KPMG

Investments

Handbook

February 2024

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Contents

Perspectives on investment accounting and the fair value option

Investment accounting is how we refer to the accounting for debt and equity securities that don't fall under other accounting models, such as the equity method or consolidation. These remaining investments typically give the investor limited (if any) influence over the investee.

The first comprehensive accounting and reporting guidance on investments in debt and equity securities was issued in 1993. Nearly 30 years later, some of those requirements and concepts are still present – including the core principles for classification and accounting for debt securities. But there have been several changes (especially for equity securities) as well as challenges in applying the guidance to new facts and circumstances and new types of investments.

This publication also addresses the application of the fair value option. The fair value option can be elected for a wide range of financial assets and liabilities, including investments in debt and equity securities. It allows these instruments to be measured at fair value on a recurring basis.

In bringing this guidance together, we aim to help you effectively and efficiently identify the guidance that applies to different types of investments and understand the related accounting requirements. We walk you through available accounting options so that you can make the choice that is right for you.

This handbook includes insights and examples – and our perspectives based on our years of experience in this area.

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About this publication

The purpose of this Handbook is to assist you in accounting for financial instruments in the scope of:

- Topic 320, Investments—Debt Securities
- Topic 321, Investments—Equity Securities
- Subtopic 825-10, Financial Instruments - Overall

Organization of the text

Each chapter of this Handbook includes excerpts from the FASB's Accounting Standards Codification® and overviews of the relevant requirements. Our in-depth guidance is explained through Q&As that reflect the questions we are encountering in practice. We include examples to explain key concepts.

Our commentary is referenced to the Codification and to other literature, where applicable. The following are examples.

- 321-10-35-2 is paragraph 35-2 of ASC Subtopic 321-10
- ASU 2016-01.BC89 is paragraph 89 of the basis for conclusions to ASU 2016-01
- FAS 133.BC274 is paragraph 274 of the basis for conclusions to FASB Statement of Financial Accounting Standards No. 133 (superseded)
- 2004 AICPA Conf is the 2004 AICPA National Conference on Current SEC and PCAOB Developments. References to SEC staff speeches at these conferences are hyperlinked to the source when available.
- A&FRI.I.E. is section I.E of the Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance

February 2024 edition

The February 2024 edition of our Handbook includes updates for the following:

- guidance on electing the fair value option in Subtopic 825-10, and
- new and updated guidance based on our experience with companies applying the guidance.

Compared to the September 2022 edition, new sections, Questions, Examples and other items added are identified throughout the Handbook with ** and items that have been significantly updated or revised are identified with #.

Pending content

This Handbook incorporates a number of Codification amendments in Accounting Standards Updates that are not yet effective for all entities in all periods. When amendments were effective by January 1, 2023 for calendar year-end public business entities, the Codification excerpts are reproduced as if the pending content is currently effective for all entities – i.e. the amendments are not labeled as pending content.

In contrast, the amendments in the following recent Accounting Standards Updates are labeled as pending content in the Codification excerpts. Our interpretative guidance presumes they have **not** been adopted.

- ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions
- ASU 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method

When an excerpt from the Codification is affected by pending content, the pending content marked for changes from the original wording follows at the end of the excerpt. These three recent ASUs are explained below.

Recent ASUs

These recent ASUs modify the guidance on accounting for investment securities.

ASU 2022-03, Equity securities subject to contractual restrictions

In June 2022, the FASB issued ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions. The ASU clarifies that contractual sale restrictions are not considered in measuring the fair value of equity securities.

All entities except those that qualify as investment companies under Topic 946 apply the ASU prospectively. Investment companies have different transition requirements to mitigate the effect of adopting this ASU on net asset value computations. Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance.

Effective dates

Public business entities	Other entities
Annual and interim periods in fiscal years beginning after December 15, 2023	Annual and interim periods in fiscal years beginning after December 15, 2024

ASU 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method

In March 2023, the FASB issued ASU 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method. The ASU expands the population of investments for which an investor may elect to apply the proportional amortization method (PAM).

Investors may choose between the modified retrospective and retrospective transition methods when adopting the changes related to the expansion of the PAM and PAM-related clarifications. For other changes in the ASU, investors may apply either the prospective method or the method elected to account for the expansion of the PAM and PAM-related clarifications. Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance.

Effective dates

Public business entities	Other entities
Annual and interim periods in fiscal years beginning after December 15, 2023	Annual and interim periods in fiscal years beginning after December 15, 2024

Abbreviations

We use the following abbreviations in this Handbook.

AFS	Available-for-sale
AOCI	Accumulated other comprehensive income
AICPA	American Institute of Certified Public Accountants
CD	Certificate of deposit
EIR	Effective interest rate
FVO	Fair value option
HTM	Held-to-maturity
IPO	Initial Public Offering
NAV	Net asset value
NFP	Not-for-profit
PBE	Public business entity
OCI	Other comprehensive income
OTC	Over-the-counter
TDR	Troubled debt restructuring

We use the following additional abbreviation in the charts and diagrams:

FV	Fair value

1. Executive summary

There are many models to account for investments in debt and equity securities, including the consolidation and equity method.

This Handbook addresses how to account for investments that fall under the accounting models in Topic 320 (debt) or Topic 321 (equity). These two models typically apply when the other models do not. They also treat debt security investments differently than equity security investments, which has not always been the case.

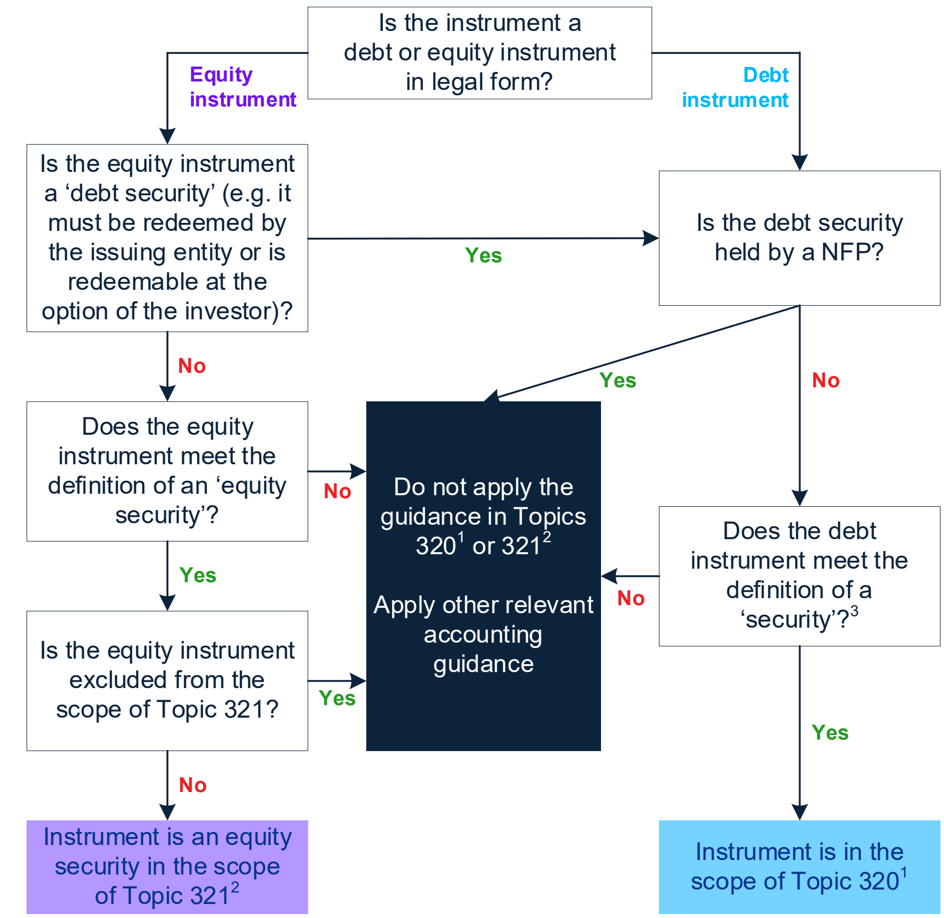
Scope

Topic 320 applies to investments in debt securities, and Topic 321 applies to investments in equity securities and other ownership interests in an entity.

Topic 320	Topic 321
Investments in debt securities, including those resulting from the securitization of other financial instruments.	Investments in equity securities and other ownership interests in an entity.
Scope exceptions	
• An investment held by an entity whose specialized accounting practices include accounting for substantially all investments at fair value, with changes therein reported in earnings (or in the change in net assets). • An investment in a consolidated subsidiary. • An instrument required to be accounted for as a derivative under Topic 815.	

There are additional investments excluded from the scope of Topic 321 – e.g. investments accounted for under the equity method.

The following decision tree summarizes the steps for determining whether all other investments are in the scope of Topic 320 or Topic 321.



Notes:

1. Certain instruments that are not in the scope of Topic 320 are also required to follow its provisions.
2. Certain instruments that are not in the scope of Topic 321 are also required to follow its provisions.
3. We believe it is preferable to account for convertible debt that is not a ‘security’ under Topic 320.

Read more: Chapter 2

Debt securities: accounting

When acquired, a debt security is initially recognized on the balance sheet as an asset and classified into one of three categories.

Trading

Held-to-maturity (HTM)

Available-for-sale (AFS)

Initial measurement and subsequent measurement

A debt security's initial measurement, subsequent measurement and the treatment of unrealized holding gains and losses depends on the classification.

Classification	Initial measurement[1]	Subsequent measurement	Treatment of unrealized holding gains and losses
Trading	Transaction price or fair value	Fair value	Included in earnings
AFS	Transaction price or fair value	Fair value	Excluded from earnings and reported in OCI (and accumulated in AOCI until realized)
HTM	Transaction price	Amortized cost	Not recognized in the financial statements until realized, but disclosed in the notes to the financial statements
Note: 1. Unless other US GAAP applies.			

This Handbook does not address issues associated with accounting for income taxes related to debt securities or credit losses on debt securities. See KPMG Handbooks, Accounting for income taxes and Credit impairment, respectively, for guidance.

Read more: Chapter 3

Debt securities: classification

A debt security's classification dictates its accounting treatment as well as presentation and disclosure requirements. An investor needs to determine:

- how to initially classify debt securities;
- when to reassess the classification; and
- how to account for transfers between the classification categories.

Initial classification

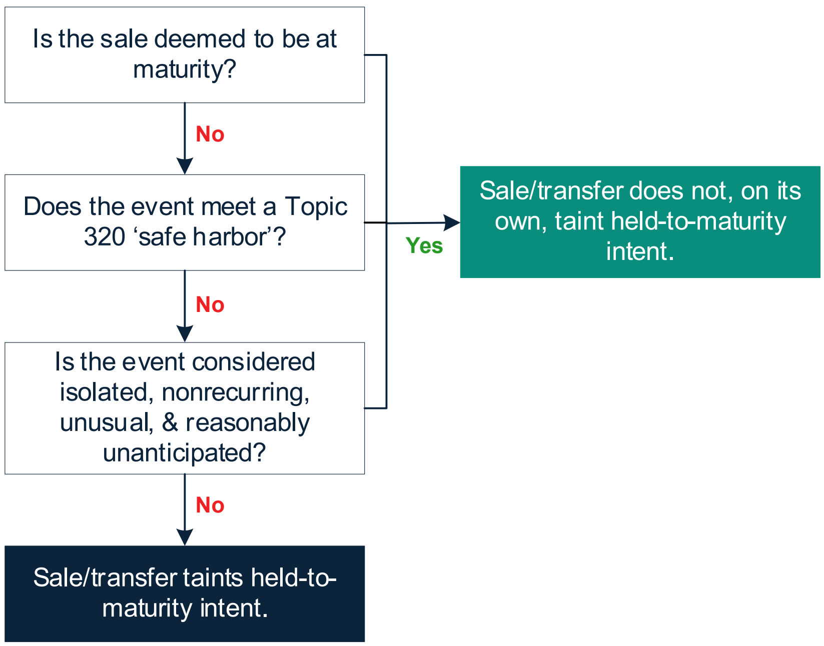
At acquisition, an investor initially determines and documents its classification of debt securities into the following categories.

Trading	Debt securities acquired that the investor generally intends to sell in the near term
HTM	Debt securities for which the investor has a positive intent and ability to hold until maturity
AFS	Debt securities that are not classified as trading or HTM

Reassessment of classification

Classification is reassessed at each reporting date to determine whether relevant facts and circumstances have changed – e.g. the investor no longer has the ability to hold a debt security to maturity. Outside of certain limited circumstances, sales or transfers of HTM debt securities call into question (taint) an investor's intent to hold other debt securities to maturity.

The following decision tree summarizes circumstances in which sales or transfers are consistent with HTM classification.



Transfers between classification categories

A reclassification is accounted for as of the transfer date. The accounting depends on the categories a security is being transferred from and to.

<table>
<tr><th>Transfer type</th><th>Transferred at</th><th>Treatment of unrealized gain/loss at transfer date</th><th>Treatment of allowance for credit losses</th></tr>
<tr><td>Trading → AFS</td><td rowspan="3">Fair value at transfer date</td><td rowspan="2">N/A – already included in earnings and not reversed</td><td>Evaluate the AFS securities under Subtopic 326-30</td></tr>
<tr><td>Trading → HTM</td><td>Evaluate the HTM securities under Subtopic 326-20</td></tr>
<tr><td>AFS → Trading</td><td>Reverse associated AOCI and report in earnings</td><td>Reverse previously recorded amounts with an offset to credit loss expense</td></tr>
</table>

<table>
<tr><th>Transfer type</th><th>Transferred at</th><th>Treatment of unrealized gain/loss at transfer date</th><th>Treatment of allowance for credit losses</th></tr>
<tr><td>AFS → HTM</td><td>Amortized cost[1] at transfer date plus/minus unrealized gain/loss in AOCI</td><td>Amortize amounts in AOCI over remaining life as a yield adjustment</td><td rowspan="2">Reverse previously recorded amounts with an offset to credit loss expense

Evaluate under Subtopic 326-20 (HTM) or Subtopic 326-30 (AFS)</td></tr>
<tr><td>HTM → AFS</td><td>Amortized cost[1] at transfer date</td><td>Report in OCI (and accumulated in AOCI)</td></tr>
<tr><td>HTM → Trading</td><td>Fair value at transfer date</td><td>Report in earnings</td><td>Reverse previously recorded amounts with an offset to credit loss expense</td></tr>
<tr><td colspan="4">Note:
1. This amount is reduced by previous writeoffs but excludes the allowance for credit losses.</td></tr>
</table>

Read more: Chapter 4

Equity securities: accounting

Initial and subsequent measurement

The initial and subsequent measurement of equity securities is summarized in the following table. Measurement issues can require significant judgment because fair value measurement principles apply..

<table>
<tr><th>Type of equity security</th><th>Initial measurement[1]</th><th>Subsequent measurement</th></tr>
<tr><td>With a readily determinable fair value

or

Without a readily determinable fair value when measurement alternative not elected</td><td>Transaction price
or
fair value</td><td>At fair value with changes reported in earnings</td></tr>
<tr><td>Without a readily determinable fair value when measurement alternative is elected</td><td>Cost</td><td>Using the measurement alternative[2]</td></tr>
<tr><td colspan="3">Notes:
1. Unless other US GAAP applies.
2. Cost - any impairment +/- fair value changes when there are observable prices.</td></tr>
</table>

Read more: Chapter 5

Fair value option

An entity may irrevocably elect the fair value option for certain financial assets and liabilities upon the occurrence of certain election events. This election is made for the entire instrument and cannot be applied to only specified risks, specific cash flows or portions of an instrument.

If the fair value option is elected for a financial instrument, the instrument is initially and subsequently measured at fair value. The treatment of unrealized gains and losses depends on the nature of the financial instrument.

Instrument	Treatment of unrealized gains and losses
Financial liabilities	Changes in fair value due to instrument-specific credit risk included in OCI. All other changes in fair value included in earnings.
All other items	Included in earnings.

On the balance sheet, an entity is required to distinguish financial assets and financial liabilities that are subsequently measured at fair value pursuant to the fair value option from those that are subsequently measured using another measurement attribute.

Subtopic 825-10 requires disclosures related to the fair value option as well as other financial instrument disclosures related to fair value, credit risk and market risk.

Read more: Chapter 6

2. Scope and scope exceptions

Detailed contents

New item added to this edition: **

2.1 How the standard works

Topic 320 applies to investments in debt securities, and Topic 321 applies to investments in equity securities and other ownership interests in an entity. For ease of reference, this handbook generally refers to all investments in the scope of Topic 321 as 'equity securities'.

This chapter addresses how to determine whether an instrument is in the scope of one of those Topics. It is organized in the following manner.

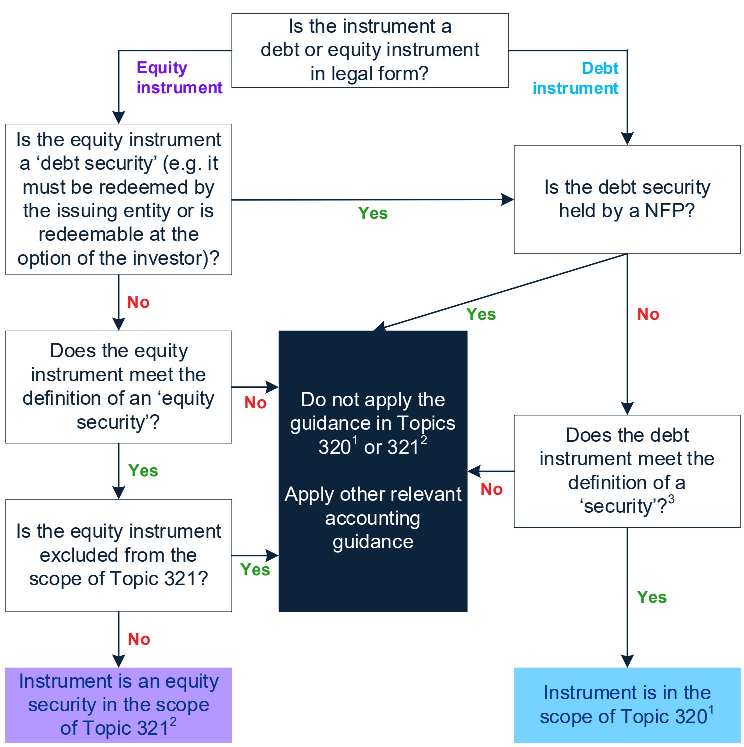
Considerations relevant to both debt and equity securities	Section 2.2
Distinguishing between debt and equity securities	Section 2.3
Considerations specific to debt securities	Section 2.4
Considerations specific to equity securities	Section 2.5

The following investments are excluded from the scope of both Topics.

- An investment held by an entity whose specialized accounting practices include accounting for substantially all investments at fair value, with changes therein reported in earnings (or in the change in net assets).
- An investment in a consolidated subsidiary.
- An instrument required to be accounted for as a derivative under Topic 815.

There are additional investments excluded from the scope of Topic 321 (e.g. investments accounted for under the equity method).

The following decision tree summarizes the steps for determining whether all other investments are in the scope of Topic 320 or Topic 321.



Notes:

1. Certain instruments that are not in the scope of Topic 320 are also required to follow its provisions.
2. Certain instruments that are not in the scope of Topic 321 are also required to follow its provisions.
3. We believe it is preferable to account for convertible debt that is not a 'security' under Topic 320 (Question 2.4.50).

2.2 Considerations relevant to both debt and equity securities

2.2.10 Entities

Excerpt from ASC 320-10

> Entities

15-2 The guidance in the Investments—Debt Securities Topic applies to all entities, including the following entities that are not deemed to belong to specialized industries for purposes of this Topic:

a. Cooperatives and mutual entities (such as credit unions and mutual insurance entities)
b. Trusts that do not report substantially all of their **debt securities** at **fair value**.

15-3 The guidance in this Topic does not apply to the following entities:

a. Entities in certain specialized industries. Entities whose specialized accounting practices include accounting for substantially all investments in **debt securities** at fair value, with changes in value recognized in earnings (income) or in the change in net assets. Examples of those entities are:
   1. Brokers and dealers in securities (Topic 940)
   2. Defined benefit pension, other postretirement, and health and welfare plans (Topics 960, 962, and 965)
   3. Investment companies (Topic 946).

Excerpt from ASC 321-10

> Entities

15-2 The guidance in the Investments—Equity Securities Topic applies to all entities, including the following entities that are not deemed to be specialized industries for purposes of this Topic:

a. Cooperatives and mutual entities (such as credit unions and mutual insurance entities)
b. Trusts that do not report substantially all of their **securities** at **fair value**.

15-3 The guidance in this Topic does not apply to entities in certain specialized industries whose specialized accounting practices include accounting for substantially all investments at fair value, with changes in value recognized in earnings (income) or in the change in net assets. Examples of those entities are:

a. Brokers and dealers in securities (Topic 940)

b. Defined benefit pension, other postretirement, and health and welfare plans (Topics 960, 962, and 965)
c. Investment companies (Topic 946).

Topics 320 and 321 apply to investments held by all entities, except for entities specifically excluded from their scopes. [320-10-15-2 – 15-4, 321-10-15-2 – 15-3]

Question 2.2.10
What entities are excluded from the scopes of both Topics 320 and 321?

Interpretive response: Topics 320 and 321 do not apply to entities in industries whose specialized accounting practices include accounting for substantially all investments at fair value, with changes in fair value reported in earnings (or in the change in net assets). [320-10-15-3, 321-10-15-3]

The following are examples of entities in specialized industries that are excluded from the scopes of Topic 320 and 321. [320-10-15-3, 321-10-15-3]

Specialized industry	Applicable guidance
Brokers and dealers in securities	Topic 940
Investment companies	Topic 946
Defined benefit pension plans	Topic 960
Other postretirement plans	Topic 962
Health and welfare plans	Topic 965

The following entities are not deemed to belong to those specialized industries, and are therefore in the scopes of Topic 320 and 321: [320-10-15-2, 321-10-15-2]

- cooperatives and mutual entities (e.g. credit unions, mutual insurance entities); and
- trusts that do not report substantially all debt securities at fair value.

In a difference between the scopes, Topic 320 does not apply to NFP entities (see Question 2.4.10).

2.2.20 Instruments

Excerpt from ASC 320-10

> Instruments

15-5 The guidance in the Investments—Debt Securities Topic establishes standards of financial accounting and reporting for all investments in debt securities, including those resulting from the securitization of other financial instruments.

15-7 The guidance in this Topic does not apply to any of the following:

a. Derivative instruments that are subject to the requirements of Topic 815, including those that have been separated from a host contract as required by Section 815-15-25. If an investment would otherwise be in the scope of this Topic and it has within it an embedded derivative that is required by that Section to be separated, the host instrument (as described in that Section) remains within the scope of this Topic.

…

d. Investments in consolidated subsidiaries.

Excerpt from ASC 321-10

> Instruments

15-4 The guidance in the Investments—Equity Securities Topic establishes standards of financial accounting and reporting for investments in **equity securities** and other ownership interests in an entity, including investments in partnerships, unincorporated joint ventures, and limited liability companies as if those other ownership interests are equity securities.

15-5 The guidance in this Topic does not apply to any of the following:

a. Derivative instruments that are subject to the requirements of Topic 815, including those that have been separated from a host contract as required by Section 815-15-25. If an investment otherwise would be in the scope of this Topic and it has within it an embedded derivative that is required by that Section to be separated, the host instrument (as described in that Section) remains within the scope of this Topic.
b. Investments accounted for under the equity method (Topic 323).
c. Investments in consolidated subsidiaries.
d. An exchange membership that has the characteristics specified in paragraph 940-340-25-1(b) for an ownership interest in the exchange.
e. Federal Home Loan Bank and Federal Reserve Bank Stock (Subtopic 942-325).

> Implementation Guidance

• > Scope Application to Certain Instruments and Transactions

• • > Convertible Preferred Stock

55-2 If convertible preferred stock is not redeemable, it is considered an **equity security** and, therefore, this Topic would apply.

20 Glossary

Equity Security

Any security representing an ownership interest in an entity (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants, rights, forward purchase contracts, and call options) or dispose of (for example, put options and forward sale contracts) an ownership interest in an entity at fixed or determinable prices. The term equity security does not include any of the following:

a. Written equity options (because they represent obligations of the writer, not investments)
b. Cash-settled options on equity securities or options on equity-based indexes (because those instruments do not represent ownership interests in an entity)
c. Convertible debt or preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor.

Question 2.2.20

What types of investments are in the scope of Topics 320 and 321?

Interpretive response: Topics 320 and 321 establish standards of financial accounting and reporting for the types of investments described in the following table. [320-10-15-5, 321-10-15-4]

Topic 320	Topic 321
Investments in debt securities (see Question 2.3.10), including those resulting from the securitization of other financial instruments.	Investments in equity securities (see Question 2.3.20) and other ownership interests in an entity, including investments in partnerships, unincorporated joint ventures, and limited liability companies. For ease of reference, this handbook generally refers to all investments in the scope of Topic 321 as 'equity securities'.

See section 2.3 for distinguishing between debt and equity securities.

Question 2.2.30

What instruments are excluded from the scopes of both Topics 320 and 321?

Interpretive response: Topics 320 and 321 do not apply to the investments described in the following table. [320-10-15-7, 321-10-15-5]

Investment	Applicable guidance
Investments in consolidated subsidiaries	Topic 810 See KPMG Handbook, Consolidation
Derivative instruments, including embedded derivatives (See Question 2.2.70)	Topic 815 See KPMG Handbook Derivatives and hedging

See Question 2.5.10 for additional instruments that are excluded from the scope of Topic 321.

Question 2.2.40
Does the nature of the underlying securities determine if the investment is a debt or equity security?

Excerpt from ASC 320-10

> Implementation Guidance

• > Scope Application: No Look-Through Permitted

55-8 An entity should not look through the form of its investment to the nature of the securities held by an investee to determine whether the scope of this Topic applies.

