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# FASB Issues Narrow Financial Instrument Accounting Updates

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## Introduction

The FASB recently issued [ASU 2019-04](#),<sup>1</sup> which clarifies certain aspects of accounting for credit losses, hedging activities, and financial instruments (addressed by [ASUs 2016-13](#),<sup>2</sup> [2017-12](#),<sup>3</sup> and [2016-01](#),<sup>4</sup> respectively). This *Heads Up* highlights key provisions of ASU 2019-04. The changes contained in its amendments apply to all entities within the scope of the affected guidance. Many of the amendments reflect decisions reached at FASB meetings or meetings of the Board's credit losses transition resource group (TRG). These decisions have been discussed in Deloitte publications that are referenced in the links below. Readers seeking additional details are encouraged to refer to those publications and to ASU 2019-04.

## Key Provisions of the New Guidance

### Current Expected Credit Losses — Notable Changes Made to ASU 2016-13 by ASU 2019-04

Significant amendments made to the provisions of ASU 2016-13 by ASU 2019-04 are summarized by topic below.

- **Accrued interest** — Amortized cost basis is defined in ASU 2016-13 as “the amount at which a financing receivable or investment is originated or acquired, **adjusted for applicable accrued interest**, accretion or amortization of premium, discount, and

<sup>1</sup> FASB Accounting Standards Update (ASU) No. 2019-04, *Codification Improvements to Topic 326, Financial Instruments — Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*.

<sup>2</sup> FASB Accounting Standards Update No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.

<sup>3</sup> FASB Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*.

<sup>4</sup> FASB Accounting Standards Update No. 2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*.

net deferred fees or costs, collection of cash, writeoffs, foreign exchange, and fair value hedge accounting adjustments” (emphasis added). To address stakeholders’ concerns that the inclusion of accrued interest in the definition of amortized cost basis could make application of the credit loss guidance operationally burdensome, ASU 2019-04 provides certain alternatives for the measurement of the allowance for credit losses (ALL) on accrued interest receivable (AIR). These measurement alternatives include (1) measuring an ALL on AIR separately, (2) electing to provide separate disclosure of the AIR component of amortized cost as a practical expedient, and (3) making accounting policy elections to simplify certain aspects of the presentation and measurement of such AIR. For further information, see Deloitte’s June 2018 *TRG Snapshot*.

- ***Transfers between classifications or categories for loans and debt securities*** — The amendments in ASU 2019-04 clarify the steps entities should take when recording the transfer of loans or debt securities between measurement classifications or categories (e.g., the transfer of a loan held for sale to a loan held for investment). Under the amendments, an entity making such a transfer would (1) remove any existing allowance and adjust earnings accordingly, (2) record the transfer to the new measurement category, and (3) apply the appropriate measurement method for that category. For further information, see Deloitte’s June 2018 *TRG Snapshot*.
- ***Recoveries*** — ASU 2019-04 clarifies that entities should include expected recoveries on financial assets in the calculation of the current expected credit losses allowance for both pools of financial assets and individual financial assets. The amendments also provide guidance on how an entity should consider expected recoveries in its determination of the allowance. For further information, see Deloitte’s November 2018 *TRG Snapshot*.
- ***Reinsurance recoverables*** — ASU 2019-04 clarifies that all reinsurance recoverables are within the scope of the credit loss guidance (ASC 326-20<sup>5</sup>), including those measured on a basis other than amortized cost (e.g., those measured on a net present value basis in accordance with the accounting for insurance contracts (ASC 944)).
- ***Projections of interest rate environments for variable-rate financial instruments*** — The amendments in ASU 2019-04 allow an entity to consider its projections of future interest rate environments when it measures expected credit losses on variable-rate financial instruments by using a discounted cash flow method. Further, the amendments clarify that an entity should use the same assumptions (e.g., projections of future interest rates) to (1) estimate expected cash flows and (2) identify the effective interest rate (adjusted as necessary to consider anticipated prepayments) that should be used to discount the cash flows.
- ***Costs to sell when foreclosure is probable*** — Under the credit loss guidance (ASC 326-20), if a financial asset is collateral dependent and foreclosure is deemed probable, an entity must measure the expected credit losses on the basis of the collateral’s fair value as of the reporting date. ASU 2019-04 clarifies the guidance in ASC 326-20-35-4 by requiring that an entity adjust the fair value to reflect the entity’s estimated costs to sell if the entity intends to sell the collateral after foreclosure. Such selling costs should be undiscounted. However, if the entity intends to operate the collateral, it does not need to consider estimated selling costs in its measurement of expected credit losses.
- ***Consideration of expected prepayments when determining the effective interest rate*** — The amendments in ASU 2019-04 clarify that when an entity estimates expected credit losses by using a discounted cash flow method, it can elect to “adjust the effective interest rate used to discount expected future cash flows for expected prepayments

<sup>5</sup> For titles of FASB Accounting Standards Codification references, see Deloitte’s “Titles of Topics and Subtopics in the FASB Accounting Standards Codification.”

on financial assets.” However, if the financial asset is restructured in a troubled debt restructuring, an entity “should not adjust the effective interest rate . . . for subsequent changes in expected prepayments.”

