited.</p> <p>A conditional FVO is also available when an entity manages the net exposure of a group of financial assets and liabilities on a fair value basis and information is provided to management on that basis.</p> <p>Changes in the fair value of a financial liability for which the FVO has been elected are presented separately in OCI rather than NI if they result from a change in the reporting entity's own credit risk. Cumulative gains and losses recognized in OCI that are associated with changes in an entity's own credit risk are recognized in NI upon the settlement of the liability.</p>
Reclassification	<p>Required under IFRS 9 for a financial asset if the business model changes; however, changes in the business model are expected to be infrequent.</p>	<p>Substantially converged with IFRS 9.</p>

¹⁶ IAS 28 (Revised 2011), *Investments in Associates and Joint Ventures*.

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