55-9 For example, an entity invests in a limited partnership interest (or a venture capital entity) that meets the definition of an equity security. However, substantially all of the partnership's assets consist of investments in debt securities. It is not appropriate to look through the form of an investment to determine whether this Topic applies. In the specific situation described in this paragraph, the investment would be considered an equity security. So, this Topic would not apply to that type of investment. (Topic 321 and Subtopic 323-30 provide guidance on the accounting for limited partnership investments.) Another example of an investment that is considered an equity security is an investment in a mutual fund that invests only in U.S. government debt securities.

Excerpt from ASC 321-10

> Implementation Guidance

• > Scope Application: No Look-Through Permitted

55-6 An entity should not look through the form of its investment to the nature of the securities held by an investee to determine whether the scope of this Topic applies.

55-7 For example, an entity invests in a limited partnership interest (or a venture capital entity) that meets the definition of an equity security. However, substantially all of the partnership's assets consist of investments in debt securities or equity securities. It is not appropriate to look through the form of an investment to determine whether this Topic applies. In the specific situation described in this paragraph, the investment would be considered an equity security. So, this Topic would apply to that type of investment. (Subtopic 323-30 provides guidance on the accounting for limited partnership investments.) Another example of an investment that is considered an equity security is an investment in a mutual fund that invests only in U.S. government debt securities.

Interpretive response: No. It is not appropriate to look through the form of an investment to the nature of the securities held by the investee to determine if the instrument meets the definition of a debt security in the scope of Topic 320 or an equity security in the scope of Topic 321. [320-10-55-8, 321-10-55-6]

For example, ABC Corp has an investment in XYZ Corp (a legal entity) that meets the definition of an equity security. Substantially all of XYZ's assets consist of investments in debt securities. ABC accounts for its investment as an equity security in the scope of Topic 321. [320-10-55-9, 321-10-55-7]

Question 2.2.50

Can an instrument classified as a cash equivalent in the financial statements be in the scope of Topic 320 or 321?

Excerpt from ASC 320-10

20 Glossary

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that have both of the following characteristics:

a. Readily convertible to known amounts of cash
b. So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less qualify under that definition. Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year U.S. Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months. Examples of items commonly considered to be cash equivalents are

Treasury bills, commercial paper, money market funds, and federal funds sold (for an entity with banking operations).

Interpretive response: Yes. The scopes of Topics 320 and 321 are based on the form of the instrument, not its classification in the financial statements. For example, investments in three-month Treasury bills are in the scope of Topic 320 even though they may be classified as cash equivalents on the balance sheet. [320-10 Glossary]

Section 6.3 of KPMG Handbook, Statement of cash flows, discusses how to determine if an instrument is a cash equivalent.

Question 2.2.60

Is a short sale of a security in the scope of either Topic 320 or 321?

Excerpt from ASC 320-10

> Implementation Guidance

• > Scope Application to Certain Instruments and Transactions

• • > Short Sales of Debt Securities

55-6 Sales of securities that the seller does not own at the time of sale are obligations to deliver securities, not investments. Short sale obligations are addressed in the guidance for certain industries (see paragraph 940-320-35-1 with respect to broker-dealers and paragraph 942-405-25-1 with respect to depository institutions). For guidance on evaluating whether a short sale transaction involves a derivative instrument, see paragraph 815-10-55-57.

Excerpt from ASC 321-10

> Implementation Guidance

• > Scope Application to Certain Instruments and Transactions

• • > Short Sales of Equity Securities

55-4 Sales of securities that the seller does not own at the time of sale are obligations to deliver securities, not investments. Short sale obligations are addressed in the guidance for certain industries (see paragraph 940-320-35-1 with respect to broker-dealers and paragraph 942-405-25-1 with respect to depository institutions). For guidance on evaluating whether a short sale transaction involves a derivative instrument, see paragraph 815-10-55-57.

Interpretive response: No. A short sale is a sale of securities that the seller does not own at the time of sale. Short sales are obligations to deliver securities, not investments. Therefore, they are not subject to Topic 320 or 321. [320-10-55-6, 321-10-55-4]

Question 2.2.70
Are instruments with embedded derivatives requiring bifurcation in the scope of Topic 320 or 321?

Interpretive response: Yes, an investment contract with embedded features is in the scope of Topic 320 or 321 even if it has embedded features that require bifurcation. If an embedded derivative is required to be bifurcated, the remaining investment host contract is accounted for under Topic 320 or 321. In contrast, the embedded derivative that was bifurcated is in the scope of Topic 815 – i.e. not in the scope of Topic 320 or 321 (see Question 2.2.30). [320-10-15-7(a), 321-10-15-5(a), 815-15-25-1]

However, a bifurcation analysis is required only if the investment as a whole is not otherwise measured at fair value with changes in fair value reported in earnings under Topic 320 or 321. The following table summarizes investments for which an analysis is (or is not) required.

Investments measured at FV with changes reported in earnings (bifurcation analysis *not* required)	Investments not measured at FV with changes reported in earnings (bifurcation analysis required)
Investments in scope of Topic 320	
Debt securities for which the fair value option has been elected	Debt securities classified[1] as HTM or AFS (for which fair value option was not elected)
Debt securities classified[1] as trading	
Investments in scope of Topic 321	
Investments not measured using the measurement alternative[2]	Investments measured using the measurement alternative[2]

Notes:
1. For further discussion of the classification of investments in debt securities, see chapter 4.
2. For further discussion on using the measurement alternative for an investment in equity securities in the scope of Topic 321, see chapter 5.

For further discussion on whether to bifurcate an embedded derivative, see section 4 of KPMG Handbook, Derivatives and hedging.

2.3 Distinguishing between debt and equity securities

2.3.10 Overall

Excerpt from ASC 320-10

20 Glossary

Debt Security

Any security representing a creditor relationship with an entity. The term debt security also includes all of the following:

a. Preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor
b. A collateralized mortgage obligation (or other instrument) that is issued in equity form but is required to be accounted for as a nonequity instrument regardless of how that instrument is classified (that is, whether equity or debt) in the issuer's statement of financial position
c. U.S. Treasury securities
d. U.S. government agency securities
e. Municipal securities
f. Corporate bonds
g. Convertible debt
h. Commercial paper
i. All securitized debt instruments, such as collateralized mortgage obligations and real estate mortgage investment conduits
j. Interest-only and principal-only strips.

The term debt security excludes all of the following:

a. Option contracts
b. Financial futures contracts
c. Forward contracts
d. Lease contracts
e. Receivables that do not meet the definition of security and, so, are not debt securities, for example:
   1. Trade accounts receivable arising from sales on credit by industrial or commercial entities
   2. Loans receivable arising from consumer, commercial, and real estate lending activities of financial institutions.

Question 2.3.10
What is a 'debt security'?

Interpretive response: Topic 320 defines a debt security as any security (see Questions 2.4.20 and 2.4.30) representing a creditor relationship with an entity.

It also includes a list of instruments that meet and do not meet that definition. [320-10 Glossary]

The instruments appearing on the left side of the following table are instruments specifically listed in this definition. The instruments appearing on the right side are specifically excluded from the definition of a debt security. [320-10 Glossary]

Debt security	Not a debt security
• Preferred share that by its terms either must be redeemed by the issuer or is redeemable at the option of the investor (see Question 2.3.30) • US Treasury securities • US government agency securities • Municipal securities • Corporate bonds • Convertible debt • Commercial paper • All securitized debt instruments – e.g. collateralized mortgage obligations, real estate mortgage investment conduits • Interest-only and principal-only strips	• Option contracts[1] • Financial futures contracts • Forward contracts[1] • Lease contracts • Receivables that do not meet the definition of security and, so, are not debt securities, e.g.: – trade accounts receivable arising from sales on credit by industrial or commercial entities – loans receivable arising from consumer, commercial and real estate lending activities of financial institutions
Note: 1. Question 2.4.70 discusses certain options and forwards that are accounted for under Topic 320.	

Question 2.3.20
What is an 'equity security'?

Interpretive response: Topic 321 defines an equity security as any security representing: [321-10 Glossary]

- an ownership interest in an entity (e.g. common, preferred, other capital stock); or
- the right to acquire (e.g. warrants, rights, forward purchase contracts, call options) or dispose of (e.g. put options, forward sale contracts) an ownership interest in an entity at fixed or determinable prices.

The Topic 321 definition of an equity security explicitly excludes the following instruments. [321-10 Glossary]

Not an equity security	Explanation
Written equity options	These instruments represent obligations of the writer, not investments
Cash-settled options on equity securities or options on equity-based indexes	These instruments do not represent ownership interests in an entity (or the

Not an equity security	Explanation
	right to acquire or dispose of an ownership interest)
Convertible debt or a preferred share that, by its terms, either must be redeemed by the issuer or is redeemable at the option of the investor	These instruments are debt securities in the scope of Topic 320 (see Question 2.3.30)

Question 2.3.30
Is a preferred share in the scope of Topic 320 or 321?

Interpretive response: It depends on whether it meets the definition of a debt or an equity security. The legal form of an instrument does not always determine whether a security is accounted for as a debt security (in the scope of Topic 320) or an equity security (in the scope of Topic 321).

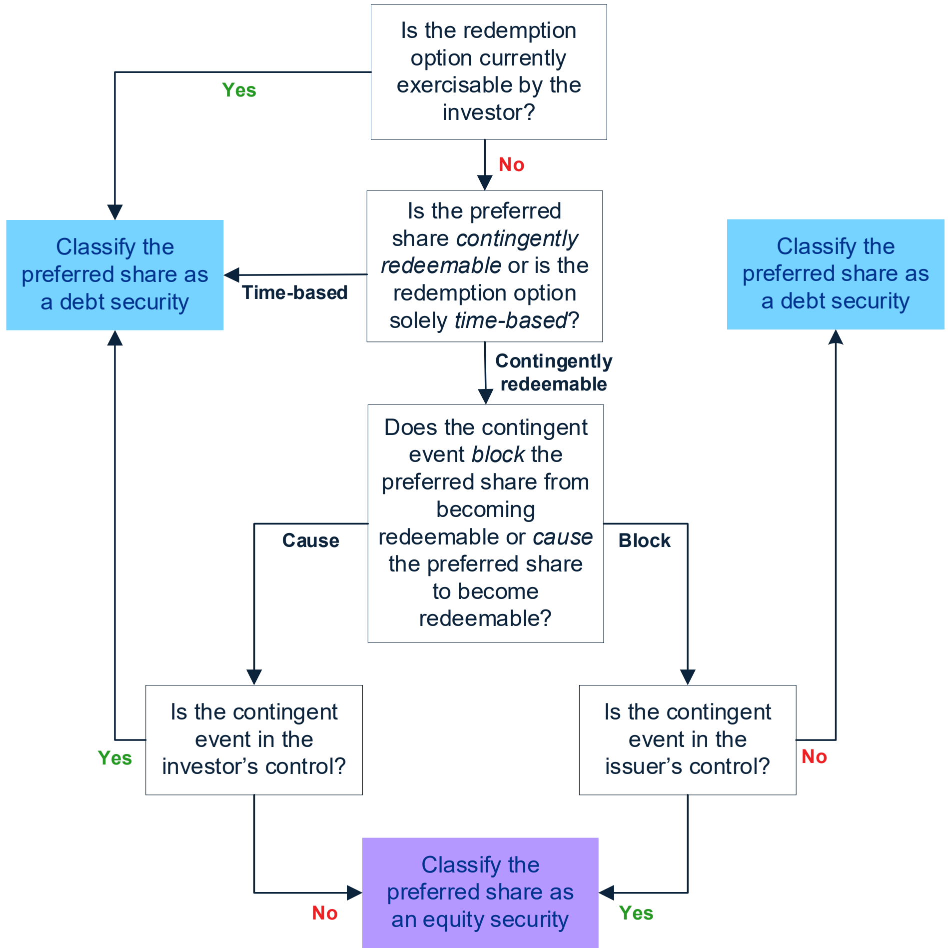
The definition of a debt security specifically includes (and the definition of equity security specifically excludes) a preferred share that, by its terms, either: [320-10 Glossary, 321-10 Glossary, 320-10-55-2]

- must be redeemed by the issuer; or
- is redeemable at the option of the investor.

We believe that for a preferred share that is redeemable at the option of the investor to be classified as a debt security (in the scope of Topic 320), the investor should currently have the unilateral ability to control redemption. This requires an entity to continually assess whether a preferred share is an equity security or a debt security (see Question 2.3.40).

The following decision tree summarizes what we believe are the key considerations in determining whether a preferred share that is redeemable at the option of the investor is in the scope of Topic 320 or Topic 321. For purposes of the decision tree, the preferred share may be:

- **Time-based:** certain of becoming redeemable with the passage of time; or
- **Contingently redeemable:** redeemable either (1) upon the occurrence of a contingent event or (2) after time has passed unless a contingent event occurs.



Example 2.3.10
Contingently redeemable preferred shares

Scenario 1: Preferred shares that become redeemable if an event occurs that is outside the investor's control

Investor owns 10% of the outstanding preferred shares of Issuer. If there is a change in control of Issuer, all of the preferred shareholders may elect to redeem their preferred shares for cash. There are no other mandatory or optional redemption features. A change in control has not yet occurred and Investor does not control whether there is a change in control of Issuer.

Investor accounts for its preferred shares as equity securities (in the scope of Topic 321) because the occurrence of the contingent event (i.e. a change in control of Issuer) would cause the preferred shares to become redeemable by Investor, but the contingent event is not in Investor's control.

Scenario 2: Preferred shares that become redeemable if an event occurs that the investor controls

Investor owns 51% of the outstanding preferred shares of Issuer. The preferred shares can be redeemed for cash if a majority of preferred shareholders elect the redemption. A majority of preferred shareholders has not yet elected the redemption.

Investor accounts for its preferred shares as debt securities (in the scope of Topic 320) because the occurrence of the contingent event (i.e. majority of preferred shareholders elect the redemption) would cause the shares to become redeemable by Investor, and the occurrence of the contingent event is in Investor's control – Investor can unilaterally cause redemption of the shares because it owns a majority of the preferred shares.

Scenario 3: Preferred shares become redeemable at a future date unless an event occurs that the issuer does not control

Investor owns 51% of the outstanding convertible preferred shares of Issuer. The preferred shares become redeemable at Investor's option in five years. However, if Issuer completes an IPO before then, the preferred shares will not become redeemable. Issuer does not control its ability to successfully complete an IPO. An IPO has not yet occurred.

Investor accounts for its convertible preferred shares as debt securities (in the scope of Topic 320). The shares are contingently redeemable because the occurrence of a contingent event (i.e. Issuer completing an IPO) would block the preferred shares from becoming redeemable. Further, the contingent event is not in Issuer's control thereby requiring Investor to account for the shares as debt securities.

Question 2.3.40

Is whether an investment meets the definition of a debt or equity security reassessed?

Interpretive response: Yes. We believe an entity should reassess whether an investment meets the definition of a debt or an equity security on an ongoing basis. This is because there could be changes that impact its classification as a debt or an equity security. For example, an event may occur that impacts whether a preferred share is currently redeemable at the option of the investor (see Question 2.3.30 and Example 2.3.10).

Question 2.3.60 discusses how to account for changes in classification.

Example 2.3.20
Contingently redeemable preferred shares – reassessment after contingent events occur

Scenario 1: Reassessment of preferred shares that become redeemable due to occurrence of a contingent event outside the investor's control

Assume the same facts as in Scenario 1 of Example 2.3.10, except that a change in control of Issuer has occurred. Investor reassesses whether the preferred shares meet the definition of debt or equity securities.

Following the change in control, Investor can exercise the redemption option – i.e. the preferred shares are currently exercisable rather than being contingently redeemable. Therefore, Investor accounts for the preferred shares as debt securities instead of equity securities.

Scenario 2: Reassessment of preferred shares that will no longer become redeemable

Assume the same facts as Scenario 3 of Example 2.3.10, except that Issuer successfully completes an IPO within two years and, as a result, the preferred shares will not become redeemable.

Upon successful completion of the IPO, Investor reassesses whether the preferred shares meet the definition of debt or equity securities. Following completion of the IPO, Investor accounts for the preferred shares as equity securities in the scope of Topic 321 because the preferred shares are no longer redeemable.

Question 2.3.50
Do the investor's and issuer's classification of preferred shares always align?

Interpretive response: No. The investor's determination of whether an investment in a preferred share meets the definition of a debt or equity security will not necessarily align with the issuer's balance sheet classification. For example, there may be instances where the investor will conclude that its investment in a preferred share meets the definition of a debt security because it is redeemable at the investor's option, while the issuer classifies the preferred share as equity (e.g. temporary equity) in its financial statements because it is not a mandatorily redeemable financial instrument. [320-10 Glossary, 321-10 Glossary, 320-10-55-2]

Question 2.3.60
How is an investment recognized when a debt security subsequently becomes an equity security (or vice versa)?

Interpretive response: As discussed in Question 2.3.40, an entity reassesses whether an investment is a debt or an equity security on an ongoing basis. However, US GAAP does not provide guidance on how to account for a change in investment classification resulting from that reassessment.

We believe that in many cases it is acceptable to analogize to the guidance for transfers between categories of debt securities (see section 4.4) and/or between equity securities and equity method investments (see Question 5.4.240). For example, Topic 320 requires transfers from or to trading debt securities to be recognized at fair value. Similarly, we believe it would be acceptable to recognize at fair value transfers from debt securities to equity securities measured at fair value with changes reported in earnings.

2.4 Considerations specific to debt securities

2.4.10 Entities

Question 2.4.10
Are investments in debt securities held by NFPs in the scope of Topic 320?

Excerpt from ASC 320-10

> Entities

15-4 This Topic does not apply to not-for-profit entities (NFPs). Subtopic 958-320 establishes standards for investments in debt securities by NFPs.

Interpretive response: No. Topic 320 does not apply to NFPs. An NFP applies Subtopic 958-320 to investments in debt securities. [320-10-15-4]

2.4.20 Instruments

Question 2.4.20
What is a security?

Excerpt from ASC 320-10

20 Glossary

Security

A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

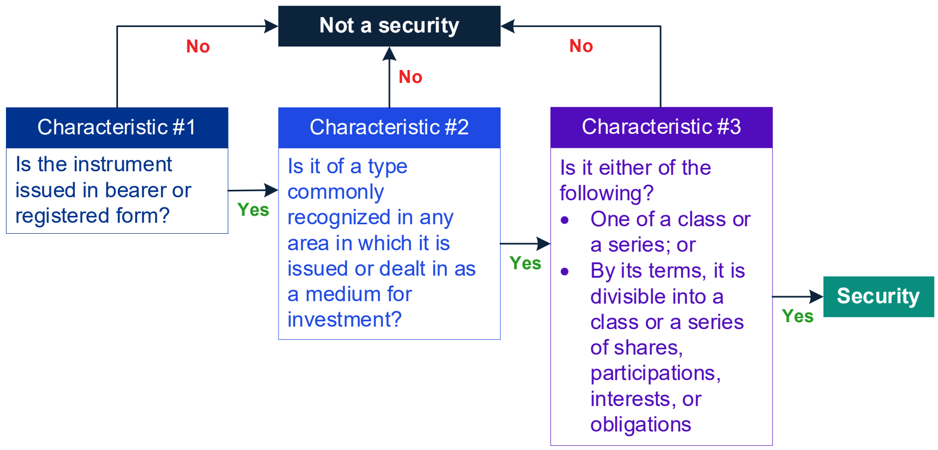
a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Interpretive response: Topic 320 defines a security as a share, participation, or other interest in: [320-10 Glossary]

- property;
- an entity of the issuer; or
- an obligation of the issuer.

Further, the share, participation, or other interest needs to have three characteristics to meet the definition of a security. The relevant characteristics depend on whether the item is or is not an instrument.

In our experience, most debt investments are in the form of an instrument. An entity applies the following decision tree to determine if an instrument is a security.



Question 2.4.30
Can an investment be a 'security' if it does not meet the legal definition of a security?

Interpretive response: Yes. The legal form of an instrument does not determine whether an investment is a security for accounting purposes.

Although the definition of security in Topics 320 and 321 was based on the Uniform Commercial Code (UCC) at the time the guidance was developed, it is not consistent with the current UCC or securities law definitions. Certain instruments may require careful evaluation to determine whether they meet the definition of a security. For example, the SEC staff believes that beneficial interests in certificate form generally meet the definition of a security, even if they are not considered securities under the current UCC code. [FAS 115.BC46, 320-10 Glossary, 321-10 Glossary, 1997 AICPA Conf]

Question 2.4.40
Is a loan in the scope of Topic 320?

Excerpt from ASC 320-10

> Instruments

15-6 The guidance in this Topic applies to all loans that meet the definition of a security.

> Implementation Guidance

• > Scope Application to Certain Instruments and Transactions

• • > Certain Debt Instruments

55-3 Even if a loan could readily be converted into a security, the loan is not a debt security until it has been securitized. An example of unsecuritized loans is unsecuritized mortgage loans. However, after mortgage loans are converted to mortgage-backed securities, they are subject to the guidance in this Topic.

Interpretive response: It depends on whether the loan meets the definition of a security in its current form. Loans that do not meet the definition are generally in the scope of Topic 310. [320-10-15-6]

A loan typically does not meet the definition of a security. A loan that can be readily converted into a security is not a debt security until it has been so converted. For example, a group of mortgage loans can be converted to mortgage-backed securities through a securitization transaction. Mortgage loans are not subject to Topic 320, while mortgage-backed securities are. However, an investor that transfers loans into a securitization vehicle only accounts for beneficial interests received as debt securities that are subject to Topic 320 if the transfer is accounted for as a sale. KPMG Handbook, Transfers and servicing of financial assets, addresses whether transfers of loans are accounted for as sales or secured borrowings. [320-10-55-3, 860-30-25-2]

Question 2.4.50
Is convertible debt that is not a security in the scope of Topic 320?

Background: Bank originates a loan to Borrower. The loan agreement includes an embedded conversion option that permits Bank to convert the loan into Borrower's common shares in settlement, and the embedded conversion option does not require bifurcation. The convertible loan does not meet the 'security' definition.

Interpretive response: We understand there are two views in practice, based on different interpretations of the 'debt security' definition (see Question 2.3.10).

- View A – All convertible debt is in the scope of Topic 320. Topic 320 defines a debt security as 'any security representing a creditor relationship with an entity' and provides a list of instruments that are also included in that definition. Under this view, convertible debt is in the scope of Topic 320 even if it does not meet the definition of a 'security' because it is included in that list.
- View B – Convertible debt is in the scope of Topic 320 only if it is a 'security'. Under this view, Topic 320 defines a debt security as a 'security' representing a creditor relationship with an entity, and therefore an instrument must meet that definition to be in the scope of Topic 320. Further, the definition provides a list of instruments that are excluded from

the 'debt security' definition, which includes loans receivable that do not meet the definition of a security.

Given the diversity in practice, we believe both views are acceptable as an accounting policy election applied consistently. However, we believe View A is preferable because it results in the embedded conversion option being recognized on the balance sheet through fair value measurement of the convertible debt under the AFS or trading categories; HTM is precluded for convertible debt (see Question 4.2.140).

Question 2.4.60

What are examples in Topic 320 of debt instruments that are within its scope?

Excerpt from ASC 320-10

> Implementation Guidance

• > Scope Application to Certain Instruments and Transactions

• • > Certain Debt Instruments

55-2 All of the following debt instruments are within the scope of this Topic if they meet the definition of a **debt security**:

a. Loans restructured as securities. For example, any loan that was restructured involving a modification of terms would be subject to the provisions of this Topic if the debt instrument meets the definition of a **security**. See paragraph 310-20-40-10 for additional information.
b. Beneficial interests in securitized financial assets that are in equity form but that meet the definition of a debt security. For example, some beneficial interests issued in the form of equity represent solely a right to receive a stream of future cash flows to be collected under preset terms and conditions (that is, a creditor relationship), while others, according to the terms of the special-purpose entity, must be redeemed by the issuing entity or must be redeemable at the option of the investor. Consequently, those beneficial interests would be within the scope of both this Topic and Subtopic 325-40 since they are required to be accounted for as debt securities.
c. Certificates of deposit (CDs) or guaranteed investment contracts. For example, certain negotiable jumbo CDs and guaranteed investment contracts might meet the definition of security, which was modeled after the definition provided in the Uniform Commercial Code.
d. Redeemable convertible preferred stock. For example, convertible preferred stock that has mandatory redemption provisions or is redeemable at the option of the investor is considered a debt security and this Topic would apply.

Interpretive response: All of the following debt instruments are in the scope of Topic 320. [320-10-55-2]

Debt instrument	Examples in the scope of Topic 320
Loans restructured as securities	A loan restructuring that involves a modification of terms if the debt instrument[1] meets the definition of a security.
Beneficial interests[2] in securitized financial assets that are in equity form but that meet the definition of a debt security	• Beneficial interests issued in the form of equity that represent solely a right to receive a stream of future cash flows to be collected under preset terms and conditions. • Beneficial interests that must be redeemed by the issuer or must be redeemable at the option of the investor. Question 2.4.30 discusses certain beneficial interests that are accounted for like debt securities, even though they are not debt securities.
Certificates of deposit (CDs) or guaranteed investment contracts	Certain negotiable jumbo CDs and guaranteed investment contracts that meet the definition of debt security.
Redeemable convertible preferred shares	Convertible preferred shares that, by its terms, either: • must be redeemed by the issuer; or • is redeemable at the option of the investor. See Question 2.3.30 for further guidance.

Notes:

1. Paragraph 310-40-40-8A addresses the initial recognition of the debt security received. [320-10-55-2(a)]

Beneficial interests are in the scope of both Topic 320 and Subtopic 325-40 because they are required to be accounted for as debt securities.

Question 2.4.70

Does Topic 320 apply to any instruments that do not meet the definition of a debt security?

Excerpt from ASC 320-10

> Instruments

15-7A Paragraph 815-10-15-141 explains that the guidance in the Certain Contracts on Debt and Equity Securities Subsections applies to those forward contracts and purchased options that are not derivative instruments subject to Topic 815 but that involve the acquisition of securities that will be accounted for under Subtopic 320-10.