- **Vintage disclosures** — ASU 2019-04 states that the amortized cost basis of line-of-credit arrangements that are converted to term loans must be presented in a separate column of the vintage disclosure table as illustrated in Example 15 in ASC 326-20-55-79. For further information, see Deloitte’s November 2018 *TRG Snapshot*.
- **Extension and renewal options** — Under ASU 2019-04, extension and renewal options that are not unconditionally cancelable by the entity (excluding those accounted for as derivatives under ASC 815) that are included in the original or modified contract should be considered in the entity’s determination of expected credit losses. For further information, see Deloitte’s November 2018 *TRG Snapshot*.

ASU 2019-04 made other conforming amendments to ASC 310-40 and ASC 323-10.

### **Effective Date and Transition Requirements**

For entities that have adopted ASU 2016-13, the amendments in ASU 2019-04 related to ASU 2016-13 are effective for fiscal years beginning after December 15, 2019, and interim periods therein. An entity may early adopt ASU 2019-04 in any interim period after its issuance if the entity has adopted ASU 2016-13. ASU 2019-04’s amendments should be applied “on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening retained earnings balance in the statement of financial position as of the date an entity adopted the amendments in [ASU] 2016-13.” Certain disclosures are also required.

For all other entities, the effective date will be the same as the effective date in ASU 2016-13.

### **Hedging Activities — Notable Changes Made to ASU 2017-12 by ASU 2019-04**

Significant amendments made to the provisions of ASU 2017-12 by ASU 2019-04 are summarized by topic below.

- **Partial-term fair value hedges of interest rate risk** — ASU 2017-12 allows an entity to designate partial-term fair value hedges of interest rate risk and measure the hedged item by using an assumed maturity. ASU 2019-04 clarifies that (1) an entity is still eligible to designate a partial-term hedge if it is hedging both interest rate and foreign exchange risk; however, for such a hedge, an entity must measure the changes in the hedged item attributable to foreign exchange risk on the basis of changes in the spot exchange rate; (2) multiple partial-term hedges of a single financial instrument may exist at the same time; and (3) for a forward-starting partial-term fair value hedge, the issuance of the hedged item is assumed to occur “on the date that the first hedged cash flow begins to accrue.”
- **Amortization of fair value hedge basis adjustments** — ASU 2019-04 clarifies that an entity can start to amortize the hedged item’s basis adjustment in a fair value hedge “before the hedging relationship is discontinued”; however, if the hedging relationship is a partial-term hedge, the entity should fully amortize the basis adjustment by the hedged item’s assumed maturity date.
- **Disclosure of fair value hedge basis adjustments** — ASU 2017-12 requires entities to disclose for fair value hedging relationships the carrying amounts of hedged assets and liabilities and the cumulative amount of fair value hedge basis adjustments. ASU 2019-04 clarifies that when an available-for-sale (AFS) debt security is the hedged item, an entity should disclose its amortized cost (not its fair value) to comply with this disclosure requirement. In addition, ASU 2019-04 states that basis adjustments attributable to foreign exchange risk should not be included in the carrying amount or cumulative basis adjustment disclosure.

