The amendments respond to questions stakeholders raised about the guidance on credit losses, hedging, and recognizing and measuring financial instruments.

What you need to know

- The FASB amended its standards on credit losses, hedging, and recognizing and measuring financial instruments to clarify them and address implementation issues.
- The amendments clarify the scope of the credit losses standard and address issues related to accrued interest receivable balances, recoveries, variable interest rates and prepayments, among other things.
- With respect to hedge accounting, the amendments address partial-term fair value hedges, fair value hedge basis adjustments, application by not-for-profit entities and private companies, and certain transition requirements, among other things.
- On recognizing and measuring financial instruments, they address the scope of the guidance, the requirement for remeasurement under ASC 820 when using the measurement alternative, certain disclosure requirements and which equity securities have to be remeasured at historical exchange rates.
- The amendments to the credit losses and hedging standards have the same effective dates as those standards, unless an entity has already adopted the standards. The amendments to the recognition and measurement guidance are effective for fiscal years beginning after 15 December 2019. Early adoption is permitted.

Overview

The Financial Accounting Standards Board (FASB or Board) amended the new guidance on credit losses, hedging, and recognizing and measuring financial instruments in response to questions raised by stakeholders.¹
The FASB issued the amendments as part of its ongoing project to improve the Accounting Standards Codification (ASC) and correct unintended application. The Board made these changes in a separate Accounting Standards Update (ASU)\(^2\) to increase stakeholders’ awareness and to expedite the amendments.

### Key considerations

#### Credit losses

**Accrued interest**

The amendments allow an entity to separately measure an allowance for credit losses on accrued interest receivables from other components of the amortized cost basis. The amendments also allow entities to make a policy election about where to present and disclose accrued interest receivables and the related allowance for credit losses, and entities that write off uncollectible accrued interest receivables in a timely manner can make a policy election not to measure an allowance on the accrued interest receivable. Entities must disclose the policies they elect.

**Recoveries**

The amendments clarify that an entity should include all expected recoveries in its estimate of the allowance for credit losses for assets in the scope of ASC 326-20, which cannot exceed the aggregate of amounts previously written off and expected to be written off. These amendments do not apply to purchased financial assets with credit deterioration (PCD assets), which the FASB is expected to address in separate standard setting.

#### How we see it

Expected recoveries have to be reasonable and supportable to be included in the credit loss estimate. Entities will need to have appropriate processes and controls in place to support their estimates of expected recoveries.

**Projections of the interest rate environment**

The Board added guidance allowing the use of projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate instruments and clarifying that these projections also should be used to determine the effective interest rate (EIR) to discount those expected cash flows.

**Consideration of prepayments**

The amendments allow entities to make an accounting policy election to adjust the EIR used to discount expected future cash flows for expected prepayments to appropriately isolate credit risk when determining the allowance for credit losses. The amendments require that entities use a prepayment-adjusted EIR if they elect to use projections of future interest rate environments to measure credit losses on variable-rate assets. The amendments also clarify that an entity should not adjust the EIR used to discount expected cash flows for changes in the expected timing of cash flows resulting from a troubled debt restructuring.

**Other**

The amendments also clarify the following areas of the guidance: (1) the scope of the guidance for reinsurance recoverables, (2) estimated costs to sell collateral, (3) the vintage disclosure requirements related to lines of credit that are converted to term loans, (4) extension or renewal options that are not unconditionally cancelable by the entity, and (5) transfers of loans and debt securities between classifications or categories.
Hedging

Partial-term fair value hedges
The amendments clarify that an entity may only use an assumed term to measure the change in fair value of a hedged item due to changes in interest rate risk. This approach can be used in hedges of solely interest rate risk or in hedges of both interest rate risk and foreign exchange risk. The amendments also clarify that multiple partial-term fair value hedging relationships related to a single financial instrument can be outstanding at the same time.