Excerpt from ASC 815-10

> Instruments

15-141 The guidance in the Certain Contracts on Debt and Equity Securities Subsections applies only to those forward contracts and purchased options having all of the following characteristics:

a. The contract is entered into to purchase securities that will be accounted for under either Topic 320 or Topic 321.
b. The contract's terms require physical settlement of the contract by delivery of the securities.
c. The contract is not a **derivative instrument** otherwise subject to this Subtopic.
d. The contract, if a purchased option, has no intrinsic value at acquisition.

Interpretive response: Yes. The following instruments do not meet the Topic 320 definition of a debt security but are accounted for as if they do, unless they are accounted for as derivatives under Topic 815. [320-10-15-7A, 320-10 Glossary]

Instrument	Applicable provisions of Topic 320
Forward contracts and options to acquire securities that will (when purchased) be subject to Topic 320 and that meet all of the following conditions: [815-10-15-141, 815-10-25-17] • the contract is not accounted for as a derivative under Topic 815; • the contract's terms require physical settlement; and • if the contract is a purchased option, it has no intrinsic value at acquisition.	Topic 815 requires these instruments to be accounted for as if they were in the scope of Topic 320, including that they are designated as HTM, AFS or trading at inception. For further discussion, see section 2.3.50 of KPMG Handbook, Derivatives and hedging.
Beneficial interests that are not debt securities but can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its recorded investment (e.g. an interest-only strip that is not a security). [860-20-35-2, 35-3, 35-5] See also Question 4.2.90.	These instruments are required to be recognized and measured like investments in debt securities classified as AFS or trading (not HTM). However, Topic 320 disclosures are not required. For further discussion, see section 7.3.10 of KPMG Handbook, Transfers and servicing of financial assets.

Question 2.4.80
Is a debt security in the scope of Topic 320 if the entity elects the fair value option?

Excerpt from ASC 825-10

> Other Considerations

• > Interaction with Other Topics

15-6 The Fair Value Option Subsections:

a. Do not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value
b. Do not establish requirements for recognizing and measuring dividend income, interest income, or interest expense
c. Do not eliminate disclosure requirements included in other Subtopics, including requirements for disclosures about fair value measurements included in Topic 820.

Background: The Subtopic 825-10 fair value option allows an entity to irrevocably elect to subsequently measure certain financial instruments at fair value with changes in fair value reported in earnings. However, it does not: [825-10-15-6]

- establish requirements for recognizing and measuring dividend income, interest income or interest expense; or
- eliminate the disclosures required by other Subtopics.

Interpretive response: Yes. Topic 320 does not provide a scope exclusion for instruments for which the fair value option has been elected. If an entity elects to measure a debt security under the fair value option that would otherwise be in the scope of Topic 320, we believe the debt security continues to be in the scope of Topic 320. As a result, an entity should apply the guidance in Topic 320 – e.g. for recognizing and measuring interest income and preparing disclosures (see chapter 3).

Note: The primary difference between classifying a debt security as a trading security versus electing the fair value option is that it is possible to subsequently transfer securities from the trading category in certain limited circumstances (see section 3.6.20). This has the practical effect of ceasing the subsequent measurement of the security at fair value though earnings. In contrast, paragraph 825-10-25-2 states that the decision about whether to elect the fair value option is irrevocable unless a new election date occurs (as discussed in paragraph 825-10-25-4). [825-10-25-2, 25-4]

2.5 Considerations specific to equity securities

2.5.10 Instruments

Question 2.5.10
Are all equity securities in the scope of Topic 321?

Interpretive response: No. In addition to the instruments that are excluded from the scopes of both Topics 320 and 321 (see Question 2.2.30), the following equity securities are outside the scope of Topic 321. [321-10-15-5, 320-10 Glossary]

Equity securities	Applicable guidance
Investments that are accounted for under the equity method	Topic 323 See KPMG Handbook, Equity method of accounting
Exchange memberships that have the characteristics specified in paragraph 940-340-25-1(b) for an ownership interest in the exchange	Subtopic 940-340
Stock issued by the Federal Home Loan Bank and Federal Reserve Bank (Question 2.5.80)	Subtopic 942-325
Certain types of preferred shares that meet the definition of debt securities (Question 2.3.30)	Topic 320

Question 2.5.20
Is an equity investment in an entity that is not a business in the scope of Topic 321?

Interpretive response: The scope of Topic 321 applies to equity investments in all types of entities, irrespective of whether the entity meets the definition of a business. Therefore, if a specific scope exception is not met (see Questions 2.2.30 and 2.5.10), the guidance in Topic 321 applies to an equity investment in an entity that is not a business. [321-10-15-5]

Question 2.5.30

Is a noncontrolling investor's investment in a corporate subsidiary that is a real estate venture in the scope of Topic 321?

Excerpt from ASC 321-10

> Implementation Guidance

• > Scope Application by Noncontrolling Shareholders

55-5 Paragraph 970-323-25-10 explains that an investment in a corporate subsidiary that is a real estate venture shall be accounted for by the investor-parent using the principles applicable to investments in subsidiaries rather than those applicable to investments in corporate joint ventures. That is, that paragraph requires that noncontrolling shareholders in such a real estate venture should account for their investment using the principles applicable to investments in common stock set forth in Topic 323 or this Topic as applicable.

Excerpt from ASC 970-323

> Corporate Joint Ventures

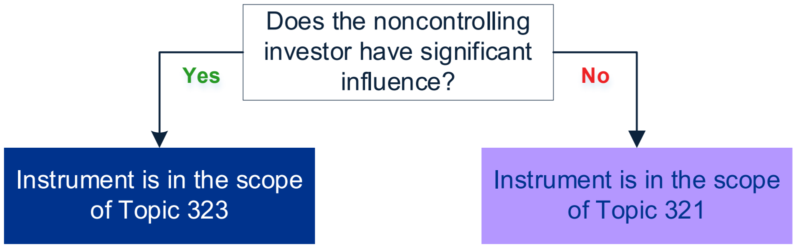
25-9 Topic 323 provides the standards for use of the equity method for **corporate joint ventures** and includes guidance for applying that method in the financial statements of the investor. That Topic applies to corporate joint ventures created to own or operate real estate projects.

25-10 Accordingly, an investment in a corporate subsidiary that is a **real estate venture** shall be accounted for by the investor-parent using the principles applicable to investments in subsidiaries rather than those applicable to investments in corporate joint ventures.

25-11 Noncontrolling shareholders in such a real estate venture shall account for their investment using the principles applicable to investments in common stock set forth in Topic 321 or 323.

Background: The guidance in Topic 970 applies to entities with productive activities relating to real property, excluding property used primarily in the entity's non-real estate operations. [970-10-15-3]

Interpretive response: It depends on whether the noncontrolling investor has significant influence as determined by Topic 323. An investment in a corporate subsidiary that is a joint venture, general partnership, limited partnership or undivided interest (collectively referred to as a real estate venture) is accounted for by the noncontrolling investor using the principles applicable to investments in subsidiaries. Therefore, the noncontrolling investor accounts for its investment using the principles applicable to investments in common shares as follows. [321-10-55-5]



Question 2.5.40

Are investments in qualified affordable housing projects in the scope of Topic 321?

Excerpt from ASC 323-740

25-2 For an investment in a qualified affordable housing project through a limited liability entity not accounted for using the proportional amortization method, the investment shall be accounted for in accordance with Subtopic 970-323. In accounting for such an investment under that Subtopic, the requirements in paragraphs 323-740-25-3 through 25-5 and paragraphs 323-740-50-1 through 50-2 of this Subsection that are not related to the proportional amortization method, shall be applied.

25-2A Accounting for an investment in a qualified affordable housing project using the cost method may be appropriate. In accounting for such an investment using the cost method, the requirements in paragraphs 323-740-25-3 through 25-5 and paragraphs 323-740-50-1 through 50-2 of this Subsection that are not related to the proportional amortization method shall be applied.

Pending Content:

Transition Date: *(P) December 16, 2023; (N) December 16, 2024* **Transition Guidance:** 323-740-65-2

25-2 Paragraph superseded by Accounting Standards Update No. 2023-02

25-2A Paragraph superseded by Accounting Standards Update No. 2023-02

Excerpt from ASC 970-323

> Limited Partnerships

25-6 The equity method of accounting for investments in general partnerships is generally appropriate for accounting by limited partners for their investments in limited partnerships. A limited partner's interest may be so minor that the limited partner may have virtually no influence over partnership operating and financial policies. Such a limited partner is, in substance, in the same position with respect to the investment as an investor that owns a minor common stock interest in a corporation, and, accordingly, the limited partner should account for its investment in accordance with Topic 321.

25-8 If the substance of the partnership arrangement is such that the general partners are not in control of the major operating and financial policies of the partnership, a limited partner may be in control. An example could be a limited partner holding over 50 percent of the limited partnership's **kick-out rights** through voting interests in accordance with paragraph 810-10-15-8A. A controlling limited partner shall be guided in accounting for its investment by the principles for investments in subsidiaries in Topic 810 on consolidation. Noncontrolling limited partners shall account for their investments by the equity method and shall be guided by the provisions of Topic 323, as discussed in the guidance beginning in paragraph 970-323-25-5, or by the guidance in Topic 321.

Background: Subtopic 323-740 applies to investors that have investments in limited liability entities that manage or invest in qualified affordable housing projects and are flow-through entities for tax purposes. Under this guidance, investors in limited partnerships often apply either the proportional amortization method or the equity method of accounting. However, there may be circumstances in which the investment does not qualify for the proportional amortization method (or that method is not elected) and the equity method of accounting is not appropriate – i.e. the investor has virtually no influence over the partnership's operating and financial policies. [323-740-05-2 – 05-3]

Appendix B of KPMG Handbook, Accounting for income taxes, discusses the accounting for investments in qualified affordable housing projects; and chapter 2 of KPMG Handbook, Equity method of accounting, provides guidance on whether the equity method of accounting is appropriate.

Interpretive response: It depends. If an investor in a limited partnership applies the proportional amortization method or the equity method of accounting, its investment is outside the scope of Topic 321. If neither the proportional amortization method nor the equity method of accounting is applied, we believe there is conflicting guidance in Subtopics 970-323 and 323-740 on the subsequent accounting for these investments.

Paragraphs 970-323-25-6 and 25-8 indicate that real estate investors with virtually no influence account for their investments under Topic 321. At the same time, paragraph 323-740-25-2A (as amended by ASU 2016-01) states that the cost method may be appropriate and an illustration of the application of the cost method was retained in paragraph 323-740-55-7. [323-740-25-2A, 55-7, 970-323-25-6, 25-8]

As a result of this conflicting guidance, we believe an investor may elect, and should consistently apply, an accounting policy to account for these investments either under Topic 321 or using the cost method.

Forthcoming requirements**

In March 2023, the FASB issued ASU 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method, which expands the population of investments for which an investor may elect the proportional amortization method. The amendments in the ASU also remove the guidance indicating that it may be appropriate to apply the cost method to qualifying investments in qualified affordable housing projects. Therefore, such investments that are not accounted for using the proportional amortization method or the equity method apply the guidance in Topic 321.

If an investor applied the cost method prior to the adoption of the ASU, it adjusts the carrying amount of the investment using either the transition method selected for other aspects of the ASU or prospective application of Topic 321.

For a summary of the amendments, see chapter 6 of KPMG Handbook, Tax credits.

Question 2.5.50

Are investments in contracts to acquire or sell equity securities, such as options and forward contracts, in the scope of Topic 321?

Excerpt from ASC 321-10

> Instruments

15-6 Paragraph 815-10-15-141 explains that the guidance in the Certain Contracts on Debt and Equity Securities Subsections applies to those forward contracts and purchased options that are not derivative instruments subject to Topic 815 but that involve the acquisition of securities that will be accounted for under Topic 321. Paragraph 815-10-15-141A provides guidance on applying the guidance in paragraph 815-10-15-141 to forward contracts and purchased options to purchase securities within the scope of Topic 321

20 Glossary

Equity Security

Any security representing an ownership interest in an entity (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants, rights, forward purchase contracts, and call options) or dispose of (for example, put options and forward sale contracts) an ownership interest in an entity at fixed or determinable prices. The term equity security does not include any of the following:

a. Written equity options (because they represent obligations of the writer, not investments)
b. Cash-settled options on equity securities or options on equity-based indexes (because those instruments do not represent ownership interests in an entity)
c. Convertible debt or preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor.

> Implementation Guidance

• > Scope Application to Certain Instruments and Transactions

• • > Call Options and Forward Contracts on Equity Securities

55-3 An option to buy an equity security that does not meet the definition of a derivative instrument is within the scope of this Topic. An investment in an option on securities should be accounted for under the requirements of Subtopic 815-10 if the option meets the definition of a derivative instrument, including the criteria for net settlement in paragraph 815-10-15-83(c). This Topic applies to those forward contracts and options that are not derivative instruments subject to Subtopic 815-10 but that involve the acquisition of securities that will be accounted for under this Topic. Paragraph 815-10-15-141A provides guidance on applying the guidance in paragraph 815-10-15-141 to forward contracts and purchased options to purchase securities within the scope of Topic 321.

Excerpt from ASC 815-10

> Instruments

15-141 The guidance in the Certain Contracts on Debt and Equity Securities Subsections applies only to those forward contracts and purchased options having all of the following characteristics:

a. The contract is entered into to purchase securities that will be accounted for under either Topic 320 or Topic 321.
b. The contract's terms require physical settlement of the contract by delivery of the securities.
c. The contract is not a **derivative instrument** otherwise subject to this Subtopic.

d. The contract, if a purchased option, has no intrinsic value at acquisition.

15-141A For the purposes of applying paragraph 815-10-15-141(a) for forward contracts and purchased options, an entity shall not consider whether, upon the settlement of the forward contract or the exercise of the purchased option, individually or with existing investments, the underlying securities would be accounted for under either of the following:

a. The equity method in accordance with Topic 323
b. The fair value option in accordance with Topic 825 if those securities otherwise would have been accounted for under Topic 323.

15-142 The guidance in the Certain Contracts on Debt and Equity Securities Subsections does not apply to contracts involving securities not within the scope of either Topic 320 or Topic 321, after considering the guidance in paragraph 815-10-15-141A.

Certain Contracts on Debt and Equity Securities

25-18 Forward contracts and purchased options on equity securities within the scope of this Subsection (see the Certain Contracts on Debt and Equity Securities Subsection of Section 815-10-15) shall, at inception, be recognized in a manner consistent with the accounting prescribed by Topic 321 for equity securities. Such forward and option contracts are not eligible to be hedging instruments.

30-6 Forward contracts and purchased options on equity securities within the scope of this Subsection shall be measured initially in a manner consistent with the accounting prescribed by Topic 321.

Interpretive response: It depends. An investment in a contract is in the scope of Topic 321 if the contract: [321-10-15-6, 321-10 Glossary, 321-10-55-3, 815-10-15-141 – 142]

- is not accounted for as a derivative under Topic 815 (derivatives and hedging); and
- provides the entity with either:
  - the right (i.e. an option) or the right and obligation (i.e. a forward) to acquire an ownership interest in another entity at a fixed or determinable price when such interest, once acquired, will be in the scope of Topic 321, Topic 323 or accounted for under the fair value option in Topic 825 (if those securities otherwise would have been accounted for under Topic 323); or
  - the right or the right and obligation to dispose of an ownership interest in another entity at a fixed or determinable price.

This means that share-settled contracts such as warrants, purchased call options, forward purchase contracts, purchased put options and forward sale contracts are in the scope of Topic 321 if they are either:

- nonderivative instruments; or
- derivative instruments that are outside the scope of Topic 815.

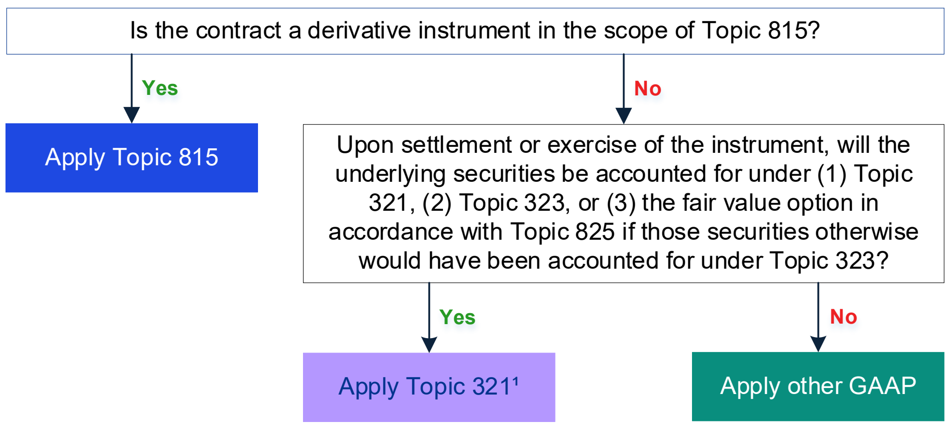
Investments outside the scope of Topic 321

Written options are not in the scope of Topic 321 because they are considered to be obligations of the writer, not investments (see Question 2.3.20).

Also outside the scope of Topic 321 are contracts to buy equity securities in an investee that, once acquired, will be consolidated under Topic 810.

Decision tree

The following decision tree summarizes considerations for whether contracts to acquire equity securities are in the scope of Topic 321.



Note:

1. Certain contracts may be in the scope of Subtopic 815-10. However, we believe the initial and subsequent measurement guidance is the same regardless of whether the nonderivative contract is in the scope of the 'Certain Contracts on Debt and Equity Securities' subheading in Subtopic 815-10 or Topic 321. [815-10-25-18, 30-6]

Question 2.5.60
Is a contingent forward or option contract to acquire or sell equity securities in the scope of Topic 321?

Background: As discussed in Question 2.5.50, certain share-settled contracts – e.g. some warrants, purchased call options, forward purchase contracts, purchased put options and forward sale contracts – are in the scope of Topic 321 if they are either:

- nonderivative instruments; or
- derivative instruments that are outside the scope of Topic 815.

Some forward contracts and purchased options are only exercisable when a pre-specified contingent event occurs. For example, a forward contract might be exercisable only if the investee obtains regulatory approval for a new drug that it is developing.

Interpretive response: Yes. We believe that if a contract would otherwise have been in the scope of Topic 321 based on the guidance in Question 2.5.50, the fact that the forward or purchased option is contingently exercisable does not cause it to be outside the scope.

Question 2.5.70

Is a prepaid forward contract to acquire equity securities in the scope of Topic 321?

Background: An investor enters into an agreement with an entity to make a fixed upfront cash payment in exchange for the right to receive equity securities of the entity in the future. The forward is not a derivative in the scope of Topic 815 because the initial net investment criteria are not met.

Interpretive response: Yes. We believe a prepaid forward contract to acquire equity securities is in the scope of Topic 321 regardless of whether it is for a fixed or variable number of equity securities. As discussed in Question 2.5.50, an investment in a contract is in the scope of Topic 321 if the contract: [321-10-15-6, 321-10 Glossary, 321-10-55-3, 815-10-15-141 – 142]

- is not accounted for as a derivative under Topic 815; and
- provides the entity with either:
  - the right (i.e. an option) or the right and obligation (i.e. a forward) to acquire an ownership interest in another entity at a fixed or determinable price when such interest, once acquired, will be in the scope of Topic 321, Topic 323 or accounted for under the fair value option in Topic 825 (if those securities otherwise would have been accounted for under Topic 323); or
  - the right or the right and obligation to dispose of an ownership interest in another entity at a fixed or determinable price.

We do not believe the fact that the forward is prepaid causes the forward to be outside the scope of Topic 321.

Question 2.5.80

How does a bank account for its investment in Federal Home Loan Bank and Federal Reserve Bank stock?

Interpretive response: Although Federal Home Loan Bank and Federal Reserve Bank stock is an equity interest, it is explicitly outside the scope of Topic 321. An investment in such stock is measured at cost and evaluated for impairment based on the bank's expectation of the ultimate recoverability of the stock's cost basis. [321-10-15-5, 942-325-35-1]

Question 2.5.90

Is an equity security in the scope of Topic 321 if the entity elected the fair value option?

Background: The Subtopic 825-10 fair value option allows an entity to irrevocably elect to subsequently measure certain financial instruments at fair value with changes in fair value reported in earnings. However, it does not: [825-10-15-6]

- establish requirements for recognizing and measuring dividend income, interest income or interest expense; or
- eliminate the disclosures required by other Subtopics.

Interpretive response: Yes. Topic 321 does not provide a scope exclusion for instruments that have elected the fair value option. If an entity elects to measure an equity security under the fair value option that would otherwise be in the scope of Topic 321, we believe the equity security continues to be in the scope of Topic 321. As a result, an entity should apply the guidance in Topic 321 – e.g. for recognizing and measuring dividend income and preparing disclosures (see chapter 5).

Note: The primary difference in practice between classifying an equity security as an equity security with a readily determinable fair value versus those for which the fair value option is elected is that if the fair value option is not elected, an entity can elect to apply the measurement alternative for the security if its fair value ceases to be readily determinable (see Question 5.4.90). This has the practical effect of ceasing the subsequent measurement of the security at fair value though earnings. In contrast, paragraph 825-10-25-2 states that the decision about whether to elect the fair value option is irrevocable unless a new election date occurs (as discussed in paragraph 825-10-25-4). [825-10-25-2, 25-4]

3. Accounting for investments in debt securities

Detailed contents

New item added to this edition: **

3.1 How the standard works

When acquired, a debt security is initially recognized on the balance sheet as an asset and classified into one of three categories: trading, AFS or HTM; those classifications and transfers between categories are discussed in chapter 4.

A debt security's initial measurement, subsequent measurement and the treatment of unrealized holding gains and losses depends on the classification.

Classification	Initial measurement[1]	Subsequent measurement	Treatment of unrealized holding gains and losses
Trading	Transaction price or fair value	Fair value	Included in earnings
AFS	Transaction price or fair value	Fair value	Excluded from earnings and reported in OCI (and accumulated in AOCI until realized)
HTM	Transaction price	Amortized cost	Not recognized in the financial statements until realized but disclosed in notes to the financial statements.
Note: 1. Unless other US GAAP applies.			

This Handbook does not address issues associated with:

- income taxes related to debt securities. See KPMG Handbook, Accounting for income taxes, for guidance on recording the tax effects of debt securities.
- credit losses on debt securities. See KPMG Handbook, Credit impairment, for guidance on estimating and recognizing expected credit losses.

3.2 Recognition and initial measurement

3.2.10 Recognition

Topic 320 requires an entity to classify debt securities as trading, AFS or HTM at initial recognition (see section 4.2.10). However, Topic 320 does not provide specific guidance on other aspects of the recognition of debt securities.

Question 3.2.10
Is the purchase of a debt security reported on the trade date or settlement date?

Excerpt from ASC 815-10

• • > Regular-Way Security Trades

15-15 Regular-way security trades are defined as contracts that provide for delivery of a security within the period of time (after the trade date) generally established by regulations or conventions in the marketplace or exchange in which the transaction is being executed. For example, a contract to purchase or sell a publicly traded equity security in the United States customarily requires settlement within three business days. If a contract for purchase of that type of security requires settlement in three business days, the regular-way security trades scope exception applies, but if the contract requires settlement in five days, the regular-way security trades scope exception does not apply unless the reporting entity is required to account for the contract on a trade-date basis.

Interpretive response: A debt security is recognized on either the trade date or settlement date. [FAS133.BC274]

- Trade date is the date when an order to purchase or sell a financial instrument occurs.
- Settlement date is the date the seller is required to deliver, and the purchaser is required to pay for, the financial instrument(s).

Entities in certain industries are required to apply trade date accounting to regular-way security trades. For example, broker dealers in the scope of Topic 940 and depository and lending institutions in the scope of Topic 942 are required to apply trade date accounting to regular-way security trades. [860-20-25-2, 940-320-25-1, 942-325-25-2]

Regular-way security trades

Regular-way security trades are contracts that provide for delivery of a security within the period generally established by regulations or conventions in the marketplace or exchange in which the transaction is being executed. [815-10-15-15]

If industry-specific guidance requiring trade date accounting does not apply to the purchase in such trades, we believe the investor/purchaser may elect an accounting policy to use either trade date or settlement date accounting. However, we do not believe trade date accounting should be applied if there are any conditions required for closing that have not been met; in that case, settlement date accounting should be applied.

Trades that are not regular-way

We do not believe trade date accounting should be applied to trades that are not regular-way. In that case, settlement date accounting should be applied.

Applying settlement date accounting

A purchaser/investor that applies settlement date accounting to a security underlying a contract is required to recognize the purchase contract itself when: [815-10-15-141]

- Topic 815 requires the purchase contract to be accounted for as a derivative. Derivative accounting is not required if the contract does not meet the definition of a derivative or qualifies for the scope exception for regular-way securities trades. Chapter 2 of KPMG Handbook, Derivatives and hedging, discusses the Topic 815 scope and scope exceptions; or
- Topic 815 requires the purchase contract to be accounted for as if it is in the scope of Topic 320, including designating the purchase contract as HTM, AFS or trading at inception (see Question 2.4.70).

Example 3.2.10
Trade date vs settlement date

On December 29, Year 1 (trade date), ABC Corp purchases publicly traded debt securities for their par amount of $1,000. The purchase is a regular-way trade. The transaction settles on January 2, Year 2 (settlement date). ABC designates the debt securities as trading (see section 3.3).

The debt securities have a fair value of $1,000 on the trade date and $1,015 on both December 31 and January 2 (settlement date). On December 31, Year 1 and January 2, Year 2 the forward purchase contract has a fair value of $15. For simplicity, this example disregards transaction costs.

Scenario 1: Entity records debt securities on trade date

ABC is a depository institution subject to Topic 942, which requires that regular-way purchases be recorded on the trade date. ABC records the following journal entries for the purchase.