- *Consideration of the hedged contractually specified interest rate under the hypothetical derivative method* — ASU 2019-04 clarifies that when an entity uses the hypothetical derivative method to assess hedge effectiveness for certain cash flow hedges, it “should consider the contractually specified interest rate being hedged.”
- *Application of a first-payments-received cash flow hedging technique to overall cash flows on a group of variable interest payments* — ASU 2019-04 states that an entity still is permitted to apply a first-payments-received technique for hedges of the risk of changes in overall cash flows related to a group of variable interest payments.
- *Not-for-profit entities* — ASU 2019-04 stipulates that (1) a not-for-profit entity (NFP) that does not report earnings separately may not elect to apply the amortization method for any excluded component in a fair value hedge and (2) NFPs (other than those “that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market”) qualify for the same relief related to the required timing of quarterly effectiveness assessments as do certain private companies.
- *Private companies that are not financial institutions* — ASU 2019-04 states that a private company that is not a financial institution must prepare its analysis to support designation of any last-of-layer hedge at hedge inception.
- *Transition guidance* — ASU 2019-04 also addresses feedback about transition received from stakeholders by providing that an entity may, as part of the transition: (1) rebalance a fair value hedge of interest rate risk, when it opts to measure the hedged item on the basis of changes in the benchmark rate component of cash flows, by increasing or reducing the designated notional amount of the existing hedging instrument or hedged item, (2) change its method of assessing a hedging relationship’s effectiveness from a quantitative long-haul approach to a qualitative critical-terms-match method if all the requirements for application of the critical-terms-match method are satisfied, (3) do both (1) and (2), or (4) do neither (1) nor (2). ASU 2019-04 clarifies that an entity that reclassifies debt securities from the held-to-maturity (HTM) category to AFS as part of its transition would not (1) call in to question its HTM assertion for other securities held at the entity’s most recent reporting date, (2) be required to actually designate any reclassified security in a last-of-layer hedge, or (3) be restricted from selling any reclassified security. ASU 2019-04 also changes the ASU 2017-12 transition guidance to state that any transition adjustment arising from an entity’s election to change its method of measuring the hedged item in a fair value hedge of interest rate risk should be made “as of the date of initial application.”

### ***Effective Date and Transition Requirements***

As noted in ASU 2019-04, “[f]or entities that have not yet adopted the amendments in [ASU] 2017-12 as of the issuance date of [ASU] 2019-04, the effective dates and transition requirements for the amendments to Topic 815 are the same as the effective dates and transition requirements in [ASU] 2017-12.”

For entities that have adopted ASU 2017-12, ASU 2019-04 is effective “as of the beginning of the first annual reporting period beginning after the date of issuance of [ASU] 2019-04.” Those entities may early adopt ASU 2019-04 at any time after its issuance.

Entities that have already adopted ASU 2017-12 as of the issuance date of ASU 2019-04 may elect to either (1) retrospectively apply ASU 2019-04 as of the date the entity adopted ASU 2017-12 or (2) prospectively apply ASU 2019-04 as of the date of adoption of the amendments in ASU 2019-04 with certain exceptions. Notably, entities that elected to (1) adopt ASU 2017-12 in an interim period and change their method of measuring the hedged item in a fair value hedge of interest rate risk or (2) rebalance fair value hedging relationships at transition must reflect transition adjustments determined as of the date of their initial application of ASU

2017-12. Also, as part of the transition of ASU 2019-04, entities may reclassify securities that would qualify for designation as the hedged item in a last-of-layer hedging relationship from HTM to AFS; however, entities that already made such a reclassification upon their adoption of ASU 2017-12 are precluded from reclassifying additional securities.

ASU 2019-04 also requires certain transition disclosures.

## **Financial Instruments — Notable Changes Made to ASU 2016-01 by ASU 2019-04**

Significant amendments made to ASU 2016-01 by ASU 2019-04 are summarized by topic below.

- *HTM debt securities fair value disclosures* — The amendments clarify that entities other than public business entities<sup>6</sup> are exempt from the “fair value disclosure requirements for financial instruments not measured at fair value on the balance sheet.”
- *Measurement alternative in ASC 321-10-35-2* — The amendments in ASU 2019-04 indicate that the measurement alternative in ASC 321-10-35-2 for equity securities without readily determinable fair values represents a nonrecurring fair value measurement under ASC 820; therefore, such securities should be remeasured at fair value when an entity identifies an orderly transaction “for an identical or similar investment of the same issuer,” and applicable ASC 820 disclosures are required.
- *Remeasurement of equity securities at historical exchange rates* — The amendments clarify that (1) an entity should remeasure equity securities without readily determinable fair values subject to the measurement alternative at historical exchange rates and (2) the historical exchange rate used should be that at the later of the acquisition date or the most recent fair value measurement date.

### ***Effective Date and Transition Requirements***

The amendments in ASU 2019-04 related to ASU 2016-01 are effective for fiscal years beginning after December 15, 2019, including interim periods therein. Early adoption is permitted in any interim period after issuance of ASU 2019-04 for those entities that have already adopted ASU 2016-01.

The amendments related to equity securities without readily determinable fair values require prospective application; however, the remaining amendments should be “applied on a modified-retrospective transition basis by means of a cumulative-effect adjustment to the opening retained earnings balance in the statement of financial position as of the date an entity adopted all of the amendments in [ASU] 2016-01.”

ASU 2019-04 also requires certain transition disclosures.

<sup>6</sup> As defined in the ASC master glossary.

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