Fair value hedge basis adjustments
The amendments clarify that if an entity elects to amortize the basis adjustment on an outstanding partial-term fair value hedging relationship, that basis adjustment should be fully amortized on or before the hedged item's assumed maturity date. The amendments also clarify that certain new disclosure requirements don't apply to fair value hedge basis adjustments related to hedges of foreign exchange risk.

Not-for-profit entities and private companies
The amendments clarify that a not-for-profit entity that does not separately report earnings may not elect the amortization approach for amounts excluded from the assessment of effectiveness for fair value hedging relationships. The amendments also clarify the application of cash flow hedging for not-for-profit health care entities.

In addition, the amendments require a private company that is not a financial institution to document its analysis supporting a last-of-layer hedge designation at hedge inception and clarify that the subsequent quarterly hedge effectiveness timing relief applies to certain not-for-profit entities in addition to certain private companies.

First-payments-received cash flow hedging
The amendments clarify that entities are still permitted to apply the first-payments-received cash flow hedging technique to changes in overall cash flows on a group of variable interest payments.

Transition requirements
The amendments clarify that:

- If an entity elects to change its measurement methodology for the hedged item in an existing fair value hedge of interest rate risk, the transition adjustment would be made as of the date of the initial application of ASU 2017-12, not as of the date of adoption.

- There are many ways an entity may rebalance a fair value hedging relationship of interest rate risk when it changes its measurement methodology for the hedged item from total contractual coupon cash flows to the benchmark rate component of the contractual coupon cash flows.

- An entity may transition from a quantitative method of hedge effectiveness assessment to the critical terms match method without dedesignating the hedging relationship.

- The reclassification of a debt security from held to maturity to available for sale under the transition guidance in ASU 2017-12 does not call into question the classification of other held-to-maturity securities. The security may be sold at any time after reclassification, and the holder is not required to designate it in a last-of-layer hedging relationship.

How we see it
The FASB plans to address additional implementation issues and stakeholder questions on the hedging standard in a separate round of codification improvements.
Financial instruments
The amendments to the guidance on recognizing and measuring financial instruments:

- Require an entity to remeasure an equity security without a readily determinable fair value accounted for under the measurement alternative at fair value in accordance with ASC 820\(^3\) when an orderly transaction is identified for an identical or similar investment of the same issuer and provide the disclosures for a nonrecurring fair value measurement

- Clarify that only foreign-denominated equity securities without readily determinable fair values accounted for under the measurement alternative must be remeasured at historical exchange rates (i.e., the rate as of the later of the acquisition date or most recent date on which the equity security was adjusted to fair value)

- Specifically name health and welfare plans accounted for under ASC 965\(^4\) in the list of entities excluded from the scope of ASC 320\(^5\) and ASC 321\(^6\)

- Clarify that only public business entities must provide the fair value disclosures for financial instruments not measured at fair value on the balance sheet

Transition and effective date
The amendments to the credit losses and hedging standards have the same effective dates and transition requirements as those standards, unless an entity has already adopted the standard.

For entities that have already adopted the credit losses standard, the amendments are effective for fiscal years beginning after 15 December 2019, including interim periods within those years. Early adoption is permitted, and the amendments should be applied on a modified retrospective basis.

For entities that have already adopted the hedge accounting standard, the amendments are effective as of the beginning of the entity’s next annual period. Early adoption is permitted. Entities either retrospectively apply the amendments as of the date they adopted ASU 2017-12 or prospectively apply them as of the date they adopt the amendments, with certain exceptions.

The amendments on recognizing and measuring financial instruments are effective for fiscal years beginning after 15 December 2019, including interim periods in those years. Early adoption is permitted for entities that have adopted the standard. Entities are required to apply the amendments on a modified retrospective basis, except for those related to equity securities without readily determinable fair values that are measured using the measurement alternative, which entities are required to apply prospectively.

Endnotes:

1 The standards were created by ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments; ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities; and ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.


3 ASC 820, Fair Value Measurement.


5 ASC 320, Investments – Debt Securities.

6 ASC 321, Investments – Equity Securities.