	Debit	*Credit*
Debt securities – trading Payable to seller[1] *To record purchase of debt securities on trade date (Dec 29, Year 1).*	1,000	 1,000
Debt securities – trading Gain/loss – earnings[2] *To measure debt securities at fair value at period-end (Dec 31, Year 1).*	15	 15
Payable to seller Cash *To record receipt of cash and remove payable on settlement date (Jan 2, Year 2).*	1,000	 1,000

Notes:

1. A payable to the seller is recorded because the transaction has not yet settled.
2. The unrealized holding gain on trading debt securities is reported in earnings (see Question 3.3.10).

Scenario 2: Entity records debt securities on settlement date

This scenario assumes the contract to purchase securities qualifies for the regular-way trades scope exception from derivative accounting (i.e. is not accounted for as a derivative) and is accounted for as if it is in the scope of ASC 320.

ABC is in an industry that does not require regular-way purchases of securities to be recorded on the trade date. ABC's accounting policy is to record debt security purchases on the settlement date.

ABC records the following journal entries for the purchase; no entry is made on trade date (Dec 29, Year 1).

	Debit	*Credit*
Forward purchase contract (Debt securities – trading) Gain/loss – earnings[1] *To record increase in fair value of forward purchase contract at period-end (Dec 31, Year 1).*	15	 15
Debt securities – trading[2] Forward purchase contract Cash *To record debt security and payment of cash to seller on settlement date (Jan 2, Year 2).*	1,015	 15 1,000

Notes:

1. Changes in fair value of the forward purchase contract are reported in earnings; see Question 2.3.70 of KPMG Handbook, Derivatives and hedging, for accounting guidance on forward or option contracts to purchase debt securities.
2. Trading debt securities acquired under a forward purchase contract subject to Subtopic 815-10 are initially measured at their fair value at the settlement date (see Question 3.2.30).

3.2.20 Initial measurement

Topic 320 does not provide specific guidance on initial measurement of debt securities.

Question 3.2.20
How are debt securities initially measured?

Background: In most cases, a debt security's transaction price (excluding transaction costs) and fair value will be the same. However, there are a limited number of circumstances in which the amounts will differ. For example, this could be the case when the transaction: [820-10-30-3A]

- is between related parties;
- was entered into in a market other than the entity's principal market; or
- takes place under duress or the seller is forced to accept the price in the transaction.

See Question I10 in KPMG Handbook, Fair value measurement, for further discussion of differences between the transaction price and fair value and Question E80 for the effect of transaction costs on initial measurement.

Interpretive response: Topic 320 does not provide specific guidance on the recognition and initial measurement of debt securities. In some situations, other Topics provide specific guidance – e.g. debt securities acquired under certain forward or option contracts (see Question 3.2.30) or in a business combination (Topic 805).

Entities other than investment companies

We believe an entity (except for an investment company) may elect an accounting policy, to be applied consistently, to initially measure debt securities classified as trading or AFS at either transaction price or fair value. For trading debt securities, the practical effect of either measurement (i.e. transaction price or fair value) is the same because such securities are remeasured at fair value through earnings immediately following initial recognition. As a result, any difference between fair value and transaction price at initial recognition is reported in earnings immediately.

We believe HTM debt securities are initially measured at cost.

Investment companies

An investment company is required to measure debt securities at transaction price and therefore cannot elect to measure them at fair value. The securities are remeasured at fair value through earnings immediately following initial recognition. As such, the difference between transaction price and fair value is reported in earnings immediately. [946-320-30-1, 35-1]

Question 3.2.30

How are debt securities measured upon settlement or exercise of a purchase contract in the scope of Subtopic 815-10?

Excerpt from ASC 815-10

Certain Contracts on Debt and Equity Securities

35-5 Forward contracts and purchased options on debt securities within the scope of this Subsection shall be measured subsequently according to their initial classification as follows:

a. Held to maturity:
   1. Changes in the **fair value** of the forward contract or purchased option shall not be recognized. Credit losses on the underlying securities in a forward contract shall be recorded through an allowance for credit losses in accordance with Subtopic 326-20 on financial instruments measured at amortized cost. Credit losses on the underlying securities in a purchased option shall be recorded through an allowance for credit losses in accordance with Subtopic 326-20 and shall be limited by the amount of the option premium.
   2. Debt securities purchased under a forward contract shall be recorded at the forward contract price at the settlement date.
   3. Debt securities purchased by exercising an option shall be recorded at the option strike price plus any remaining carrying amount for the option premium at the exercise date.
   4. If an option expires worthless and the same debt security is purchased in the market, the security shall be recorded at its market price plus any remaining carrying amount for the option premium.
   5. If an entity does not take delivery under the forward contract or purchase the same security in the market if the option expires worthless, the entity's intent to hold other debt securities to maturity will be called into question.

b. Available for sale:
   1. Changes in the fair value of the forward contract or purchased option shall be recognized as part of the separate component of shareholders' equity under Topic 320 as they occur. Credit losses on the underlying securities in a forward contract shall be recorded through an allowance for credit losses in accordance with Subtopic 326-30 on measuring credit losses on available-for-sale debt securities. Credit losses on the underlying securities in a purchased option shall be recorded through an allowance for credit losses in accordance with Subtopic 326-30 and shall be limited by the amount of the option premium.
   2. Debt securities purchased under a forward contract shall be recorded at their fair values at the settlement date.

3. Debt securities purchased by exercising an option shall be recorded at the option strike price plus the fair value of the option at the exercise date.
4. If the option expires worthless and the same debt security is purchased in the market, the security shall be recorded at its market price plus any remaining carrying amount for the option premium.

c. **Trading**:

1. Changes in the fair value of the forward contract or purchased option shall be recognized in earnings as they occur.
2. Debt securities purchased under a forward contract or by exercising an option shall be recorded at their fair values at the settlement date.

Interpretive response: It depends on the debt security's classification (see Question 3.3.10) and the type of purchase contract (i.e. forward or option contract). [815-10-35-5]

Type of purchase contract	HTM[1]	AFS[2]	Trading
Forward contract	Forward contract price at settlement date[5]	Fair value at settlement date	Fair value at settlement date
Option contract	Option strike price plus any remaining carrying amount for the option premium at exercise date[3,4]	Option strike price plus the fair value of the option at exercise date[3]	Fair value at settlement date

Notes:

1. Credit losses on HTM securities are recorded through an allowance for credit losses under Subtopic 326-20. See KPMG Handbook, Credit impairment.
2. Credit losses on AFS securities are recorded through an allowance for credit losses under Subtopic 326-30. See chapter 19 of KPMG Handbook, Credit impairment.
3. If the option expires worthless and the same debt security is purchased in the market, the debt security is recorded at market price plus any remaining carrying amount for the option premium.
4. HTM intent is called into question if the entity does not take delivery or purchase the same security in the market if the option expires worthless. See section 4.2.40 for tainting of HTM debt securities.
5. If the forward contract has a remaining carrying amount at settlement date (e.g. if a price was paid to enter into the contract), we believe that amount should also be included in the measurement of the debt security upon settlement.

See Question 2.3.70 of KPMG Handbook, Derivatives and hedging, for accounting guidance on the forward or option contract before its settlement.

3.3 Subsequent measurement

3.3.10 Overview

The primary aspects to subsequent measurement of debt securities are the result of:

- subsequent measurement on the balance sheet (see section 3.3.20); and
- adjustments to the amortized cost basis (see section 3.3.30).

As discussed in Question 2.4.80, a debt security is in the scope of Topic 320 if the entity elects the fair value option. Securities that were classified as either HTM or AFS at the date of initial adoption of the fair value option accounting guidance, and for which the fair value option was elected, are subsequently accounted for as trading securities. [FAS159.29, A50]

This Handbook does not address credit impairment of debt securities classified as AFS or HTM. For guidance on credit impairment, see KPMG Handbook, Credit impairment. Debt securities classified as trading are not evaluated for impairment because they are measured at fair value with changes in fair value reported in earnings.

3.3.20 Subsequent measurement on the balance sheet

Excerpt from ASC 320-10

35-1 Investments in **debt securities** shall be measured subsequently as follows:

a. **Trading securities.** Investments in debt securities that are classified as **trading** shall be measured subsequently at **fair value** in the statement of financial position. Unrealized **holding gains and losses** for trading securities shall be included in earnings.
b. **Available-for-sale securities**. Investments in debt securities that are classified as available for sale shall be measured subsequently at fair value in the statement of financial position. Unrealized holding gains and losses for available-for-sale securities (including those classified as current assets) shall be excluded from earnings and reported in other comprehensive income until realized except as indicated in the following sentences. All or a portion of the unrealized holding gain and loss of an available-for-sale security that is designated as being hedged in a fair value hedge that is not a portfolio layer method hedge shall be recognized in earnings during the period of the hedge, pursuant to paragraphs 815-25-35-1(b), 815-25-35-4, and 815-25-35-6. The portion of the unrealized holding gain and loss of a closed portfolio that includes an available-for-sale security or securities that is designated as being hedged in a portfolio layer method hedge pursuant to paragraph 815-20-25-12A shall be recognized in earnings during the

period of the hedge pursuant to paragraphs 815-25-35-1(c), 815-25-35-4, and 815-25-35-6.

c. Held-to-maturity securities. Investments in debt securities classified as held to maturity shall be measured subsequently at amortized cost in the statement of financial position. A transaction gain or loss on a held-to-maturity foreign-currency-denominated debt security shall be accounted for pursuant to Subtopic 830-20.

> Income Statement Classification

45-8 Paragraph 320-10-35-1 explains that all or a portion of the unrealized holding gain and loss of an available-for-sale security that is designated as being hedged in a fair value hedge shall be recognized in earnings during the period of the hedge, pursuant to paragraphs 815-25-35-1 and 815-25-35-4.

> Other Comprehensive Income

45-9 Subsequent increases or decreases in the fair value of available-for-sale securities that do not result in recognition or reversal of an allowance for credit loss or write-down in accordance with Subtopic 326-30 on measuring credit losses on available-for-sale debt securities shall be included in other comprehensive income pursuant to paragraphs 320-10-35-1(b) and 320-10-45-8.

Question 3.3.10
How is a debt security subsequently measured?

Interpretive response: It depends on how the debt security is classified, as described in the following table. [320-10-35-1, 45-9, 45-10]

Classification	Subsequently measured at	Unrealized holding gains and losses treatment
Trading	Fair value	Included in earnings
AFS	Fair value	Excluded from earnings and reported in OCI, net of tax effect (and accumulated in AOCI until realized)[1, 2]
HTM	Amortized cost basis	Not recognized in the financial statements[1] until realized but disclosed in the notes to the financial statements (see section 3.7)

Notes:
1. Question 3.3.40 discusses the impact of hedge accounting.
2. Any adjustments that result in recognition or reversal of an allowance for credit losses or write down under Subtopic 326-30 on measuring credit losses on AFS debt securities are reported in earnings. [320-10-45-8B]

A debt security's fair value is measured under Topic 820 (fair value measurement). See KPMG Handbook, Fair value measurement.

3.3.30 Adjustments to the amortized cost basis

Excerpt from ASC 320-10

20 Glossary

Amortized Cost Basis

The amortized cost basis is 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 net deferred fees or costs, collection of cash, writeoffs, foreign exchange, and fair value hedge accounting adjustments.

Question 3.3.20
How is a debt security's amortized cost basis determined?

Interpretive response: The amortized cost basis represents the amount at which a financing receivable or investment is originated or acquired, adjusted for any of the following that apply: [320-10 Glossary]

- accrued interest;
- accretion/amortization of a discount/premium and net deferred fees or costs (see section 3.3.40);
- collection of cash;
- writeoffs (see section 3.3 of KPMG Handbook, Credit impairment);
- foreign exchange adjustments (see Question 3.3.60);
- fair value hedge accounting adjustments (see Question 3.3.40); and
- recognition of equity method losses (see Question 3.3.50).

Section 3.2 discusses how to initially recognize and measure a debt security.

Question 3.3.30
Does an AFS debt security's amortized cost basis need to be determined?

Interpretive response: Yes. Even though AFS debt securities are subsequently measured at fair value, an entity needs to determine the amortized cost basis in order to determine unrealized holding gains and losses (i.e. the net change in fair value that is recognized in OCI) and to recognize related interest income. Further, it is required for disclosures (see Question 3.7.20). [320-10 Glossary, 320-10-35-1]

Question 3.3.40
Is a debt security eligible for hedge accounting?

Interpretive response: It depends on the debt security's classification. [320-10-35-1, 45-8, 815-25-35-6, 815-10-35-2]

Classification	Eligible for hedge accounting?	Summary of hedge accounting impact on debt security's measurement
HTM[1]	It depends on the risk being hedged • Yes for credit risk and/or foreign currency risk • No for interest rate risk and/or price risk (e.g. total change in fair value or cash flows)	**Fair value hedge:** Changes in the debt security's fair value during the hedging period that are attributable to the risk being hedged are reported in earnings; the remaining change in fair value is not recognized. **Cash flow hedge:** No impact on the debt security's measurement – i.e. the debt security continues to be measured at amortized cost. However, changes in the hedging instrument's fair value are reported in OCI.
AFS[2]	Yes	**Fair value hedge:** Changes in the debt security's fair value during the hedging period that are attributable to the risk being hedged are reported in earnings, not in OCI. **Cash flow hedge:** No impact on the debt security's measurement – i.e. changes in fair value continue to be reported in OCI. However, changes in the hedging instrument's fair value are reported in OCI.
Trading	No, because a trading debt security is subsequently measured at fair value with changes in fair value reported in earnings	N/A

Notes:

1. For discussion on the limitations on hedged risks for HTM securities, see section 6.3.90 in KPMG Handbook, Derivatives and hedging.
2. For discussion on the limitations on financial assets and liabilities measured at fair value, see section 6.3.100 and Question 8.2.10 in KPMG Handbook, Derivatives and hedging.

Question 3.3.50

How does an equity method investor account for losses when it has investments in debt securities of the investee?

Excerpt from ASC 320-10

35-3 Paragraphs 323-10-35-23 through 35-26 identify circumstances in which an entity must adjust the basis of its investment in debt securities of an equity method investee for the amount of an equity method loss based on the investment's seniority. For investments accounted for in accordance with this Subtopic, the adjusted basis resulting from the application of paragraphs 323-10-35-23 through 35-26 becomes the debt security's basis from which subsequent changes in fair value are measured.

Background: An investor generally stops applying the equity method of accounting when its share of net losses has reduced its equity method investment's carrying amount to zero. However, an investor continues to recognize investee losses in excess of its investment in certain situations, including when it has made additional investments in the investee – e.g. investments in preferred shares or other capital, debt securities, and loans or advances. [320-10-35-3]

Interpretive response: An investor that has reduced its equity method investment to zero but has other investments (including debt securities) in the investee sequences its application of US GAAP as follows. [323-10-35-23 – 35-26]

Step 1	Apply Topic 323 (equity method) to determine the maximum amount of investee losses the investor attributes to the other investments.
Step 2	Determine whether the adjusted basis[1] of the debt security is positive. • If yes, the investor attributes equity method losses to it based on the investments' seniority. • If no, the investor no longer recognizes equity method losses, but instead tracks the amount of suspended losses to know when to resume recognizing equity method income.
Step 3	Apply Subtopics 310-10 (loans, receivables, etc.), 320-10 (debt securities), 321-10 (equity securities), 326-20 and 326-30 to the adjusted basis of the other investments in the investee, as applicable.[2]
Step 4	Apply relevant US GAAP to other investments that are outside the scope of Subtopics 310-10, 320-10, 326-20 or 326-30.

Notes:

1. For this step, the adjusted basis is the other investments' initial cost adjusted for the following amounts that were recognized in previous periods, as applicable:
   - writedowns;
   - unrealized holding gains and losses reported in earnings on trading debt securities or equity securities;

- allowance for credit losses;
- amortization or accretion of a discount or premium on debt securities or financing receivables; and/or
- equity method losses that have already been attributed to the other investments.

2. When an investor attributes equity method losses to an investment in Step 2, it decreases the investment's amortized cost basis. That decrease in the amortized cost basis may result in the investor recognizing a lower amount of credit losses in Step 3 than it would have if equity method losses had not been attributed to the investment.

For additional discussion, see section 4.4.30 in KPMG Handbook, Equity method of accounting.

Question 3.3.60

How are changes in the exchange rate treated for foreign-currency-denominated debt securities?

Excerpt from ASC 320-10

> Fair Value Changes of Foreign-Currency-Denominated Available-for-Sale Debt Securities

35-36 The change in the fair value of foreign-currency-denominated available-for-sale debt securities, excluding the amount recorded in the allowance for credit losses, shall be reported in other comprehensive income. See Subtopic 326-30 for measuring credit losses on available-for-sale debt securities. In accordance with the guidance in Subtopic 326-30, an entity shall report credit losses on available-for-sale debt securities in the statement of financial performance as credit loss expense.

Interpretive response: The measurement of all foreign-currency-denominated debt securities is based on the current exchange rate on the reporting date.

However, the treatment of the change in foreign exchange rate depends on the debt security's classification. [320-10-35-1, 35-36]

Classification	Treatment of change in foreign exchange rate	Explanation
HTM	Reported in earnings	Although HTM debt securities are measured at amortized cost on the balance sheet under Topic 320, they are monetary assets under Topic 830 (foreign currency). As a result, Topic 830 requires remeasuring them at the current exchange rate with the resulting gains and losses reported in earnings. [830-20-35-2]
AFS	Reported in OCI	AFS debt securities are measured on the balance sheet at their fair value under

Classification	Treatment of change in foreign exchange rate	Explanation
		Topic 320, and the fair value measurement incorporates the current exchange rate.[1] Topic 320 requires reporting the entire change in fair value of foreign-currency-denominated AFS debt securities in OCI (other than the amount recorded in the allowance for credit losses under Subtopic 326-30).
Trading	Reported in earnings	Trading debt securities are measured on the balance sheet at their fair value under Topic 320, and the fair value measurement incorporates the current exchange rate.[1] Topic 320 requires reporting the entire change in fair value of trading securities (which includes the effect of the changes in exchange rates) in earnings.

Note:

1. Although AFS and trading debt securities are nonmonetary assets under Topic 830, and nonmonetary assets are generally remeasured at their historical exchange rates, these securities are subsequently measured at fair value and those fair value measurements require the use of current exchange rates. [830-10-45-18, 320-10-35-1]

For additional guidance on foreign-currency-denominated debt securities, see section 3 of KPMG Handbook, Foreign currency.

3.3.40 Interest income recognition

Excerpt from ASC 320-10

> Other Considerations

15-8 For debt securities within its scope, Subtopic 310-20 provides incremental guidance on accounting for discounts and premiums.

15-9 For debt securities within its scope, Subtopic 325-40 provides incremental guidance on accounting for and reporting discount and credit losses.

35-4 Dividend and interest income, including amortization of the premium and discount arising at acquisition, for all three categories of investments in debt securities shall be included in earnings.

Investments in debt securities typically generate interest income, which is reported in earnings. [320-10-35-4]

The amount of interest income recognized is impacted by whether a debt security is acquired at a premium above (or a discount below) the instrument's face value (par amount) and whether the security's initial measurement includes transaction costs. Amortization or accretion of premiums, discounts and deferred fees and costs are generally accounted for as yield adjustments over the debt security's life under Subtopic 310-20 (receivables – nonrefundable fees and other costs).

Question 3.3.70
What methods are acceptable for recognizing interest income on debt securities?

Interpretive response: It depends on the debt security's type and classification. We believe an entity should record interest income as follows. [310-20-15-2(b), 15-4, 320-10-15-9, 35-38 – 35-40]

Debt security type and classification	Applicable method for recognizing interest income
Debt securities in the scope of Subtopic 325-40 (beneficial interests) – HTM, AFS and trading	Subtopic 325-40 requires the accretable yield to be recognized as interest income using the effective yield method. Subtopic 325-40 provides specific guidance on how that method is applied for these debt securities. See section 20.4 of KPMG Handbook, Credit impairment for guidance on both accretion and credit losses.
Trading debt securities that are not in the scope of Subtopic 325-40	US GAAP does not provide specific guidance and does not require[2] all entities to separately present interest income in their income statements. In our experience, some entities with trading securities do not separately present interest income but instead present all changes in fair value – including the effect of interest – together in one line item. When an entity is required (or elects) to separately present interest income for trading securities that are not in the scope of Subtopic 325-40, we believe using the interest method is acceptable (see Question 3.3.80).[3]
Certain structured notes that are not in the scope of Subtopic 325-40 – HTM and AFS[1]	Topic 320 requires use of the retrospective interest method for certain structured notes; see section 3.4.30.
HTM and AFS debt securities that are not in the scope of: • Subtopic 325-40; or	Subtopic 310-20 requires use of the interest method; see Question 3.3.80.

Debt security type and classification	Applicable method for recognizing interest income
• the guidance for certain structured notes.	

Notes:

1. See Questions 3.4.60 and 3.4.70.
2. For example, entities in the scope of Topic 946 are required to separately report investment income from interest. [946-220-45-1]
3. Subtopic 946-320 requires an investment company to use the interest method to recognize interest income. [946-320-35-20]

Question 3.3.80

What is the interest method for recognizing interest income?

Excerpt from ASC 835-30

20 Glossary

Interest Method

The method used to arrive at a periodic interest cost (including amortization) that will represent a level effective rate on the sum of the face amount of the debt and (plus or minus) the unamortized premium or discount and expense at the beginning of each period.

Interpretive response: The interest method is a method used to arrive at a periodic interest cost (including amortization) that represents a level effective rate on the sum of the face amount of the debt security plus or minus the unamortized premium or discount and expense at the beginning of each period. [835-30 Glossary]

The EIR used for applying the interest method is the rate of return implicit in the debt security, which is generally the interest rate that equates the security's contractual cash flows with its amortized cost basis (see section 3.2). Subtopic 310-20 provides guidance on applying the interest method, including specific guidance for prepayable fixed rate financial assets and variable rate financial assets. When a debt security's initial amortized cost basis is equal to its par amount, the EIR will generally equal the contractual rate.

Example 3.3.10

Recognizing interest income using the interest method – HTM debt security

On January 1, Year 1, Investor purchases for $9.5 million a $10 million par value bond that bears interest at a 6% fixed rate. The bond matures on December 31, Year 5, is not prepayable, and pays interest annually. The trade settles on January 3, Year 1.

Investor has the positive intent and ability to hold this investment to maturity. Therefore, Investor classifies the debt security as HTM.

Investor is a depository institution subject to Topic 942, which requires that regular-way purchases be recorded on the trade date. The bond's fair value on the trade date is its purchase price of $9.5 million. For simplicity, this example disregards transaction costs.

Journal entries related to purchase of the bond

Investor records the following journal entries for the purchase.

	Debit	*Credit*
Debt securities – HTM	9,500,000	
Payable to seller[1]		9,500,000
To record purchase of debt securities on trade date (Jan 1, Year 1).		
Payable to seller	9,500,000	
Cash		9,500,000
To record receipt of cash and remove payable on settlement date (Jan 3, Year 1).		

Note:
1. A payable to the seller is recorded because the transaction has not yet settled.

Journal entries to recognize interest income in Year 1

Investor determines that the bond's EIR is 7.23% (rounded) – i.e. the rate that equates the bond's contractual cash flows with its initial amortized cost.

The following table represents the projected amortization schedule for the bond's amortized cost based on its contractual cash flows.

Year	Amortized cost beginning balance	Cash payments[1]	Interest income[2]	Amortized cost ending balance[3]
1	$9,500,000	$ 600,000	$ 686,553	$ 9,586,553
2	9,586,553	600,000	692,808	9,679,361
3	9,679,361	600,000	699,515	9,778,876
4	9,778,876	600,000	706,707	9,885,583
5	9,885,583	10,600,000	714,417	0
Total		**$13,000,000**	**$3,500,000**	

Notes: 1. Interest payments of $600,000 at the end of each year ($10,000,000 par amount × 6% stated fixed rate of interest) + $10,000,000 principal payment at December 31, Year 5 (maturity). 2. Beginning amortized cost balance × the EIR of 7.23% (rounded). 3. Amortized cost beginning balance – cash payments + interest income.

Investor records the following journal entries related to recognizing interest income and collecting contractual interest for Year 1.

	Debit	*Credit*
Interest receivable[1]	600,000	
Debt securities – HTM[2]	86,553	
Interest income[3]		686,553
To recognize interest income using interest method.		
Cash	600,000	
Interest receivable		600,000
To record receipt of cash.		

Notes:
1. $10,000,000 par amount × 6% stated fixed rate of interest.
2. Debt securities balance is increased by discount accretion, which represents the difference between interest income recognized and cash interest.
3. $9.5 million × 7.23% EIR (rounded).

3.4 Structured notes

3.4.10 Overview

Excerpt from ASC 320-10

20 Glossary

Structured Note

A debt instrument whose cash flows are linked to the movement in one or more indexes, interest rates, foreign exchange rates, commodities prices, prepayment rates, or other market variables. Structured notes are issued by U.S. government-sponsored enterprises, multilateral development banks, municipalities, and private entities. The notes typically contain embedded (but not separable or detachable) forward components or option components such as caps, calls, and floors. Contractual cash flows for principal, interest, or both can vary in amount and timing throughout the life of the note based on nontraditional indexes or nontraditional uses of traditional interest rates or indexes.

