BankDirector.com CHARTING A COURSE FOR AMERICA'S BANKING LEADERS

What to Look for in 2018: Changes in Equity Investments Accounting and Fair Value Disclosures

By: *Sydney Garmong, Chad Kellar* | DECEMBER 20TH, 2017

There is a new accounting standard with only a handful of changes going into effect for public business entities (PBEs) in the first quarter of 2018, but some of the changes are meaningful, especially for equity investments and certain disclosures about fair value. Non-PBEs will begin to comply in 2019.

Issued early in 2016, the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-01 is called, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities."

Equity Investments

Equity investments will be measured at fair value with changes in fair value recognized in net income, except for certain circumstances such as investments accounted for using the equity method. This change means the available-for-sale (AFS) category no longer will be an option for equity investments, possibly resulting in income statement volatility.

For investments without a readily determinable fair value, a practicability exception exists. Those investments will be carried at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for an identical investment or a similar investment of the same issuer. Upward adjustments in fair value will be recorded, representing a change in practice.

Fair Value Option

For financial liabilities measured at fair value using the fair value option, the portion of the total fair value change caused by a change in instrument-specific credit risk is presented separately in other comprehensive income (OCI). Under current generally accepted accounting principles (GAAP), this amount is recorded in the income statement, which can create counterintuitive results (that is, a bank records income when its own credit risk worsens). The FASB permitted this provision to be early adopted.

Valuation Allowance on DTAs

The standard requires a deferred tax asset (DTA) valuation allowance related to an AFS debt security to be assessed in combination with other DTAs. Today, some evaluate the DTA on AFS debt securities separately on the basis that management can control its realizability.

Disclosure

Assets and Liabilities

On the balance sheet or in the footnotes, entities must disclose all financial assets and financial liabilities grouped by measurement category and form (for example, securities or loans and receivables) of financial assets.

Fair Value for Amortized Cost Financial Instruments

Significant changes to the existing fair value disclosures exist under Accounting Standards Codification 825, “Financial Instruments” (formerly known as FASB Statement 107, “Disclosures About Fair Value of Financial Instruments”).

First, the good news: For non-PBEs, the FASB is removing the disclosure requirement completely—and permitting early adoption.

For PBEs, the FASB is raising the bar. Existing GAAP permits loans to be measured using an entry price, which commonly is computed 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. This differs from the general requirement in GAAP to determine fair value using an exit price, which is why the FASB decided to change the requirement for this disclosure for amortized cost financial instruments. For many banks, the methodology used to prepare this footnote disclosure likely will be a significant change, especially when determining the fair value of loan portfolios. Many banks currently use in-house or third-party asset liability management systems to generate an entrance price fair value. Typically, these systems will not be adequate for performing the granular analyses and specialized fair value calculations to be required for exit pricing.

Also, the standard retains disclosure of the level of the fair value hierarchy within which the fair value measurement is categorized (level 1, 2, or 3). In some good news for PBEs, the standard removes the requirements to disclose the methods and significant assumptions used to estimate the fair value.

Effective Dates

For PBEs, the standard is effective in fiscal years beginning after Dec. 15, 2017, including interim periods in those fiscal years, which is first-quarter 2018 for calendar year end companies.

For non-PBEs, the standard is effective for fiscal years beginning after Dec. 15, 2018, and interim periods beginning after Dec. 15, 2019, which is Dec. 31, 2019, for calendar year end companies.

Sydney Garmong, CPA, is a partner with Crowe Horwath LLP and can be reached by phone at 202.779.9911 or by email.

Chad Kellar is a partner in advisory services with Crowe Horwath LLP. He can be reached at 317-208-2431 or chad.kellar@crowehorwath.com.