> Implementation Guidance

• > Structured Note Descriptions

55-10 The following are descriptions of various **structured notes**, using illustrative terms:

a. Dual-index floater. A bond with a coupon rate that is determined by the spread between two different indexes and that usually includes an above-market interest rate in Year 1. These bonds may have a teaser fixed rate for the first period of the bond's life, after which the interest rate floats according to a predetermined formula.
b. Inverse floater. A bond with a coupon rate of interest that varies inversely with changes in specified general interest rate levels or indexes, for example, the London Interbank Offered Rate (LIBOR).
c. Levered inverse floater. A bond with a coupon that varies indirectly with changes in general interest rate levels and that applies a multiplier (greater than 1.00) to the specified index in its calculation of interest.
d. Delevered floater. A bond with a coupon rate of interest that lags overall movements in specified general interest rate levels or indexes.
e. Range floater. A bond in which the investor's coupon is dependent on the number of days that a reference rate stays within a preestablished collar; otherwise, the bond pays either 0% interest or a below-market rate.
f. Lower-of and higher-of floaters. A bond that pays an interest rate stated as the lower of or higher of two different formulas.
g. Ratchet floater. A bond that pays a floating rate of interest and has an adjustable cap and/or floor that moves in sync with each new reset rate.
h. Stepped cap-floor floaters. A bond that pays a floating rate of interest, subject to a scheduled cap, scheduled floor, or both.
i. Floating to floating notes. Varying coupon (first-year LIBOR or U.S. Treasury bill based, second-year prime based).
j. Floating to fixed notes. Varying coupon (first-year coupon is fixed, second- and third-year coupons are based on LIBOR, U.S. Treasury bills, or prime).
k. Indexed amortizing notes. A bond that repays principal based on a predetermined amortization schedule or target value. This value is linked to movements within a specific mortgage-backed security or index. The maturity of the bond changes as the related index changes. This instrument includes a varying maturity.
l. Equity indexed notes. Bond return of interest and/or principal is tied to a specified equity index (for example, the Standard & Poor's S&P 500 Index). This instrument may contain fixed or varying coupon rate and may place all or a portion of principal at risk.
m. Variable principal redemption bond. A bond whose principal redemption value at maturity is dependent on the change in an underlying index over a predetermined observation period. A typical scenario would be a bond that guarantees a minimum par redemption value of 100%, and the potential for a supplemental principal payment at maturity as compensation for the below-market rate of interest offered with the instrument (providing that the bond satisfies the indexing requirements as outlined in the terms of the offering).
n. Yield curve note. Fixed coupon, principal varies as follows: [(5-year swap rate – 3-month $LIBOR – 1%) × 40 + 100%] × par (but not less than zero).

o. Crude oil knock-in notes. 1% coupon, principal guaranteed with upside potential based on the strength of the oil market.
p. Leveraged gold notes. Coupon is zero, variable principal based on the London Gold Index. These notes are designed to incorporate a collar on gold, whereby the investor buys a call and sells a put, in exchange for the coupon.
q. Gold-linked bull note. Fixed 3% coupon, principal is guaranteed with upside potential if the price of gold increases.
r. Equity-linked bear note. Fixed 4% coupon, principal is guaranteed with upside potential if a specified Standard & Poor's index falls.
s. Step-up bonds. Bond provides an introductory above-market yield and the bond then steps up to a new coupon that will be below then-current market rates or, alternatively, the bond may be called.
t. Multi step-ups. A security that pays investors an introductory above-market yield—reflecting an embedded call option—for a short lockout period, and then is either called or steps up to a higher coupon rate (which will be below then-current market rates). These bonds can also take the form of step-down or variable step-up structures.
u. Credit-sensitive bond. A bond that has a coupon rate of interest that resets based on changes in an entity's credit rating.
v. Inflation bond. A bond with a contractual principal amount that is indexed to the inflation rate; the coupon rate is typically below that of traditional bonds of similar maturity.
w. Disaster bond. A bond that pays a coupon above that of traditional bonds; however, a substantial portion or all of the principal amount is subject to loss if a specified disaster occurs.
x. Specific equity-linked bond. A bond that pays a coupon slightly below that of traditional bonds of similar maturity; however, the principal amount is linked to the stock market performance of an equity investee of the issuer. The issuer may settle the obligation by delivering the underlying shares of the equity investee or may deliver the equivalent **fair value** in cash.

Topic 320 requires the recognition of income using the retrospective interest method for certain structured notes. It also provides guidance on when structured notes are to be combined.

Question 3.4.10
What is a structured note?

Interpretive response: A structured note is a debt instrument whose cash flows are linked to the movement in one or more of the following: [320-10 Glossary]

- indexes;
- interest rates;
- foreign exchange rates;
- commodities prices;
- prepayment rates; and/or
- other market variables.

Contractual cash flows for the principal and/or interest of a structured note can vary in amount and timing throughout its life based on nontraditional indexes (or nontraditional uses of traditional interest rates or indexes). [320-10 Glossary]

Structured notes are generally issued by: [320-10 Glossary]

- US government-sponsored enterprises;
- multilateral development banks;
- municipalities; and
- private entities.

See examples of structured notes in paragraph 320-10-55-10 in the above excerpt.

Question 3.4.20
Is an investment in a structured note in the scope of Topic 320?

Interpretive response: It depends. Although some structured notes in their entirety are derivatives in the scope of Topic 815, most structured notes that are debt securities are in the scope of Topic 320. However, many structured notes that are in the scope of Topic 320 are not subject to its structured note guidance.

In our experience, most structured notes contain embedded features (e.g. caps, calls and/or floors) that require bifurcation if the notes are not subsequently measured at fair value with changes reported in earnings (see Question 2.2.70).

If an embedded derivative is bifurcated, the remaining investment host contract after bifurcation is not a structured note and therefore interest income is recognized under Topic 320's general guidance (see section 3.3.40) instead of under the retrospective interest method guidance for structured notes. Further, if the structured note is measured at fair value with changes reported in earnings (e.g. a trading security) it is excluded from the scope of the retrospective interest method guidance for structured notes.

For a complete list of structured notes excluded from the retrospective interest method guidance, see Question 3.4.60.

3.4.20 Combining structured notes

Excerpt from ASC 320-10

> Combinations of Structured Notes

25-19 The following guidance discusses a specific type of transaction in which **structured note** securities are issued in combination with other structured note securities as a unit or a pair for the purpose of achieving a certain strategic investment result for the investor. One strategy involves the purchase of two structured notes with opposite interest rate reset provisions. Under that strategy, the fixed coupon rate or maturity date for each structured note would be determined shortly after issuance depending on movements in market interest rates. Following that reset date, the resulting yields on each of the structured note securities will move in opposite directions; however, the average yield of the two securities will generally reflect the market yield of the combined instruments in effect on the issuance date. See Example 2 (paragraph 320-10-55-20) for a common example of this strategy and of how the structured note transactions can be used to achieve one of many desired accounting results.

25-20 If structured notes are acquired for the type of specified investment strategy described in paragraph 320-10-25-19, then the investor shall account for the two structured note securities as a unit until one of the securities is sold, at which time the notes shall be measured in the same way as a participating interest in paragraph 860-20-40-1A.

> Sales of Combinations of Structured Notes

40-3 As discussed in paragraph 320-10-25-20, if **structured notes** are acquired for the type of specified investment strategy described in paragraph 320-10-25-19, then the investor should account for the two structured note securities as a unit until one of the securities is sold, at which time the notes shall be measured in the same way as a participating interest in paragraph 860-20-40-1A.

> Implementation Guidance

• > Structured Notes Acquired for a Specified Investment Strategy

55-14 This paragraph and the following paragraph address whether an investor should account for the two structured note securities together as a unit or account for each security separately. The following indicators should be considered for purposes of identifying whether two securities should be viewed as being purchased for a specified investment strategy. All of these indicators are not required to exist for the securities to be accounted for as a unit. Judgment is required in reaching a determination.

a. The two securities are related in that their fair values will move in opposite directions based on changes in interest rates on a specified date, or after a specified period after issuance. The fair value changes may be caused by a change in the coupon interest rate of the two securities or by altering the maturities of the securities.
b. The two securities are issued contemporaneously and in contemplation of one another or are issued separately but the terms for their remaining lives are as described in (a).
c. The two securities are issued by the same counterparty and/or the same issuer (or issued by different issuers but structured through an intermediary).
d. The two securities were purchased by the investor for the sole purpose of achieving a desired accounting result, and the transactions considered

individually would serve no valid business purpose or would not be entered into otherwise.

55-15 The substance of the investment strategy provided in Example 2 (see paragraph 320-10-55-20) is that the investor has simply purchased a single market-based security that results in neither a gain nor a loss when the interest rate resets and, as such, the accounting should not reflect something different. However, other factors, such as a change in credit ratings or a change in market rates, may cause a change in fair value of the unit.

Question 3.4.30

When are investments in multiple structured notes combined as a single unit of account?

Interpretive response: When structured notes are issued in combination with others as a unit or a pair to achieve a certain strategic investment result for the investor, the investor accounts for the securities as a combined unit of account. [320-10-25-19 – 25-20]

One example of such a strategy is purchasing two structured notes with opposite interest rate reset provisions. Under that strategy, the fixed coupon rate or maturity date for each structured note is determined shortly after issuance depending on movements in market interest rates. Following that reset date, the resulting yields on each of the structured notes will move in opposite directions although their combined average yield will generally reflect the market yield of the combined instruments on the issuance date.

Paragraph 320-10-55-20 (reproduced below) provides an example of structured notes acquired for a specified investment strategy.

Excerpt from ASC 320-10

> Illustrations

• > Example 2: Structured Notes Acquired for a Specified Investment Strategy

55-20 This Example illustrates the guidance in paragraphs 320-10-25-19 through 25-20. An entity purchases two separate structured notes with opposite interest rate characteristics. The terms of the bonds are described below.

	Maturity	Initial Coupon	Reset Provision
Bond A:			
$ 1 billion face amount	10 years	8.00%	One month after issuance the interest rate resets to 1% if 10-year Treasury bond rates have decreased by 1 basis point since the issuance of Bond A or 15% if Treasury rates have increased by 1 basis point. After the initial reset, the rate is fixed for the remaining term of the bond.
Bond B:			
$1 billion face amount	10 years	8.00%	One month after issuance the interest rate resets to 1% if 10-year Treasury bond rates have increased by 1 basis point since the issuance of Bond B or 15% if Treasury rates have decreased by 1 basis point. After the initial reset, the rate is fixed for the remaining term of the bond.

55-21 If accounted for as separate instruments, the entity could classify the bonds as available-for-sale. (Note that these securities would have to be accounted for as a unit rather than as separate instruments.) After the interest rates on the bonds reset, the entity will sell the bond that is in a loss position recognizing a loss in earnings of $475 million (assuming that the current interest rate is 8 percent). The bond that is in a gain position will have a $475 million unrealized gain in other comprehensive income that will be recognized in earnings as a yield adjustment over the remaining 10-year life of the instrument (assuming no further changes in value).

Question 3.4.40

What indicators are considered when determining whether investments in multiple structured notes represent a single unit of account?

Interpretive response: The following indicators are considered when determining whether securities were issued in combination with others to achieve a certain strategic investment result for the investor and are to be combined into a single unit of account. Judgment is required in making this determination, and not all indicators need be met for structured notes to represent one unit of account. [320-10-55-14]

- The two securities are related in that their fair values will move in opposite directions based on changes in interest rates on a specified date, or after a specified period after issuance. Those movements could be the result of changes in their respective coupon interest rates or in their respective maturities.
- The two securities are issued either (1) contemporaneously and in contemplation of one another or (2) separately but the terms for their remaining lives are as described in the above bullet.

- The two securities are issued by the same counterparty and/or the same issuer or are issued by different issuers but structured through an intermediary.
- The two securities were purchased for the sole purpose of achieving a desired accounting result, and the transactions considered individually would have served no valid business purpose or would not have been entered into otherwise.

Question 3.4.50
When does an investor stop accounting for structured notes as a combined unit of account?

Interpretive response: When an investor combines structured notes into a single unit of account, it stops accounting for them as a single unit of account when it sells one of the structured notes. At that time, the structured notes are measured in the same way as the sale of a participating interest in paragraph 860-20-40-1A. For discussion on how to measure a participating interest, see section 7.2 of KPMG Handbook, Transfers and servicing of financial assets. [320-10-25-20]

3.4.30 Income recognition for certain structured notes

Excerpt from ASC 320-10

> Income Recognition for Certain Structured Notes

35-38 This guidance addresses the accounting for certain structured notes that are in the form of debt securities, but does not apply to any of the following:

a. Mortgage loans or other similar debt instruments that do not meet the definition of a security under this Subtopic
b. Traditional convertible bonds that are convertible into the stock of the issuer
c. Multicurrency debt securities
d. Debt securities classified as trading
e. …
f. Debt securities participating directly in the results of an issuer's operations (for example, participating mortgages or similar instruments)
g. Reverse mortgages
h. **Structured note** securities that, by their terms, suggest that it is reasonably possible that the entity could lose all or substantially all of its original investment amount (for other than failure of the borrower to pay the contractual amounts due). (Such securities shall be subsequently measured at fair value with all changes in fair value reported in earnings.)

Also, this guidance shall be applied to those beneficial interests involving securitized financial assets that do not involve contractual cash flows.

35-39 This guidance does not address the issuer's accounting for structured note securities.

35-40 Entities shall use the **retrospective interest method** for recognizing income on structured note securities that are classified as available-for-sale or held-to-maturity debt securities and that meet any of the following conditions:

a. Either the contractual principal amount of the note to be paid at maturity or the original investment amount is at risk (for other than failure of the borrower to pay the contractual amounts due). Examples include principal-indexed notes that base principal repayment on movements in the Standard & Poor's S&P 500 Index or notes that base principal repayment on the occurrence of certain events or circumstances.
b. The note's return on investment is subject to variability (other than due to credit rating changes of the borrower) because of either of the following:
    1. There is no stated coupon rate or the stated coupon is not fixed or prespecified, and the variation in the return on investment or coupon rate is not a constant percentage of, or in the same direction as, changes in market-based interest rates or interest rate index, for example, the London Interbank Offered Rate (LIBOR) or the U.S. Treasury Bill Index.
    2. The variable or fixed coupon rate is below market rates of interest for traditional notes of comparable maturity and a portion of the potential yield (for example, upside potential for principal) is based on the occurrence of future events or circumstances. (Examples of instruments that meet this condition include inverse floating-rate notes, dual-index floating notes, and equity-linked bear notes.)
c. The contractual maturity of the bond is based on a specific index or on the occurrence of specific events or circumstances outside the control of the parties to the transaction, excluding the passage of time or events that result in normal covenant violations. Examples of instruments that meet this condition include index amortizing notes and notes that base contractual maturity on the price of oil.

35-41 Under the retrospective interest method, the income recognized for a reporting period would be measured as the difference between the amortized cost of the security at the end of the period and the amortized cost at the beginning of the period, plus any cash received during the period. The amortized cost would be calculated as the present value of estimated future cash flows using an effective yield, which is the yield that equates all past actual and current estimated future cash flow streams to the initial investment. If the effective yield is negative (that is, the sum of the newly estimated undiscounted cash flows is less than the security's amortized cost), the amortized cost would be calculated using a zero percent effective yield. Example 1 (see paragraph 320-10-55-16) illustrates the application of the retrospective interest method.

35-42 For purposes of determining the effective yield at which income will be recognized, all estimates of future cash flows shall be based on quoted forward market rates or prices in active markets, when available; otherwise, they shall be based on current spot rates or prices as of the reporting date.

> Implementation Guidance

• > Retrospective Interest Method–Concept and Procedures

55-11 Paragraph 320-10-35-40 requires the **retrospective interest method** to recognize income on certain securities. The amortized cost amount is calculated as the present value of estimated future cash flows using an effective yield, which is the yield that equates all past actual and current estimates of future cash flow streams to the initial investment. If the effective yield is negative, the amortized cost amount should be calculated using a zero percent effective yield. Thus, the following procedures would be required for each reporting period:

a. Calculate the effective yield that equates all past actual cash flows and current estimates of future cash flows to the initial investment amount.
b. Using the rate calculated in (a), or zero percent if negative, calculate the present value of the estimated future cash flows. That amount represents the amortized cost at the end of the period.
c. Adjust the amortized cost balance to the amount calculated in (b) with the offsetting amount recognized as income for the period.

55-12 The preadjusted amortized cost balance should represent the amortized cost balance at the beginning of the period less any cash received on the investment during the period.

55-13 Example 1 (see paragraph 320-10-55-16) illustrates application of the retrospective interest method.

Topic 320 requires an investor to use the retrospective interest method to recognize interest income on certain structured notes. Section 3.3.40 discusses income recognition on structured notes that are not in the scope of the retrospective interest method guidance.

Question 3.4.60
What structured notes are excluded from the scope of Topic 320's retrospective interest method guidance?

Interpretive response: Topic 320's retrospective interest method guidance does not apply to any of the following structured notes: [320-10-35-38]

- mortgage loans or other similar debt instruments that do not meet the definition of a security under Topic 320;
- traditional convertible bonds that are convertible into the stock of the issuer;
- multicurrency debt securities;
- trading debt securities;
- debt securities participating directly in the results of the issuer's operations – e.g. participating mortgages or similar instruments;
- reverse mortgages;

- structured note securities that, by their terms, suggest that it is reasonably possible that the investor could lose all or substantially all of its original investment amount (for other than failure of the borrower to pay the contractual amounts due). These securities are subsequently measured at fair value with changes reported in earnings.

Question 3.4.70
What structured notes are included in the scope of Topic 320's retrospective interest method guidance?

Interpretive response: An entity uses the retrospective interest method for recognizing income on structured notes that: [320-10-35-40]

- are classified as AFS or HTM;
- are not excluded from the scope of the retrospective interest method guidance (see Question 3.4.60); and
- meet any of the conditions in the following table.

Condition	Examples that meet the condition
Either of the following is at risk (for reasons other than the risk of the borrower failing to pay contractual amounts due): • the contractual principal amount of the note to be paid at maturity; or • the original investment amount.	• Principal-indexed notes that base principal repayment on movements in the S&P 500 Index • Notes that base principal repayment on the occurrence of certain events or circumstances
The note's return on investment is subject to variability (other than due to changes in the borrower's credit rating) because of either of the following: • there is no stated coupon rate or the stated coupon is not fixed or pre-specified, and the variation in the return on investment or coupon rate is not a constant percentage of, or in the same direction as, changes in market-based interest rates or interest rate indices – e.g. the US Treasury Bill Index; • the variable or fixed coupon rate is below market rates of interest for traditional notes of comparable maturity and a portion of the potential yield (e.g. upside potential for principal) is based on the occurrence of future events or circumstances.	• Inverse floating-rate notes • Dual-index floating notes • Equity-linked bear notes
The note's contractual maturity is based on a specific index or on the occurrence of specific events or circumstances	• Index amortizing notes

Condition	Examples that meet the condition
outside the control of the parties to the transaction. This condition is not met if the note's contractual maturity is solely based on the passage of time or events that result in normal covenant violations.	• Notes that base contractual maturity on the price of oil

As explained in Question 3.4.20, in our experience, the retrospective interest method is not applied to most structured notes. For example, that method does not apply to trading debt securities or to a remaining investment host contract once embedded derivatives have been bifurcated from it.

Question 3.4.80
How is the retrospective interest method applied?

Interpretive response: Under the retrospective interest method, income recognized for a reporting period is measured using a four-step process. [320-10-55-11 – 55-12]

Step 1	**Calculate the effective yield.** The effective yield is the rate that equates all past actual cash flows and current estimates of future cash flows[1] with the initial investment amount.
Step 2	**Calculate the amortized cost balance at the end of the period.** Using the effective yield (Step 1) – or 0% if negative – calculate the present value of the estimated future cash flows, which represents the amortized cost balance at the end of the period.
Step 3	**Calculate the preadjusted amortized cost balance.** This balance is the amortized cost balance at the beginning of the period less any cash received on the investment during the period.
Step 4	**Recognize interest income.** Adjust the preadjusted amortized cost balance calculated (Step 3) to the amortized cost balance at the end of the period (Step 2), with an offsetting amount recognized as income for the period.

Note:
1. All estimates of future cash flows are based on quoted forward market rates or prices in active markets, when available. Otherwise, the estimates are based on current spot rates or prices as of the reporting date. [320-10-35-42]

Examples

The following examples illustrate the retrospective method.

- Subtopic 320-10 Example 1 – a structured note that repays a principal amount based on the performance of the S&P 500 Index.
- Example 3.4.10 – a structured note with principal repayment based on an index but that cannot decrease below par.

Excerpt from ASC 320-10

> Illustrations

• > Example 1: Assumptions and Calculation of Income Recognized under the Retrospective Interest Method

55-16 This Example illustrates the guidance in paragraphs 320-10-35-38 through 35-43. This Example has the following assumptions:

a. The investor purchases a 3-year, $100 par value structured note at par.
b. The principal to be repaid at maturity is based on the performance of the Standard & Poor's S&P 500 Index, which, based on current Standard & Poor's S&P Futures indexes, is expected to provide the investor with principal of $106 at the end of Year 3, and the coupon interest on the note is fixed at 6 percent per year.
c. On the acquisition date of the note, the investor expects the following cash flows and income to be recognized over the life of the note.

Period	Cash Flows	Income recognized	Noncash Income	Ending Amortized Cost
Acquisition	$(100)			
Year 1	6	$7.85	$1.85	$101.85
Year 2	6	8.00	2.00	103.85
Year 3	112	8.15	2.15	-

These cash flows produce an effective yield of 7.85 percent.

55-17 At the end of Year 1, assume the investor expects to receive only $80 in principal at the end of Year 3, which results in a negative effective yield of 0.71 percent over the life of the note (assume that the investor concludes that a credit loss has not occurred). Accordingly, the amortized cost amount must be reduced to the present value of the estimated future cash flows using a zero percent effective yield, or $92, at the end of Year 1. The income recognized in Year 1 is negative $2 (the amortized cost amount at the end of Year 1 in the table below of $92 less the amortized cost amount at the beginning of the year of $100 plus cash received during the year of $6). The cash flow and income recognition table as of the end of Year 1 is as follows.

Period	Cash Flows	Income Recognized	Noncash Income	Negative Yield Adjustment Recognized	Ending Amortized Cost
Acquisition	$(100)				
Year 1	6	$7.85	$1.85	$(9.85)	$92

Year 2	6	-	(6)	-	86
Year 3	86	-	(6)	-	-

55-18 These cash flows produce an effective yield of negative 0.71 percent.

55-19 At the end of Year 2, assume the S&P 500 Index market reverses and the investor now expects to receive the same cash flows that it expected upon acquisition of the note. Using the first table above, the investor would increase the amortized cost amount of the note to $103.85 at the end of Year 2, which would result in recognizing income of $17.85 in Year 2 (amortized cost from the first table at the end of Year 2 of $103.85 less the amortized cost from the second table at the end of Year 1 of $92 plus cash received in Year 2 of $6).

Example 3.4.10

Application of the retrospective interest method for structured note with principal repayment based on an index but cannot decrease below par

On January 1, Year 1, Investor purchased a three-year, nonprepayable $100 structured note at par. Principal on the structured note is due at maturity, December 31, Year 3. The principal amount paid at maturity is based on the change in an index but cannot decrease below par. The structured note also has a stated fixed interest rate of 6% that is paid at the end of each year.

There is a quoted forward market rate on the index. Based on the forward market rate of the index on January 1, Year 1, the note is estimated to pay principal of $106 at maturity. The structured note meets the conditions for the retrospective interest method because the contractual principal amount to be paid at maturity is at risk for reasons other than the risk of the borrower failing to pay contractual amounts due (i.e. based on a specific index).

The structured note's fair value on the trade date was its purchase price of $100. Investor concludes that there are no embedded features in the structured note that require bifurcation and separate accounting. For simplicity, this example disregards transaction costs.

On January 1, Year 1, Investor initially recognizes the structured note for $100. Investor has the positive intent and ability to hold this investment to maturity and classifies it as HTM.

Interest income recognition – Year 1

Investor determines that the bond's EIR is 7.85% (rounded) – i.e. that is the EIR that equates the structured note's contractual and estimated cash flows with its initial amortized cost.

Year	Contractual interest cash flows	Current estimate of future principal cash flow	Total cash flows
1	$ 6.00		$ 6.00
2	6.00		6.00
3	6.00	$106.00	112.00
Total	**$18.00**	**$106.00**	**$124.00**
	Initial amortized cost		**$100.00**
	EIR (rounded)		**7.85%**

The following table represents the projected amortization schedule for the structured note's amortized cost based on its contractual and estimated cash flows.

	Debit	*Credit*
Interest receivable[1]	6.00	
Debt security – HTM[2]	1.85	
Interest income[3]		7.85
To recognize interest income using interest method.		
Cash	6.00	
Interest receivable		6.00
To record receipt of cash.		

Notes:
1. $100 par amount × 6% stated fixed rate of interest.
2. Debt securities balance is increased by the difference between interest income recognized and contractual interest cash flow.
3. $100 million × 7.85% EIR (rounded).

Interest income recognition – Year 2

On December 31, Year 2, based on the forward market rate of the index, ABC expects to receive $100 in principal at maturity of the note, instead of $106. Also on that day, Investor receives the $6 contractually due interest on the structured note. Investor uses the four-step approach described in Question 3.4.80 to determine the amount of income to recognize in Year 2.

Step 1	**Calculate the effective yield.** The effective yield is the rate that equates all past actual cash flows and current estimates of future cash flows[1] with the initial investment amount.

Investor determines that the bond's revised EIR is 6% – i.e. the EIR that equates the structured note's past actual and current estimates of future cash flows with its initial amortized cost.

Year	Contractual interest cash flows	Current estimate of future principal cash flow	Actual past and current estimates of future cash flows
1	$ 6.00		$ 6.00
2	6.00		6.00
3	6.00	$100.00	106.00
Total	**$18.00**	**$100.00**	**$118.00**
	Initial amortized cost		**$100.00**
	Revised EIR		**6.00%**

Step 2	**Calculate the amortized cost balance at the end of the period.** Using the effective yield (Step 1) – or 0% if negative – calculate the present value of the estimated future cash flows, which represents the amortized cost balance at the end of the period.

The amortized cost balance at December 31, Year 2 is calculated as $100, which is the present value of the estimated remaining cash flows (i.e. interest to be received in Year 3, and payment of $100 principal on December 31, Year 3) using the revised effective yield of 6%.

Step 3	**Calculate the preadjusted amortized cost balance.** This balance is the amortized cost balance at the beginning of the period less any cash received on the investment during the period.

The preadjusted amortized cost balance is $95.85, which is the balance at the beginning of the period of $101.85 (i.e. the balance at the end of Year 1) less the contractual interest received on December 31, Year 2 of $6.

Step 4	**Recognize interest income.** Adjust the preadjusted amortized cost balance calculated (Step 3) to the amortized cost balance at the end of the period (Step 2), with an offsetting amount recognized as income for the period.

The interest income recognized in Year 2 is $4.15. This is the amount necessary to adjust the preadjusted amortized cost balance of $95.85 (see Step 3) with what the amortized cost balance is required to be at the end of the period of $100 (see Step 2).

The following table represents the amortization schedule for the structured note's amortized cost based on its past actual and current estimated future cash flows at December 31, Year 2.

Year	Amortized cost beginning balance	Actual past and current estimates of future cash flows [1]	Interest income[2]	Amortized cost ending balance[3]
1	$100.00	$ 6.00	$ 7.85	$101.85
2	101.85	6.00	4.15	100.00

Year	Amortized cost beginning balance	Actual past and current estimates of future cash flows [1]	Interest income[2]	Amortized cost ending balance[3]
3	100.00	106.00	6.00	0.00
Total		**$118.00**	**$18.00**	

Notes:
1. Interest payments of $6 at the end of each year ($100 par amount × 6% stated fixed rate of interest) and $100 estimated principal payment at December 31, Year 3 (maturity).
2. Beginning amortized cost balance × the revised EIR of 6.00%.
3. Amortized cost beginning balance – actual past and current estimates of future cash flows + interest income.

Investor records the following journal entries related to recognizing interest income and collecting contractual interest for Year 2.

	Debit	*Credit*
Interest receivable[1]	6.00	
Debt security – HTM[2]		1.85
Interest income[3]		4.15
To recognize interest income using interest method.		
Cash	6.00	
Interest receivable		6.00
To record receipt of cash.		

Notes:
1. $100 par amount × 6% stated fixed rate of interest.
2. Debt securities balance is increased by the difference between interest income recognized and cash interest.
3. $100 million × 7.85% EIR (rounded).

3.5 Derecognition

Excerpt from ASC 320-10

> Accounting for Sales of Securities

40-1 Section 860-10-40 provides guidance on determining whether a transfer of **securities** shall be accounted for as a sale. With respect to **trading securities**, because all changes in a trading security's **fair value** are reported in earnings as they occur, the sale of a trading security does not necessarily give rise to a gain or loss. Generally, a debit to cash (or trade date receivable) is recorded for the sales proceeds, and a credit is recorded to remove the security at its fair value (or sales price). If the entity is not taxed on the changes in fair value, the deferred tax accounts would be adjusted. Some adjustment to this procedure will be necessary for entities that have not yet recorded the security's change in fair value up to the point of sale (perhaps because fair value changes are recorded at the end of each day).

40-2 Although entities have different bookkeeping methods for **available-for-sale securities**, generally, a sale of an available-for-sale security shall be recorded by a debit to cash (or trade date receivable) for the sales proceeds, and a credit to remove the security at its fair value (or sales price). The amount recorded in other comprehensive income, representing the unrealized gain or loss at the date of sale, is reversed into earnings, and the deferred tax accounts are adjusted. Some adjustment to this procedure will be necessary for entities that have not yet recorded the security's change in fair value up to the point of sale (perhaps because fair value changes are recorded at the end of each interim period) or when write-downs have been recognized.

An entity applies the guidance in Topic 860 to determine if the transfer of a debt security qualifies as a sale, thereby requiring that the security be derecognized. KPMG Handbook, Transfers and servicing of financial assets, provides guidance on the transfer of financial assets.

Question 3.5.10
Does derecognition of an investment in a debt security result in recognition of a gain or loss?

Interpretive response: Not necessarily; it depends on how the debt security is classified. [320-10-40-1 – 40-2]

Classification	Subsequent measurement	Gain or loss recognized upon derecognition?
Trading	Fair value with changes reported in earnings	Because trading debt securities are measured at fair value with changes in fair value reported earnings, there is generally not a gain or loss on derecognition.
AFS	Fair value with changes recognized in OCI	Because changes in the fair value of AFS debt securities are recognized in OCI instead of earnings, there will generally be a gain or loss on derecognition. See Question 3.7.80 for related disclosures.
HTM	Amortized cost	Because HTM debt securities are not recognized at fair value on the balance sheet, there will generally be a gain or loss upon derecognition. However, if sold, entities will need to consider the effect of tainting on the HTM portfolio (see section 4.2.40).

Question 3.5.20
When an AFS debt security is sold, how is the unrealized gain or loss (and related reclassification from AOCI to earnings) reported?

Background: Unrealized gains or losses in AOCI related to AFS debt securities that have been sold are reclassified to net income in the period the realized gain or loss is reported in net income. [320-10-40-2, 220-10-45-15]

See section 5.4 of KPMG Handbook, Financial statement presentation, for guidance relating to presentation and disclosure of AOCI.

Interpretive response: We believe there are two acceptable policies that an entity can elect. The policy should be consistently applied and disclosed. [320-10-40-2]

- **Remeasure the AFS debt security to its fair value immediately before recognizing the sale.** Under this approach, the change in fair value during the period is reported in OCI and then the amount to be reclassified from AOCI to earnings is determined. This results in a gross presentation of the change in fair value during the reporting period.
- **Do not remeasure the AFS debt security to its fair value immediately before recognizing the sale.** Under this approach, the entity does not record the change in the security's fair value during the period of the sale. Instead, only changes from the beginning balance of AOCI (i.e. the AOCI reported at the preceding reporting date) are reclassified to earnings. This results in a net presentation of amounts related to the change in fair value during the reporting period.

Example 3.5.10
Reclassifying amounts from AOCI to earnings

On December 31, Year 1, ABC Corp holds an AFS debt security with an unrealized gain of $50. On January 30, Year 2, immediately prior to sale, the AFS debt security had appreciated by an additional $10 (i.e. had an unrealized gain of $60). The following tables illustrate the amounts presented in the statement of comprehensive income, depending on ABC's accounting policy for determining the unrealized gain and related reclassification from AOCI to earnings. ABC has also elected to present significant amounts reclassified, in their entirety, to net income on the face of the statement of operations and comprehensive income. For simplicity, the tax effect has not been considered. [220-10-45-15, 45-17]

Scenario 1: ABC's accounting policy is to remeasure the AFS debt security to its fair value immediately before recognizing the sale

	Year 1	Year 2
Gain on sale of securities (includes $60 AOCI reclassifications for unrealized net gains on AFS debt securities)	$0	$60
Net income	**0**	**60**
Other comprehensive income		
Unrealized holding gain – debt security	50	10
Reclassification adjustment for gains included in net income	0	(60)
Other comprehensive income	**50**	**(50)**
Comprehensive income	**50**	**10**

Scenario 2: ABC's accounting policy is to not remeasure the AFS debt security to its fair value immediately before recognizing the sale

	Year 1	Year 2
Gain on sale of securities (includes $50 AOCI reclassifications for unrealized net gains on AFS debt securities)	$0	$60
Net income	**0**	**60**
Other comprehensive income		
Unrealized holding gain – debt security	50	0
Reclassification adjustment for gains included in net income	0	(50)
Other comprehensive income	**50**	**(50)**
Comprehensive income	**50**	**10**

3.6 Presentation

3.6.10 Balance sheet classification

Excerpt from ASC 320-10

> Balance Sheet Classification

45-1 An entity shall report its investments in **available-for-sale securities** and **trading securities** separately from similar assets that are subsequently measured using another measurement attribute on the face of the statement of financial position. To accomplish that, an entity shall do either of the following:

a. Present the aggregate of those **fair value** and non-fair-value amounts in the same line item and parenthetically disclose the amount of fair value included in the aggregate amount
b. Present two separate line items to display the fair value and non-fair-value carrying amounts.

Entities also shall refer to the guidance in paragraph 825-10-45-1A on disaggregation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables).

45-2 An entity that presents a classified statement of financial position shall report individual held-to-maturity securities, individual available-for-sale securities, and individual trading securities as either current or noncurrent, as appropriate, under the guidance of Section 210-10-45.

Question 3.6.10

How are investments in debt securities disaggregated on the balance sheet?

Excerpt from ASC 825-10

> Statement of Financial Position

• > Disaggregation of Financial Assets and Financial Liabilities by Measurement Category and Form of Financial Asset

45-1A An entity shall separately present **financial assets** and **financial liabilities** by measurement category and form of financial asset (that is, securities or loans and receivables) in the statement of financial position or the accompanying notes to the financial statements.

Interpretive response: On the balance sheet, an entity is required to distinguish debt securities that are subsequently measured at fair value (i.e. those classified as AFS and trading) from those that are subsequently measured at amortized cost (i.e. HTM). An entity can make that distinction by either of the following presentations: [320-10-45-1]

- present debt securities in the aggregate on the balance sheet with parenthetical disclosure of the amount of fair value included in the aggregate amount; or
- present two (or more) separate line items to display those subsequently measured at fair value and those subsequently measured at amortized cost.

An entity also needs to distinguish between different measurement categories (e.g. separately distinguish AFS from trading debt securities) and forms of financial assets (e.g. separately distinguish securities from loans). An entity can make those distinctions either through separate presentation on the balance sheet or disclosure in the notes to the financial statements. [825-10-45-1A]

Question 3.6.15**

In a classified balance sheet, are marketable debt securities classified as current or noncurrent?

Excerpt from ASC 210-10

20 Glossary

Current assets

Current assets is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. See paragraphs 210-10-45-1 through 45-4.

> Classification of Current Assets

45-1 Current assets generally include all of the following:…

f. Marketable securities representing the investment of cash available for current operations...

Interpretive response: An entity presents its investments in marketable debt securities as current or noncurrent on the balance sheet based on the guidance in Topic 210 (balance sheet). [210-10-45]

For a security that pays all principal amounts at maturity, we believe the appropriate presentation depends on how the investment is classified – as trading, AFS or HTM – as summarized in the following table. We believe similar considerations apply to a security that pays principal amounts over its contractual term, except that the portion of the debt security that is contractually due within one year (or the entity's normal operating cycle, if longer) is presented as current even if that security is otherwise presented as noncurrent. [320-10-45-2]

Classification	Presented as current or noncurrent?[1]
Trading or AFS	We believe any of the following three approaches are acceptable as an accounting policy that is applied consistently. When applying these approaches, an entity's assertions should be consistent with the assertions made for other purposes (e.g. intent to sell assertions for determining whether an impaired AFS security should be written down). • **Present marketable debt securities as current if the entity reasonably expects to sell or redeem them within one year (or its normal operating cycle if longer) to fund current operations.** This approach focuses on the definition of current assets. [210-10-20]

Classification	Presented as current or noncurrent?[1]
	• **Present marketable debt securities as current if they represent the investment of cash available for current operations.** A marketable debt security is presented as current if it is available to fund current operations, regardless of whether the entity reasonably expects to sell or redeem it within one year (or normal operating cycle if longer) to fund current operations. This approach focuses on the inclusion of marketable securities in the list of assets generally included in current assets in paragraph 210-10-45-1. [210-10-45-1(f)] **Present based on the security's contractual maturity.** A marketable debt security is presented as current if the contractual maturity is within a year (or the normal operating cycle if longer).
HTM	We believe an HTM security should be presented based on its contractual maturity (or call date if exercise of the call within a year, or normal operating cycle, is probable), which is consistent with the assertion that the entity has the intent and ability to hold the security to maturity. Therefore, the security is presented as current if the contractual maturity, or probable call date, is within a year (or the normal operating cycle if longer).

Note:

1. Investments in securities (whether marketable or not) or advances that have been made are excluded from current assets if they are for the purposes of control, affiliation or other continuing business advantage. [210-10-45-4(b)]

3.6.20 Income statement classification

Excerpt from ASC 320-10

> Income Statement Classification

45-7 This Subtopic does not specify the income statement classification of gains and losses for transfers involving trading securities. However, gains and losses that have accumulated before the transfer shall be classified consistently with realized gains and losses for the category from which the security is being transferred, not the category into which the **security** is being transferred.

• > Tax Effects of Unrealized Holding Gains and Losses

45-10 Paragraph 740-20-45-11(b) provides guidance on reporting the tax effects of unrealized holding gains and losses reported in other comprehensive income.

Question 3.6.20
How are gains and losses arising from transfers to and from trading securities classified?

Interpretive response: Topic 320 does not specify the income statement classification of gains and losses for transfers involving trading securities. However, it requires an entity to classify gains and losses that accumulated before the transfer consistently with realized gains and losses for the category the security is transferred from (i.e. not based on the category the security is transferred into). [320-10-45-7]

3.6.30 Cash flow presentation

Excerpt from ASC 320-10

> Cash Flow Presentation

45-11 Cash flows from purchases, sales, and maturities of available-for-sale securities and held-to-maturity securities shall be classified as cash flows from investing activities and reported gross for each security classification in the statement of cash flows. Cash flows from purchases, sales, and maturities of trading securities shall be classified based on the nature and purpose for which the securities were acquired.

45-12 Paragraph 230-10-45-8 permits reporting activity in **cash equivalents** as a net change. However, securities that are considered cash equivalents are subject to the accounting and disclosure requirements of this Subtopic, such as disclosure of amortized cost and fair value by major security types.

45-13 This Subtopic does not require the presentation of individual amounts for the three categories of investments on the face of the statement of financial position, provided the information is disclosed in the notes. Thus, entities that report certain investments in debt securities as cash equivalents in accordance with the provisions of Topic 230 can continue that practice, provided that the notes reconcile the reporting classifications used in the statement of financial position.

Question 3.6.30
How are a debt security's cash flows classified?

Interpretive response: For debt securities that are not cash equivalents, the security's classification under Topic 320 affects the classification of its cash flows under Subtopic 825-10 (financial instruments) and Topic 230 (statement of cash flows).

Classification	Classification of cash flows from/for purchases, sales and maturities
Trading	It depends on the nature and purpose for which the security was acquired. [230-10-45-19, 320-10-45-11] • **Operating:** An investor that actively buys and sells debt securities with the intended purpose of generating trading profits in the short term classifies cash flows from those transactions as operating activities. • **Investing:** An investor whose investment objective and strategy is not to engage in such trading activities (i.e. the securities are designated, instead of defined, as trading) classifies cash flows from purchases and sales of those trading debt securities as investing activities.
AFS	**Investing** activities [320-10-45-11]
HTM	**Investing** activities [320-10-45-11]

For additional discussion on the classification of cash flows for debt securities, see section 9.2 of KPMG Handbook, Statement of cash flows.

3.7 Disclosure

Excerpt from ASC 320-10

50-1 This Section provides disclosure guidance on information about **debt securities** that is required to be presented in the financial statements.

50-1A The disclosures in this Section are required for all interim and annual periods when complete sets of financial statements are provided by an entity. The disclosures in this Section are not required when an entity provides summarized interim financial information. The minimum disclosure requirements for summarized interim financial information issued by publicly traded entities are established in paragraph 270-10-50-1.

3.7.10 Disclosures required for interim financial statements

Question 3.7.10
Are disclosures in Topic 320 required in interim financial statements?

Excerpt from ASC 270-10

> Disclosure of Summarized Interim Financial Data by Publicly Traded Companies

50-1 Many **publicly traded companies** report summarized financial information at periodic interim dates in considerably less detail than that provided in annual financial statements. While this information provides more timely information than would result if complete financial statements were issued at the end of each interim period, the timeliness of presentation may be partially offset by a reduction in detail in the information provided. As a result, certain guides as to minimum disclosure are desirable. (It should be recognized that the minimum disclosures of summarized interim financial data required of publicly traded companies do not constitute a fair presentation of financial position and results of operations in conformity with generally accepted accounting principles [GAAP].) If publicly traded companies report summarized financial information at interim dates (including reports on fourth quarters), the following data should be reported, as a minimum: …

n. The information about certain investments in debt and equity securities as required by Sections 320-10-50, 321-10-50, and 942-320-50

Interpretive response: Yes, the disclosures in Topic 320 are required when: [320-10-50-1A, 270-10-50-1]

- an entity provides a complete set of interim financial statements; or
- a publicly traded company provides summarized interim financial information.

3.7.20 Disclosures required for each balance sheet presented

Excerpt from ASC 320-10

50-1B Major security types shall be based on the nature and risks of the security. In determining whether disclosure for a particular security type is necessary and whether it is necessary to further separate a particular security type into greater detail, an entity shall consider all of the following:

a. (Shared) activity or business sector
b. Vintage
c. Geographic concentration
d. Credit quality
e. Economic characteristic.

> Securities Classified as Available for Sale

50-2 For securities classified as available for sale, all reporting entities shall disclose all of the following by major security type as of each date for which a statement of financial position is presented:

a. Amortized cost basis
aa. Aggregate **fair value**
aaa. Total allowance for credit losses
b. Total unrealized gains for securities with net gains in accumulated other comprehensive income
c. Total unrealized losses for securities with net losses in accumulated other comprehensive income
d. Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented.

50-2A If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the fair value and amortized cost basis of the available-for-sale debt security, an entity may, as a practical expedient, exclude the applicable accrued interest that is included in the amortized cost basis for the purposes of the disclosure requirements in paragraph 320-10-50-2. If an entity elects this practical expedient, it shall disclose the total amount of accrued interest, net of the allowance for credit losses (if any), excluded from the disclosed amortized cost basis.

50-3 Maturity information may be combined in appropriate groupings. In complying with this requirement, financial institutions (see paragraph 942-320-50-1) shall disclose the fair value and the net carrying amount (if different from fair value) of debt securities on the basis of at least the following four maturity groupings:

a. Within one year
b. After one year through five years
c. After 5 years through 10 years
d. After 10 years.

Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately rather than allocated over several maturity groupings; if allocated, the basis for allocation also shall be disclosed.

> Securities Classified as Held to Maturity

50-5 All reporting entities shall disclose the following for securities classified as held to maturity by major security type as of each date for which a statement of financial position is presented:

a. Amortized cost basis …
aaa. Total allowance for credit losses …
d. Net carrying amount …

e. Gross gains and losses in accumulated other comprehensive income for any derivatives that hedged the forecasted acquisition of the held-to-maturity securities
f. Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented. (Maturity information may be combined in appropriate groupings. In complying with this requirement, financial institutions [see paragraph 942-320-50-1] shall disclose the net carrying amount of debt securities on the basis of at least the following four maturity groupings:
   1. Within one year
   2. After one year through five years
   3. After 5 years through 10 years
   4. After 10 years.

Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately rather than allocated over several maturity groupings; if allocated, the basis for allocation also shall be disclosed.)

50-5A A **public business entity** shall disclose the following information for securities classified as held to maturity, by major security type, as of each date for which a statement of financial position is presented:

a. Aggregate fair value
b. Gross unrecognized holding gains
c. Gross unrecognized holding losses.

50-5B A financial institution that is a public business entity shall disclose the fair value of the debt securities classified as held to maturity, by major security type, on the basis of at least the following four maturity groupings:

a. Within 1 year
b. After 1 year through 5 years
c. After 5 years through 10 years
d. After 10 years.

Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately rather than allocated over several maturity groupings; if allocated, the basis for allocation also shall be disclosed.

50-5C If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from the amortized cost basis of held-to-maturity securities, an entity may, as a practical expedient, exclude the accrued interest receivable balance that is included in the amortized cost basis of the held-to-maturity securities for the purposes of the disclosure requirements in paragraph 320-10-50-5. If an entity applies this practical expedient, it shall disclose the total amount of accrued interest, net of the allowance for credit losses (if any), excluded from the disclosed amortized cost basis.

Question 3.7.20
What disclosures are required for investments in debt securities for each balance sheet presented?

Interpretive response: For trading debt securities, there are no required disclosures under Topic 320 for each balance sheet presented (see Question 3.7.30 for disclosure considerations under other Topics). For AFS and HTM debt securities, the required disclosures depend on the debt security's classification and are summarized in the following table. The disclosures are disaggregated by major security type (see Question 3.7.40) and are provided for each date that a balance sheet is presented, unless otherwise noted. [320-10-50-1 – 50-2, 50-5 – 50-5C]

Required disclosures	Applicable for AFS debt securities?	Applicable for HTM debt securities?
Amortized cost basis	Yes	Yes
Aggregate fair value	Yes	Yes for PBEs only
Total allowance for credit losses	Yes	Yes
Gross unrealized gains[1]	Yes	Yes for PBEs only
Gross unrealized losses[1]	Yes	Yes for PBEs only
Information about contractual maturities of the investments in debt securities as of the most recent balance sheet presented (see Questions 3.7.50 and 3.7.60)	Yes	Yes
Net carrying amount[2]	Yes[3]	Yes
Gross gains and losses in AOCI for any derivatives that hedged the forecasted acquisition of the HTM securities	No	Yes
Total amount of accrued interest, net of the allowance for credit losses (if any), excluded from the disclosed amortized cost basis	Yes, if applicable[4]	Yes, if applicable[4]

Notes:

1. Unrealized gains and losses are reported in OCI (and accumulated in AOCI) for AFS debt securities and are not recognized for HTM debt securities.
2. Fair value (for AFS debt securities) or amortized cost basis (for HTM debt securities) adjusted for any allowance for credit losses.
3. Financial institutions are required to disclose the net carrying amount of AFS debt securities, if different from fair value, in their disclosures about contractual maturities (see Question 3.7.60).

4. An entity provides this disclosure if it elects (as a practical expedient) to exclude accrued interest from the amortized cost balance (and from the fair value of AFS securities) when identifying and measuring impairment. For additional discussion about the practical expedient, see sections 19.4.30 and 24.3.10 of KPMG Handbook, Credit impairment.

Question 3.7.30

Are there requirements in Topics other than Topic 320 that may require disclosing information about a debt security?

Interpretive response: Yes. An entity also provides disclosures required by other relevant Topics. For example, an investor considers disclosure requirements in:

Topic	KPMG Handbook reference
Topic 275 (risks and uncertainties)	Chapter 7, Financial statement presentation
Topic 326 (financial instruments – credit losses)	Chapter 24, Credit impairment
Topic 820 (fair value measurements)	Section N, Fair value measurement
Topic 825 (financial instruments)	Chapter 6, Fair value option
Topic 855 (subsequent events)	Chapter 9, Financial statement presentation

Question 3.7.40

How are 'major security types' for investments in debt securities determined?

Interpretive response: Major security types are based on the nature and risks of the investment in a debt security. The factors to consider when identifying major security types include: [320-10-50-1B]

- (shared) activity or business sector;
- vintage;
- geographic concentration;
- credit quality;
- economic characteristic.

These factors are also used to determine whether it is necessary to further separate a particular security type into greater detail. For example, an entity may initially determine that government obligations should be separated from corporate obligations. It may then further disaggregate for geographic concentration – e.g. US corporate obligations versus foreign corporate obligations.

Question 3.7.50
Can information about the contractual maturities be combined into appropriate groupings?

Interpretive response: Yes. Topic 320 permits combining maturity information in appropriate groupings. Topic 320 also specifies minimum appropriate groupings for financial institutions; see Question 3.7.60. [320-10-50-3, 50-5]

Question 3.7.60
What information about contractual maturities must financial institutions provide?

Interpretive response: For financial institutions in the scope of Topic 942 (depository and lending), Topic 320 specifies what information about contractual maturities is to be provided and minimum maturity groupings. [320-10-50-3, 50-5(f), 50-5B]

Required information about contractual maturities	• AFS debt securities: – fair value – net carrying amount (if different from fair value) • HTM debt securities held by financial institutions that are public business entities: – net carrying amount – fair value • HTM debt securities held by financial institutions that are not public business entities: – net carrying amount
Minimum maturity groupings[1]	• Within 1 year • After 1 year through 5 years • After 5 years through 10 years • After 10 years

Note:
1. Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately instead of allocated over several maturity groupings. If they are allocated, the basis for allocation is also disclosed. [320-10-50-3, 50-5(f), 50-5B]

Question 3.7.70
Does the SEC have guidance on disclosure requirements for debt securities?

Excerpt from Reg S-X Rule 5-02

Balance sheets

The purpose of this rule is to indicate the various line items and certain additional disclosures which, if applicable, and except as otherwise permitted by the Commission, should appear on the face of the balance sheets or related notes filed for the persons to whom this article pertains (see § 210.4–01(a)).

Assets and Other Debits

Current Assets, when appropriate

2. *Marketable securities.* The accounting and disclosure requirements for current marketable equity securities are specified by generally accepted accounting principles. With respect to all other current marketable securities, state, parenthetically or otherwise, the basis of determining the aggregate amount shown in the balance sheet, along with the alternatives of the aggregate cost or the aggregate market value at the balance sheet date.

12. *Other investments.* The accounting and disclosure requirements for non-current marketable equity securities are specified by generally accepted accounting principles. With respect to other security investments and any other investment, state, parenthetically or otherwise, the basis of determining the aggregate amounts shown in the balance sheet, along with the alternate of the aggregate cost or aggregate market value at the balance sheet date.

Interpretive response: Reg S-X requires a public entity to disclose the basis of determining the aggregate amount shown in the balance sheet for current and noncurrent marketable securities, along with either the aggregate cost or aggregate fair value at the reporting date. [S-X Rule 5-02(2), (12)]

3.7.30 Disclosures required for each income statement presented

Excerpt from ASC 320-10

> Sales, Transfers, and Related Matters That Occurred during the Period

50-9 For each period for which the results of operations are presented, an entity shall disclose all of the following:

a. The proceeds from sales of **available-for-sale securities** and the gross realized gains and gross realized losses that have been included in earnings as a result of those sales
b. The basis on which the cost of a security sold or the amount reclassified out of accumulated other comprehensive income into earnings was determined (that is, specific identification, average cost, or other method used)
c. The gross gains and gross losses included in earnings from transfers of securities from the available-for-sale category into the **trading** category
d. The amount of the net unrealized **holding gain or loss** on available-for-sale securities for the period that has been included in accumulated other comprehensive income and the amount of gains and losses reclassified out of accumulated other comprehensive income into earnings for the period
e. The portion of trading gains and losses for the period that relates to **trading securities** still held at the reporting date.

50-10 For any sales of or transfers from securities classified as held-to-maturity, an entity shall disclose all of the following in the notes to the financial statements for each period for which the results of operations are presented:

a. The net carrying amount of the sold or transferred security
b. The net gain or loss in accumulated other comprehensive income for any derivative that hedged the forecasted acquisition of the held-to-maturity security
c. The related realized or unrealized gain or loss
d. The circumstances leading to the decision to sell or transfer the security. (Such sales or transfers should be rare, except for sales and transfers due to the changes in circumstances identified in paragraph 320-10-25-6(a) through (f).)

50-11 Paragraph 320-10-25-14 sets forth the conditions under which sales of debt securities may be considered as maturities for purposes of the disclosure requirements under paragraph 320-10-50-10.

50-12 All sales or transfers of held-to-maturity securities are subject to the disclosure requirements of paragraph 320-10-50-10, regardless of the treatment of remaining held-to-maturity securities.

Question 3.7.80
What information is disclosed about sales, transfers and related matters that occurred during each income statement presented?

Interpretive response: An entity is required to disclose all of the following: [320-10-50-9]

- the proceeds from sales of AFS debt securities and the related gross realized gains and gross realized losses reported in earnings;
- the basis on which the cost of a security sold or the amount reclassified from AOCI into earnings was determined (e.g. specific identification, average cost or other method used);
- the gross gains and gross losses reported in earnings from transfers of securities from the AFS category into the trading category;
- the amount of the net unrealized holding gains or losses on AFS debt securities included in AOCI and the amount of gains and losses reclassified out of AOCI into earnings; and
- the portion of trading gains (losses) for the period that relates to trading securities still held at the reporting date (see Question 3.7.90).

Question 3.7.100 discusses incremental disclosures required for sales of, or transfers from, HTM debt securities.

Question 3.7.90
How are unrealized gains (losses) recognized during the reporting period on trading securities still held at the reporting date calculated?

Excerpt from ASC 320-10

> Sales, Transfers, and Related Matters That Occurred during the Period

50-14 The portion of trading gains and losses for the period related to trading securities still held at the reporting date (required by paragraph 320-10-50-9(e)) is calculated as follows.

Net gains and losses recognized during the period on trading securities	$105
Less: Net gains and losses recognized during the period on trading securities *sold* during the period	(80)
Unrealized gains and losses recognized during the reporting period on trading securities *still held* at the reporting date	$25

Interpretive response: An entity discloses the portion of the unrealized gain or loss for the period that relates to trading securities still held at the reporting date. Such amount may be calculated as the net gains and losses reported during the period less the net gains or losses reported during the period on trading securities sold during the period. [320-10-50-14]

Question 3.7.100
Does Topic 320 require disclosures about sales of, or transfers from, HTM debt securities?

Interpretive response: Yes. For sales of, or transfers from, debt securities classified as HTM, Topic 320 requires an entity to disclose the following information for each income statement presented: [320-10-50-10]

- the net carrying amount of the sold or transferred security;
- the net gain or loss in AOCI for any derivative that hedged the forecasted acquisition of the HTM debt security;
- the related realized or unrealized gain or loss; and
- the circumstances leading to the decision to sell or transfer the security.

These disclosures are not required for sales that are considered maturities (see Question 4.2.200). [320-10-50-11]

Question 3.7.110
Are the disclosures about sales of, or transfers from, HTM debt securities required if the remaining HTM debt securities were reclassified to AFS debt securities?

Interpretive response: Yes. All sales or transfers of HTM debt securities are subject to those disclosure requirements other than sales that are considered maturities (see Question 3.7.100), regardless of the treatment of the remaining HTM debt securities. [320-10-50-12]

4. Classification of debt securities

Detailed contents

New item added to this edition: **
Items significantly updated in this edition: #

Example

4.1 How the standard works

A debt security's classification dictates its accounting treatment as well as presentation and disclosure requirements (see chapter 3). This chapter explains:

- how to initially classify debt securities (see section 4.2);
- when to reassess the classification (see section 4.3); and
- how to account for transfers between the classification categories (see section 4.4).

When acquired, a debt security is initially classified into one of three categories: (trading, AFS or HTM). The determined classification is reassessed each reporting date. If certain circumstances have changed, an entity may be able and, in some cases, is required to transfer a debt security between categories.

4.2 Classification of debt securities

4.2.10 Overview

Question 4.2.10
How are debt securities classified?

Excerpt from ASC 320-10

> Classification of Debt Securities

25-1 At acquisition, an entity shall classify **debt securities** into one of the following three categories:

a. **Trading securities**. If a **security** is acquired with the intent of selling it within hours or days, the security shall be classified as **trading**. However, at acquisition an entity is not precluded from classifying as trading a security it plans to hold for a longer period. Classification of a security as trading shall not be precluded simply because the entity does not intend to sell it in the near term.
b. **Available-for-sale securities**. Investments in debt securities not classified as trading securities or as held-to-maturity securities shall be classified as available-for-sale securities.
c. Held-to-maturity securities. Investments in debt securities shall be classified as held-to-maturity only if the reporting entity has the positive intent and ability to hold those securities to maturity.

25-2 At acquisition, an investor shall document the classification of debt securities.

Interpretive response: At acquisition, an entity initially determines and documents its classification of debt securities into the following categories. [320-10-25-1 – 25-2]

Category	Requirement
Trading (see section 4.2.20)	Debt securities acquired that the entity generally intends to sell in the near term.
Held-to-maturity (HTM) (see section 4.2.30 and 4.2.40)	Debt securities that the entity has both the positive intent and ability to hold to maturity.
Available-for-sale (AFS) (see section 4.2.50)	Debt securities that are not classified as either trading securities or HTM.

Entities are required to reassess classification of their debt securities at each reporting date (see section 4.3).

Question 4.2.15#

What documentation is required to support the classification of a debt security?

Interpretive response: We believe an entity's documentation supporting classification of a debt security may be in the form of:

- a broad policy that includes sufficient information to determine which securities are included; or
- instrument-specific documentation.

If the debt securities are classified as either trading or HTM, we believe the documentation needs to be in place at the initial recognition of the security.

Although not required, an entity may choose to have documentation in place for AFS debt securities. However, in the absence of documentation supporting the classification at initial recognition, the security is classified as AFS. See Question 4.2.400. [320-10-25-1(b)]

4.2.20 Trading debt securities

Question 4.2.20

When is a debt security classified as trading?

Excerpt from ASC 320-10

20 Glossary

Trading

An activity involving securities sold in the near term and held for only a short period of time. The term trading contemplates a holding period generally measured in hours and days rather than months or years. See paragraph 948-310-40-1 for clarification of the term trading for a mortgage banking entity.

Trading Securities

Securities that are bought and held principally for the purpose of selling them in the near term and therefore held for only a short period of time. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price.

Interpretive response: A debt security acquired and held with the principal intent to be sold in the near term is classified as trading. However, at acquisition, an entity can designate a security as trading even if it plans to hold the security for a longer period. [320-10-25-1(a)]

Topic 320 does not define near term or specify the expected holding period that would require a security to be classified as trading. However, Subtopic 320-10's definition of trading generally contemplates a holding period measured in hours or days, not in months or years. [320-10 Glossary, 320-10-25-1(a)]

Debt securities not acquired with the intent to be sold in the near term or with the intent to generate short-term profits may be designated as trading.

Question 4.2.40
Can debt securities be transferred into and out of the trading category?

Interpretive response: Generally, no. An entity needs to carefully consider any transfers into and out of the trading category because such transfers should be rare given the nature of a trading security. See section 4.4 for further guidance on transfers between categories. [320-10-35-12]

4.2.30 Held-to-maturity debt securities

Question 4.2.50#
When may a debt security be classified as HTM?

Excerpt from ASC 320-10

> Restrictions on Classification of a Debt Security as Held-to-Maturity

25-3 Amortized cost is relevant only if a security is actually held to maturity. Use of the held-to-maturity category is restrictive because the use of amortized cost must be justified for each investment in a debt security. At acquisition, an entity shall determine if it has the positive intent and ability to hold a security to maturity, which is distinct from the mere absence of an intent to sell. If management's intention to hold a debt security to maturity is uncertain, it is not appropriate to carry that investment at amortized cost. In establishing intent, an entity shall consider pertinent historical experience, such as sales and transfers of debt securities classified as held-to-maturity. A pattern of sales or transfers of those securities is inconsistent with an expressed current intent to hold similar debt securities to maturity.

Interpretive response: A debt security may be classified as HTM if the entity has both the positive intent and ability to hold it until maturity. The positive intent and ability to hold is different from simply not having an intent to sell. A security cannot be classified as HTM if: [320-10-25-1(c), 25-3 – 25-4]

- the entity has the intent but not the ability to hold the security until maturity;
- the intent to hold is for only an indefinite period – i.e. not specifically to maturity; or
- the entity is uncertain of its intention to hold – i.e. its exit strategy.

The objective of an HTM debt security is to collect contractual cash flows through maturity. As such, an entity would not expect to realize any gains or losses. The FASB deliberately made the HTM category restrictive because it believes that use of the amortized cost basis must be justified for each investment in a debt security. [FAS 115.BC59]

When asserting intent and ability, we believe an entity should consider all relevant facts and circumstances including those that are entity-specific. Those facts include, but are not limited to:

- historical activities with respect to securities classified as HTM;
- documented objectives and investment strategies;
- investment management policies;
- board and investment committee resolutions;
- regulatory capital requirements;
- internal and external communications about liquidity planning for different scenarios;
- circumstances in which an entity would be required to sell a debt security as a result of external compulsion (e.g. contractual or regulatory);
- tax planning strategies; and
- operating and cash flow projections.

Question 4.2.60
When is HTM classification expressly not permitted?

Excerpt from ASC 320-10

• > Circumstances Not Consistent with Held-to-Maturity Classification

25-4 An entity shall not classify a debt security as held-to-maturity if the entity has the intent to hold the security for only an indefinite period. Consequently, a debt security shall not, for example, be classified as held-to-maturity if the entity anticipates that the security would be available to be sold in response to any of the following circumstances:

a. Changes in market interest rates and related changes in the security's prepayment risk
b. Needs for liquidity (for example, due to the withdrawal of deposits, increased demand for loans, surrender of insurance policies, or payment of insurance claims)
c. Changes in the availability of and the yield on alternative investments
d. Changes in funding sources and terms
e. Changes in foreign currency risk.

25-5 Specific scenarios in which a debt security shall not be classified as held-to-maturity (or where sale or transfer of a held-to-maturity security will call into question an investor's stated intent to hold other debt securities to maturity in the future) are as follows:

a. A security shall not be classified as held-to-maturity if that security can contractually be prepaid or otherwise settled in such a way that the holder of the security would not recover substantially all of its recorded investment. The justification for using historical-cost-based measurement for debt securities classified as held-to-maturity is that no matter how market interest rates fluctuate, the holder will recover its recorded investment and thus realize no gains or losses when the issuer pays the amount promised at maturity. However, that justification does not extend to receivables purchased at a substantial premium over the amount at which they can be prepaid, and it does not apply to instruments whose payments derive from prepayable receivables but have no principal balance. Therefore, a callable debt security purchased at a significant premium might be precluded from held-to-maturity classification under paragraph 860-20-35-2 if it can be prepaid or otherwise settled in such a way that the holder of the security would not recover substantially all of its recorded investment. In addition, a mortgage-backed interest-only certificate shall not be classified as held-to-maturity. Paragraphs 860-20-35-3 through 35-6 provide further guidance on application of this paragraph. Note that a debt security that is purchased late enough in its life such that, even if it was prepaid, the holder would recover substantially all of its recorded investment, could be initially classified as held-to-maturity if the conditions of this paragraph and paragraph 320-10-25-1 are met. (A debt security that can contractually be prepaid or otherwise settled in such a way that the holder of the security would not recover substantially all of its recorded investment may contain an embedded derivative. Therefore, such a security should be evaluated in accordance with Subtopic 815-15 to determine whether it contains an embedded derivative that needs to be accounted for separately.)
b. A debt security that is available to be sold in response to changes in market interest rates, changes in the security's prepayment risk, the entity's need for liquidity, changes in foreign exchange risk, or other similar factors shall not be included in the held-to-maturity category because the possibility of a sale is indicative that the entity does not have a positive intent and ability to hold the security to maturity. A debt security that is considered available to be sold as part of an entity's asset-liability management activities shall not be classified as held-to-maturity. Similarly, an entity that maintains a

dynamic hedging program in which changes in external factors require that certain securities be sold to maintain an effective hedge would not have the intent and ability to hold those securities to maturity.

c. Securities that may need to be sold to implement tax-planning strategies (for example, to generate taxable gains to offset existing taxable losses—or vice versa—or in response to changes in the entity's anticipated future profitability—for example, if taxable losses were expected for the next several years) should be classified as available-for-sale, not held-to-maturity.

d. The sale of a held-to-maturity security in advance of any deterioration in the creditworthiness of the issuer, perhaps based solely on industry statistics, will call into question an investor's stated intent to hold other debt securities to maturity in the future. The sale of a held-to-maturity security must be in response to an actual deterioration, not mere speculation. That deterioration shall be supported by evidence about the issuer's creditworthiness; however, the entity need not await an actual downgrading in the issuer's published credit rating or inclusion on a credit watch list.

e. The sale of held-to-maturity securities to meet regulatory capital requirements will call into question an investor's stated intent to hold other debt securities to maturity in the future. An entity's ability and intent to hold securities to maturity would be called into question by the sale of held-to-maturity securities to realize gains to replenish regulatory capital that had been reduced by a provision for loan losses. Gains trading with held-to-maturity securities to meet an entity's capital requirements is inconsistent with the held-to-maturity notion.

f. The exercise of a put option on a security classified as held-to-maturity will call into question an investor's stated intent to hold other debt securities to maturity in the future. Furthermore, a puttable debt security might be precluded from held-to-maturity classification pursuant to paragraph 860-20-35-2.

g. Convertible debt securities shall not be classified as held-to-maturity. Classifying a security as held-to-maturity means that the entity is indifferent to future opportunities to profit from changes in the security's **fair value** and intends to accept the debt security's stipulated contractual cash flows, including the repayment of principal at maturity. Convertible debt securities generally bear a lower interest rate because the investor hopes to benefit from appreciation in value of the option embedded in the debt security. Given the unique opportunities for profit embedded in a convertible security, it generally would be contradictory to assert the positive intent and ability to hold a convertible debt security to maturity and forego the opportunity to exercise the conversion feature. The exercise of a conversion feature on a security classified as held-to-maturity will call into question an investor's stated intent to hold other debt securities to maturity in the future. (See Section 815-15-25 for additional guidance. If convertible debt is bifurcated into an equity option and a host debt instrument under the requirements of Subtopic 815-15, it generally still would be contradictory to assert the positive intent and ability to hold the debt host contract to maturity and forego the opportunity to exercise the conversion feature.)

h. A documented policy to initially classify all debt securities as held-to-maturity but then automatically transfer every security to available-for-sale when it reaches a predetermined point before maturity (for example, every held-to-maturity security will be transferred to available-for-sale 24 months prior to its stated maturity) so that an entity has the flexibility to sell securities is not consistent with the held-to-maturity classification. Under the policy described, the entity does not intend to hold any security to maturity.

i. An insurance entity or other regulated entity shall not classify securities as held-to-maturity and also indicate to regulators that those securities could be sold to meet liquidity needs in a defined interest rate scenario whose likelihood of occurrence is reasonably possible but not probable.

Interpretive response: Topic 320 specifies the following circumstances in which an entity may not classify debt securities as HTM: [320-10-25-4 – 25-5]

- securities that can be contractually prepaid or otherwise settled in such a way that the entity would not recover substantially all of its recorded investment (see Questions 4.2.70 to 4.2.90);
- securities that would be available to be sold as part of an entity's asset-liability management activities (see Question 4.2.100);
- securities that would be available to be sold as part of an entity's dynamic hedging program (see Question 4.2.100);
- securities that may need to be sold to implement tax-planning strategies – e.g. to generate taxable gains to offset existing taxable losses or vice versa;
- securities that would be available to be sold in response to actual or anticipated changes in:
  - market interest rates;
  - the securities' prepayment risk;
  - the entity's liquidity needs – e.g. due to the withdrawal of deposits, increased demand for loans, surrender of insurance policies, payment of insurance claims;
  - availability of and yield on alternative investments;
  - funding sources and terms;
  - foreign currency risk; or
  - other similar factors;
- securities that an entity intends to automatically make available for sale at a predetermined point before their maturity – e.g. 24 months before the securities' stated maturity; and
- securities that an insurance or regulated entity indicates to regulators could be sold to meet liquidity needs in a reasonably possible defined interest rate scenario.

Although Topic 320 specifically identifies certain circumstances that are inconsistent with HTM classification, the above listing is not comprehensive. Judgment is required depending on the specific facts and circumstances.

In addition, the subsequent sale or transfer of a debt security classified as HTM may call into question (i.e. taint) an entity's intent to hold other debt securities to maturity (see section 4.2.40). [320-10-25-5]

Question 4.2.65**

Does an entity consider a regulator's ability to order the divestiture of securities when determining if HTM classification is precluded at acquisition?

Background: Regulators of financial institutions, such as FDIC-insured banks and savings associations, have the authority to require the disposal of assets that would subject an entity to undue risk. In certain rare instances, regulators have directed institutions to sell securities. [FIL-57-94]

Interpretive response: Yes. The FASB did not intend for the existence of a regulator's general divestiture authority to automatically preclude the use of HTM classification at acquisition by regulated entities. However, an entity needs to consider whether specific facts and circumstances could indicate that it does not have the ability to hold a security to maturity. We believe that HTM classification is precluded if at the date of such classification there is a more than remote likelihood that a regulator will use its broad divestiture authority to require the entity to sell the security prior to its maturity. [EITF D-39]

We believe that this guidance should not be applied to fact patterns other than those surrounding a regulator's divestiture authority.

Question 4.2.70

Can a debt security be classified as HTM if the investor will not recover substantially all of its recorded investment?

Excerpt from ASC 860-20

> Financial Assets Subject to Prepayment

35-5 A financial asset that can be contractually prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall not be classified as held-to-maturity even if the investor concludes that prepayment or other forms of settlement are remote. The probability of prepayment or other forms of settlement that would result in the holder's not recovering substantially all of its recorded investment is not relevant in deciding whether the provisions of paragraph 860-20-35-2 apply to those financial assets.

Interpretive response: No. HTM classification is not appropriate if a security's contractual provisions permit prepayment or allow for the security to be settled in a way that the investor would not recover substantially all of its recorded investment – even if the probability of prepayment or other forms of settlement is remote. See Questions 4.2.80 and 4.2.90, respectively, for considerations when evaluating contractual provisions and 'substantially all'. An HTM debt security is permitted to be measured at amortized cost because the entity is expected to recover its recorded investment and realize no gains or losses on the investment. [320-10-25-5(a), 860-20-35-5]

Examples of securities that could be prepaid or settled in a way that the investor would not recover substantially all of its recorded investment include: [320-10-25-5(a)]

- callable debt securities purchased at a substantial premium over the amount at which they can be prepaid; and
- beneficial interests (e.g. interest-only strips) that have no principal balance.

Question 4.2.80

How does an entity determine whether a financial asset can be contractually prepaid or settled such that it would not recover substantially all of its recorded investment?

Excerpt from ASC 860-20

> Financial Assets Subject to Prepayment

35-4 The requirement in paragraph 860-20-35-2 does not apply to situations in which events that are not the result of contractual provisions, for example, borrower default or changes in the value of an instrument's denominated currency relative to the entity's functional currency, cause the holder not to recover substantially all of its recorded investment.

Interpretive response: An entity evaluates the contractual provisions of a debt security that provide for prepayment or settlement to determine whether the security can be contractually prepaid or otherwise settled such that the entity would not recover substantially all of its recorded investment. A contractual provision may not be disregarded, even if it is remote that those prepayments or settlements will occur. Events that are not the result of contractual provisions (e.g. default by a borrower) are disregarded in this analysis. [320-10-25-5(a), 860-20-35-4]

The following table indicates whether an entity considers certain events in this analysis. [860-20-55-32 – 55-37, 55-39]

Event	Is feature considered?
Changes in the exchange rate between the investment's denomination currency and the entity's functional currency	No
Issuer (borrower) defaults	No
Repayment amount is indexed to the creditworthiness of a party other than the issuer (borrower)	Yes

Question 4.2.90
What does 'substantially all' mean when determining whether an entity would not recover substantially all of its recorded investment?

Interpretive response: The FASB did not define what 'substantially all' means in the context of debt securities. However, 'substantially all' is used elsewhere in US GAAP (e.g. Topic 860) and is usually interpreted to mean at least 90%. We believe an entity should generally use 90% as its benchmark in assessing whether it would recover substantially all of its recorded investment.

Question 4.2.100
Can an entity with an active asset-liability management program or a dynamic hedging program classify debt securities as HTM?

Excerpt from ASC 320-10

• • > Other Circumstances Consistent with Held-to-Maturity Classification

25-18 Specific scenarios in which a debt security may be classified as held to maturity (or where sale or transfer of a held-to-maturity security will not call into question an investor's stated intent to hold other debt securities to maturity in the future) are as follows:

a. Although its asset-liability management may encompass consideration of the maturity and repricing characteristics of all investments in debt securities, an entity may decide that it can accomplish the necessary adjustments under its asset-liability management without having all of its debt securities available for disposition. In that case, the entity may choose to designate certain debt securities as unavailable to be sold to accomplish those ongoing adjustments deemed necessary under its asset-liability management, thereby enabling those debt securities to be accounted for at amortized cost on the basis of a positive intent and ability to hold them to maturity…

Interpretive response: It depends. As noted in Question 4.2.60, debt securities cannot be classified as HTM if they are available to be sold as part of an entity's asset-liability management activities or dynamic hedging program. However, if the entity determines that it can achieve the necessary asset/liability allocations or successfully execute adjustments needed under its dynamic hedging program using only a portion of its debt securities, it may designate certain debt securities as unavailable to be sold. The securities designated as unavailable to be sold may qualify for HTM classification. [320-10-25-18(a)]

Question 4.2.110
Can a prepayable or 'callable' debt security be classified as HTM?

Excerpt from ASC 320-10

• • > Other Circumstances Consistent with Held-to-Maturity Classification

25-18 Specific scenarios in which a debt security may be classified as held to maturity (or where sale or transfer of a held-to-maturity security will not call into question an investor's stated intent to hold other debt securities to maturity in the future) are as follows:…

c. In some circumstances it may not be possible to hold a security to its original stated maturity, such as when the security is called by the issuer before maturity. The issuer's exercise of the call option effectively accelerates the security's maturity and shall not be viewed as inconsistent with classification in the held-to-maturity category…

Interpretive response: Generally, yes. If an entity has the positive intent and ability to hold the prepayable or 'callable' debt security to maturity (absent exercise of the call option by the issuer), the fact that the debt security is callable does not preclude HTM classification. Exercise of the call option by the issuer effectively accelerates the security's maturity and therefore is not inconsistent with this classification. [FAS 115.BC77, 320-10-25-18(c)]

However, a prepayable or 'callable' debt security that can be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its investment cannot be classified as HTM (e.g. a callable debt security purchased at a significant premium to the call price) (see Question 4.2.70). [320-10-25-5(a)]

Question 4.2.120
Can a debt security with an embedded put option be classified as HTM?

Excerpt from ASC 320-10

• • > Other Circumstances Consistent with Held-to-Maturity Classification

25-18 Specific scenarios in which a debt security may be classified as held to maturity (or where sale or transfer of a held-to-maturity security will not call into question an investor's stated intent to hold other debt securities to maturity in the future) are as follows: …

d. A puttable debt security shall be classified as held-to-maturity only if the entity has the positive intent and ability to hold it to maturity…

Background: Some debt securities have embedded put options that are exercisable by the investor. Upon exercise of the embedded option, the entity (investor) surrenders the debt security in exchange for cash.

Interpretive response: It depends. If the entity expects to exercise the put option, the debt may not be classified as HTM. However, the debt may be classified as HTM if the entity: [320-10-25-5(f), 25-18(d)]

- has the positive intent and ability to hold the debt security to maturity; and
- does not expect to exercise the put option.

When evaluating whether it has the positive intent and ability to hold the debt security to maturity, we believe an entity considers the security's stated maturity date, as opposed to the date the put option becomes exercisable.

However, a puttable debt security that can be prepaid or otherwise settled in such a way that the entity (investor) would not recover substantially all of its investment is precluded from HTM classification (see Question 4.2.70). [320-10-25-5(f)]

Question 4.2.130

Can a debt security be classified as HTM if the entity holds a freestanding put option on that security that can be cash-settled?

Background: There may be circumstances in which an entity holds a freestanding put option on an HTM security and the put option can be cash-settled. In these circumstances, the freestanding put option can be exercised separate and apart from the associated debt security. As such, an entity can exercise the option and continue to hold the debt security.

Interpretive response: Yes. If the entity has the positive intent and ability to hold the debt security to maturity (including after the put option is exercised), HTM classification is not precluded. [320-10-25-18(d)]

Question 4.2.140

Can a convertible debt security be classified as HTM?

Interpretive response: No. The conversion option offers the investor the opportunity to profit from increases in the underlying stock price. Classifying a security as HTM means that an entity is indifferent to future opportunities to profit from changes in the security's fair value and intends to accept the stipulated contractual cash flows. Because an entity has the opportunity for profit through exercise of the conversion option, it would generally be contradictory to assert the positive intent and ability to hold the convertible debt security to maturity. [320-10-25-5(g)]

An entity applies Topic 815 to determine if the conversion option is an embedded derivative that is required to be separated from the debt host. See section 4 of KPMG Handbook, Derivatives and hedging. However, even if it is required to bifurcate the convertible debt into an equity option and debt host, an entity cannot assert the positive intent and ability to hold the debt host contract to maturity because it still has the opportunity to exercise the conversion option. [320-10-25-5(g)]

Question 4.2.150

Does a transfer of HTM securities in connection with a secured borrowing call into question an entity's intent and ability to hold the security to maturity?

Excerpt from ASC 320-10

• • > Other Circumstances Consistent with Held-to-Maturity Classification

25-18 Specific scenarios in which a debt security may be classified as held to maturity (or where sale or transfer of a held-to-maturity security will not call into question an investor's stated intent to hold other debt securities to maturity in the future) are as follows: …

e. If a transfer of a held-to-maturity debt security is accounted for as a sale under Subtopic 860-20 and it is transferred for a reason other than those specified in paragraphs 320-10-25-6, 320-10-25-9, and 320-10-25-14, then the transfer would taint the held-to-maturity portfolio. However, if the transfer is accounted for as a secured borrowing, then the transfer would not taint the held-to-maturity portfolio. Transactions involving held-to-maturity securities that are not accounted for as sales under Subtopic 860-20 would not contradict an entity's stated intent to hold a security to maturity and, therefore, do not call into question the entity's intent to hold other debt securities to maturity. Examples of such transactions are as follows:

1. Held-to-maturity securities pledged as collateral, provided that the transaction is not accounted for as a sale under Subtopic 860-20 and the entity intends and expects to be able to satisfy the obligation and recover access to its collateral
2. Held-to-maturity securities subject to a repurchase agreement or a securities lending agreement, provided that the transaction is accounted for as a secured borrowing under Subtopic 860-20 and the entity intends and expects to be able to repay the borrowing…

Background: A transfer of an HTM debt security to a third party is accounted for as a secured borrowing if it does not qualify as a sale. For guidance on determining whether to account for transfers of financial assets as a sale or secured borrowing, see KPMG Handbook, Transfers and servicing of financial assets.

If the transfer of an HTM debt security is accounted for as a sale, the entity then determines if the transfer taints the remaining (and future) HTM securities (see section 4.2.40).

Interpretive response: Generally, no. A transfer of HTM debt securities in a transaction accounted for as secured borrowing generally does not call into question an entity's positive intent and ability to hold the security to maturity. [320-10-25-18(e)]

The following table includes examples of such transactions and considerations as to whether the transaction calls into question an entity's intent and ability to hold to maturity. [320-10-25-18(e)]

Transaction	Considerations
HTM debt securities pledged as collateral	Will not call into question intent and ability to hold to maturity if the entity intends and expects to satisfy the obligation and recover the collateral. The entity makes this assessment on an ongoing basis.
HTM debt securities subject to a repurchase agreement or securities lending transaction	Will not call into question intent and ability to hold to maturity if the entity intends and expects to be able to repay the borrowing and recover the collateral. See additional discussion in: • Question 4.2.160: the counterparty does not return the HTM debt securities provided as collateral. • Question 4.2.170: repurchase-to-maturity transactions.

Question 4.2.160

Does the failure to recover an HTM security subject to a repurchase agreement call into question the entity's intent and ability to hold it to maturity?

Background: The terms of a repurchase agreement typically indicate that if the counterparty fails to deliver the entity's collateral on conclusion of the repurchase agreement, the entity will retain the proceeds from the borrowing and will have the option to acquire a replacement for the previously transferred security from others.

Interpretive response: Not necessarily. We believe that a counterparty's failure to return an HTM security provided as collateral in a secured borrowing transaction would generally not call into question the entity's intent and ability to hold other securities to maturity if, on origination of the repurchase agreement, the entity intended and expected to repay the borrowing.

However, if a specific counterparty is unable to deliver an entity's collateral, we believe the entity should reassess whether it expects to be able to recover access to its collateral classified as HTM under other existing or future repurchase agreements with that counterparty. If an entity does not expect to be able to recover access to the HTM securities held as collateral by that counterparty, it would call into question an entity's intent and ability to hold those securities to maturity.

An entity considers the following factors when assessing ability to recover access to its collateral.

Factor that led to specific counterparty failing to deliver collateral	Impact
Specific to counterparty – e.g. operational issues at the counterparty led to the failure to deliver	We believe only a reassessment by the entity of its expectation to be able to recover access to its collateral under current and future repurchase agreements from that specific counterparty is necessary.
Not isolated to that specific counterparty – e.g. general market conditions led to the failure to deliver	We believe a reassessment by the entity of its expectation to be able to recover access to its collateral from other counterparties may also be necessary going forward.

For considerations specific to repurchase-to-maturity transactions, see Question 4.2.170.

Question 4.2.170

Does transferring an HTM security in a repurchase-to-maturity transaction call into question the entity's intent and ability to hold it to maturity?

Excerpt from ASC 860-10

20 Glossary

Repurchase-to-Maturity Transaction

A **repurchase agreement** in which the settlement date of the agreement to repurchase a transferred financial asset is at the maturity date of that financial asset and the agreement would not require the transferor to reacquire the financial asset.

Background: A repurchase-to-maturity transaction is a repurchase agreement in which the settlement date for repurchasing a transferred financial asset is at that asset's maturity date. Typically, the settlement is a net-cash payment because the repurchase agreement settles on the same day the financial asset matures, meaning the financial asset is no longer available to be returned. In this limited circumstance, the exchange of cash is considered equivalent to the return of the financial asset because cash is the only possible form of settlement once the transferred financial asset has matured. Repurchase-to-maturity transactions are accounted for as secured borrowings. [860-10 Glossary, 860-10-40-5A]

Interpretive response: No, such transfer would not call into question the entity's intent and ability to hold the security to maturity.

As part of its deliberations, the FASB noted that a repurchase-to-maturity is economically similar to a transfer with a forward repurchase agreement that settles at maturity. The FASB determined that a transfer of an HTM debt security with a forward repurchase that settles at maturity accounted for as a secured borrowing would not contradict the transferor's stated intent to hold the HTM debt security to maturity. The FASB acknowledged that the settlement of the transactions typically do not result in the return of the financial asset because the transactions are cash-settled or net-cash-settled. However, because the entity does not derecognize the transferred asset and, if settled gross, would receive the settlement value of the debt in cash, such transaction is consistent with holding securities to collect contractual cash flows. [ASU 2014-11.BC42]

Question 4.2.180

Would a desecuritization of a beneficial interest classified as HTM call into question the entity's intent and ability to hold other HTM securities to maturity?

Excerpt from ASC 320-10

• • > Other Circumstances Consistent with Held-to-Maturity Classification

25-18 Specific scenarios in which a debt security may be classified as held to maturity (or where sale or transfer of a held-to-maturity security will not call into question an investor's stated intent to hold other debt securities to maturity in the future) are as follows:…

e. If a transfer of a held-to-maturity debt security is accounted for as a sale under Subtopic 860-20 and it is transferred for a reason other than those specified in paragraphs 320-10-25-6, 320-10-25-9, and 320-10-25-14, then the transfer would taint the held-to-maturity portfolio. However, if the transfer is accounted for as a secured borrowing, then the transfer would not taint the held-to-maturity portfolio. Transactions involving held-to-maturity securities that are not accounted for as sales under Subtopic 860-20 would not contradict an entity's stated intent to hold a security to maturity and, therefore, do not call into question the entity's intent to hold other debt securities to maturity. Examples of such transactions are as follows:…

3. Beneficial interests classified as held-to-maturity that are desecuritized in a transaction that is not accounted for as a sale if the financial assets received in or that continue to be held after the desecuritization are held to maturity. Unless the debt instrument received or retained as a result of the transaction is held to maturity, the transaction would call into question the entity's intent to hold other debt securities to maturity. Desecuritizations are not specifically included within the scope of this paragraph. Nevertheless, that guidance is also appropriate for desecuritizations that are not accounted for as sales.

Background: Securitization is the process by which financial assets are transformed into securities. A portfolio of financial assets is transferred to a securitization entity and that entity issues beneficial interests to investors. Beneficial interests represent rights to receive all or portions of specified cash inflows received by a trust or other entity. Examples of beneficial interests involving securitized financial assets include mortgage-backed securities, asset-backed securities, and collateralized debt obligations. For discussion of beneficial interests in securitizations, see KPMG Handbook, Transfers and servicing of financial assets. [860-10 Glossary, 860-20 Glossary]

A desecuritization transaction reverses a securitization transaction and converts the securities back into their underlying financial assets.

Interpretive response: It depends. When a beneficial interest classified as HTM is exchanged for the underlying asset itself (i.e. desecuritized), the transfer would not call into question the entity's intent and ability to hold the security to maturity if: [320-10-25-18(e)]

- the desecuritization transaction is not accounted for as a sale; and
- the financial assets received or retained in the desecuritization transaction will be held to maturity.

For example, if a beneficial interest in a collateralized bond obligation is desecuritized in a transaction not accounted for as a sale and the entity has the intent and ability to hold the underlying bonds to maturity, the transaction would not call into question the entity's intent to hold other HTM securities to maturity. section 4.2.40 discusses tainting of HTM securities.

4.2.40 Tainting of held-to-maturity debt securities

Excerpt from ASC 320-10

• > Sales and Transfers that Taint the Entity's Held-to-Maturity Intent

35-8 A sale or transfer of a security classified as held-to-maturity that occurs for a reason other than those specified in paragraphs 320-10-25-6, 320-10-25-9, and 320-10-25-14, calls into question (taints) the entity's intent about all securities that remain in the held-to-maturity category. The entity makes the same assertion about all debt securities in the held-to-maturity category—namely, that it has the positive intent and ability to hold each security to maturity. Only a sale or transfer in response to certain changes in conditions will not call into question an entity's intent to hold other debt securities to maturity in the future.

Outside of certain limited circumstances, sales or transfers of HTM debt securities call into question (i.e. taint) an entity's:

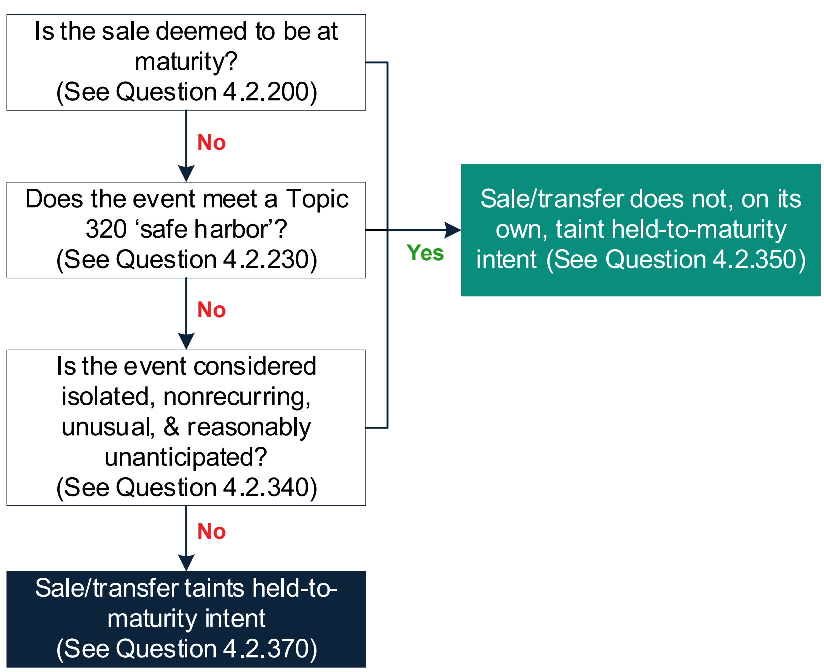
- previous assertions regarding the classification of those securities;
- current assertions regarding the classification of remaining HTM debt securities; and
- future assertions regarding debt securities classified as HTM.

Such sales or transfers impact all securities that remain in the HTM category, not just the type of security that was sold or transferred. Section 4.4 further discusses transfers between categories. [320-10-35-8, A&FRI.I.E]

Question 4.2.190

In what circumstances are sales or transfers of HTM securities consistent with HTM classification?

Interpretive response: The following decision tree summarizes circumstances in which sales or transfers are consistent with HTM classification. [320-10-25-6, 25-9, 25-14]



In addition, in connection with the adoption of certain accounting standards, the FASB has provided, as part of the transition provisions, limited one-time optional elections to sell or reclassify certain debt securities from HTM to AFS without tainting the remainder of the portfolio.

Question 4.2.200

What sales are deemed to be at maturity of a debt security?

Excerpt from ASC 320-10

• • > Sale After a Substantial Portion of Principal Is Collected

25-14 Sales of debt securities that meet either of the following conditions may be considered as maturities for purposes of the classification of securities and the disclosure requirements under this Subtopic:

a. The sale of a security occurs near enough to its maturity date (or call date if exercise of the call is probable) that interest rate risk is substantially eliminated as a pricing factor. That is, the date of sale is so near the maturity or call date (for example, within three months) that changes in market interest rates would not have a significant effect on the security's fair value.
b. The sale of a security occurs after the entity has already collected a substantial portion (at least 85 percent) of the principal outstanding at acquisition due either to prepayments on the debt security or to scheduled payments on a debt security payable in equal installments (both principal and interest) over its term. For variable-rate securities, the scheduled payments need not be equal.

Interpretive response: A sale that meets either of the following conditions may be deemed to occur at the maturity of a debt security: [320-10-25-14]

- the sale is near enough to the security's maturity (or call date if exercise of the call is probable) that changes in the market rate of interest would not significantly impact the security's fair value (see Question 4.2.210); or
- the sale is after a substantial portion of the principal outstanding at acquisition has been collected. The FASB provided a limited practical exception for certain debt securities (see Question 4.2.220).

A sale that meets either of the above conditions would not taint the entity's HTM intent.

Question 4.2.210
When is a sale considered 'near enough' to a debt security's maturity date?

Interpretive response: A sale is considered 'near enough' to maturity if interest rates are eliminated as a pricing factor – i.e. changes in interest rates do not significantly impact the fair value of the security. This determination generally depends on the type of security; however, Topic 320 provides three months as an example timeframe. [320-10-25-14(a), FAS 115.BC64]

This timeframe conforms with the definition of cash equivalents under Topic 230, which notes that cash equivalents are "so near their maturity that they present insignificant risk of changes in value because of changes in interest rates." [FAS 115.BC64, 230-10 Glossary]

Question 4.2.220#
When has a substantial portion of principal outstanding been deemed collected?

Excerpt from ASC 320-10

• • > Sale After a Substantial Portion of Principal Is Collected

25-15 Selling a debt security after a substantial portion of the principal has been collected shall be considered equivalent to holding the security to maturity. The collection of 85 percent of the principal outstanding at acquisition (not the principal outstanding at issuance for securities purchased in the secondary market) constitutes a reasonable threshold of what represents a substantial portion of the principal.

25-16 The limited practical exception in the preceding paragraph applies to both of the following:

a. Debt securities that are payable in equal installments that comprise both principal and interest, such as certain level-payment mortgage-backed securities. For example, many banks routinely sell their investments in mortgage-backed securities after a substantial portion of the principal has been recovered through prepayments. The tail portion of a mortgage-backed security is sold because it no longer represents an efficient investment to the entity mainly due to the economic costs of accounting for remnants of the original issue.
b. Variable-rate debt securities when the scheduled payments would be payable in equal installments absent a change in interest rates.

25-17 It is not appropriate to apply the limited practical exception in paragraph 320-10-25-15 by analogy to a debt security that has a contractual payment schedule of level principal payments plus interest that accrues based on the declining outstanding principal balance; the payments on that type of security do not represent equal installments that are made up of both principal and interest.

Background: As discussed in Question 4.2.200, the FASB provided a limited practical exception for certain debt securities to allow an entity to deem a sale to occur at maturity after a substantial portion of the principal outstanding at acquisition has been collected.

Interpretive response: Topic 320 provides that 85% of principal outstanding at acquisition is a reasonable threshold to represent a substantial portion of principal outstanding. [320-10-25-15]

This limited practical exception only applies to specific types of debt securities.

Practical exception may be applied [320-10-25-16]	Practical exception may not be applied [320-10-25-17]
• Debt securities when payments are payable in equal installments that comprise both principal and interest. • Variable-rate debt securities with scheduled payments made in equal installments (assuming interest rates remain unchanged).	Debt securities that have equal installments of principal but for which interest accrues based upon the remaining outstanding principal balance as payments. Such terms do not represent equal installments of principal and interest.

Topic 320 states that certain level-payment mortgage-backed securities are examples of debt securities that are payable in equal installments that comprise both principal and interest. We believe the practical exception may be applied to both (1) mortgage-backed securities payable in equal installments that comprise both principal and interest and (2) mortgage-backed securities with underlying mortgage loans if each of those loans are payable in equal installments that comprise both principal and interest. [320-10-25-15]

We believe a borrower's ability to make voluntary payments (e.g. prepayments) should not be considered when evaluating whether a security has payments that are payable in equal installments.

Question 4.2.230
What safe harbor exemptions are provided in Topic 320?

Excerpt from ASC 320-10

• > Circumstances Consistent with Held-to-Maturity Classification

25-6 The following changes in circumstances may cause the entity to change its intent to hold a certain security to maturity without calling into question its intent to hold other debt securities to maturity in the future. The sale or transfer of a held-to-maturity security due to one of the following changes in circumstances shall not be considered inconsistent with its original classification:

a. Evidence of a significant deterioration in the issuer's creditworthiness (for example, a downgrading of an issuer's published credit rating)
b. A change in tax law that eliminates or reduces the tax-exempt status of interest on the debt security (but not a change in tax law that revises the marginal tax rates applicable to interest income)
c. A major business combination or major disposition (such as sale of a **component of an entity**) that necessitates the sale or transfer of held-to-maturity securities to maintain the entity's existing interest rate risk position or credit risk policy
d. A change in statutory or regulatory requirements significantly modifying either what constitutes a permissible investment or the maximum level of investments in certain kinds of securities, thereby causing an entity to dispose of a held-to-maturity security
e. A significant increase by the regulator in the industry's capital requirements that causes the entity to downsize by selling held-to-maturity securities
f. A significant increase in the risk weights of debt securities used for regulatory risk-based capital purposes.

25-7 It is not appropriate to analogize to the exceptions specified in (a) through (f) in the preceding paragraph.

Interpretive response: Topic 320 provides several safe harbor exemptions in which a sale or transfer would not call into question an entity's intent to hold other debt securities to maturity. In the context of this Handbook, a safe harbor exemption applies under the following scenarios. [320-10-25-6]

Safe harbor	Description	Reference
Deterioration in creditworthiness	Applies if there is evidence of significant deterioration in the issuer's creditworthiness	Questions 4.2.240 and 4.2.250
Change in tax law	Applies if a change in tax law eliminates or reduces the tax-exempt status of interest on the debt security	Question 4.2.260
Major business combination/disposition	Applies if a major business combination or disposition necessitates the sale or transfer of HTM debt securities to maintain the entity's existing interest rate position or credit risk policy	Question 4.2.270 to 4.2.310
Change in statutory/regulatory requirements	Applies if a change in statutory/regulatory requirements significantly modifies either what represents a permissible investment or the maximum level of investments in certain kinds of securities	Question 4.2.320

Safe harbor	Description	Reference
Increase in industry-wide capital requirements	Applies if a change in regulatory requirements significantly increases an industry's capital requirements	Question 4.2.330
Increase in regulatory risk weights	Applies if there is a significant increase in risk weights used for regulatory risk-based capital purposes	

An entity may not apply these safe harbors to other scenarios by analogy. [320-10-25-7]

To qualify for the safe harbors that relate to specific events or changes that occur at a specific point in time (i.e. a change in statutory or regulatory requirements), we believe the decision to sell or transfer the security generally should be made at the time the event or change takes place or shortly thereafter.

Question 4.2.240

What constitutes 'evidence of significant deterioration' for the deterioration in creditworthiness safe harbor exemption?

Background: As discussed in Question 4.2.230, evidence of a significant deterioration in the issuer's creditworthiness (e.g. a downgrading of an issuer's published credit rating) is one safe harbor provided under Topic 320. As such, a sale or transfer of an HTM security in response to such event would not, on its own, taint the remaining or future HTM debt securities (see Question 4.2.350). [320-10-25-6(a)]

Interpretive response: We believe that deterioration in creditworthiness should be evaluated relative to the individual security and that security's credit quality at acquisition (as opposed to at the original issuance date).

The FASB did not define 'significant' in the context of credit deterioration. Therefore, judgment is required, and management should establish a policy about what is considered significant deterioration in creditworthiness and consistently apply it.

Evidence of significant credit deterioration requires external information that is specific to the issuer or the security. This may be in the form of a published credit rating downgrade by third parties (such as Standard & Poor's, Moody's or Fitch) or placement on a credit watch list.

A speculated deterioration in creditworthiness without external evidence specific to the issuer or the security does not meet the safe harbor exemption. However, an entity does not have to wait for an actual published downgrading or inclusion on a credit watch list. We believe that an entity's internal credit evaluation process may also provide evidence of credit deterioration if it is based on external information. [320-10-25-5(d), 25-6(a)]

Question 4.2.250
Can the sale or transfer of an HTM security in advance of actual credit deterioration meet the deterioration in creditworthiness safe harbor?

Interpretive response: No, a sale or transfer in advance of actual credit deterioration of the issuer or security is not consistent with HTM classification – e.g. a sale based solely on industry statistics. [320-10-25-5(d)]

Question 4.2.260
Can the sale or transfer of an HTM security in response to either a change in tax status of the entity or the entity's tax rate meet the change in tax law safe harbor?

Interpretive response: No. Topic 320 provides a safe harbor exemption for changes in tax law that eliminate or reduce the tax-exempt status of interest on debt securities. However, we believe this exemption may not be applied by analogy to the following: [320-10-25-6(b)]

- a change in tax status of the entity – e.g. conversion from a C corporation to an S corporation;
- a change in the federal income tax rate.

Question 4.2.270
What constitutes a major business combination or major disposition for the major business combination/ disposition safe harbor?

Excerpt from ASC 320-10

• • > Sale or Transfer Due to a Major Business Combination or Major Disposition

25-12 With respect to the discussion in paragraph 320-10-25-6(c) about a major business combination or a major disposition, this Subtopic does not specify a quantitative threshold for a major business combination or disposition. Examples of transactions that would qualify for the exception in paragraph 320-10-25-6(c) are as follows:

a. Sales of held-to-maturity securities only when the combination or disposition necessitates the sale or transfer of held-to-maturity securities to maintain the entity's existing interest rate risk position or credit risk policy. Necessary transfers or sales shall occur concurrent with or shortly after the business combination or disposition. This Subtopic does not define shortly. As time passes, however, it is increasingly difficult to demonstrate that the business combination, and not other events or circumstances, necessitated the transfer or sale of held-to-maturity securities.
b. A sale of a component of an entity is an example of a major disposition.

25-13 Examples of transactions that would not qualify for the exception in paragraph 320-10-25-6(c) are as follows:

a. A purchase or sale of a large pool of financial assets (for example, conforming mortgages) or liabilities (for example, deposit liabilities) (which would not be considered a major business combination or disposition)
b. Sales of held-to-maturity securities to fund an acquisition (or a disposition, for example, if deposit liabilities are being assumed by the other party)
c. Sales of held-to-maturity securities in anticipation of or otherwise before a major business combination or disposition
d. A sale of held-to-maturity securities in response to an unsolicited tender offer from the issuer (which also is not an event that is isolated, nonrecurring, and unusual that could not have been reasonably anticipated).

Interpretive response: Topic 320 does not define the threshold for a major business combination or major disposition, other than stating that a sale of a component of an entity would be an example of a major disposition. See chapter 3 of KPMG handbook, Discontinued operations and HFS disposal groups, for the definition of a component. Judgment is necessary to determine whether a business combination or disposition qualifies for the safe harbor exemption. Management should establish a policy about what is considered a major business combination or major disposition and consistently apply it. [320-10-25-12]

Sales and acquisitions of financial assets (e.g. portfolio of loans) and liabilities (e.g. portfolio of deposits) would not be considered a major business combination or disposition. We believe the set of assets and liabilities acquired or disposed of, if applicable, should meet the definition of a business in paragraph 805-10-55-3A (see section 2 of the KPMG Handbook, Business combinations). [320-10-25-13]

Question 4.2.280
Can the sale or transfer of an HTM debt security in anticipation of or to fund a major business combination/disposition meet the safe harbor?

Interpretive response: No. The sale or transfer of HTM debt securities in anticipation of or to fund an acquisition or disposition does not qualify for the major business combination/disposition safe harbor exemption. To qualify for this safe harbor, sales or transfers of HTM debt securities must: [320-10-25-6(c), 25-12, 25-13]

- occur concurrently with or shortly after the business combination or disposition; and
- be necessary to maintain existing interest rate risk position or credit policy.

Question 4.2.290
How are debt securities acquired as part of a business combination classified?

Interpretive response: We believe debt securities acquired as part of a business combination should be classified based upon the acquiror's intent as opposed to the acquiree's intent. Classifying debt securities in this manner is therefore similar to classifying debt securities acquired outside of a business combination.

Question 4.2.300
Can the sale or transfer of an HTM debt security after a business combination meet the major business combination/disposition safe harbor?

Interpretive response: It depends. To qualify for the major business combination/disposition safe harbor exemption, necessary transfers or sales need to occur concurrent with or shortly after the business combination or disposition. While Topic 320 does not define 'shortly', as time passes it is increasingly difficult to demonstrate that the business combination, and not other events or circumstances, necessitated the transfer or sale of HTM securities. [320-10-25-12(a)]

Question 4.2.310
Can the sale or transfer of an HTM debt security in response to an unsolicited tender offer meet the major business combination/disposition safe harbor?

Background: A tender offer is a bid to purchase some or all of shareholders' stock in a corporation. Tender offers are typically made publicly and invite shareholders to sell their shares for a specified price and within a particular window of time. The price offered is usually at a premium to the market price and is often contingent on a minimum or a maximum number of shares being tendered.

Interpretive response: No. An unsolicited tender offer from the HTM debt security's issuer cannot be analogized to a business acquisition or disposition and, as such, does not meet the major business combination/disposition safe harbor exemption. [320-10-25-13(d)]

Question 4.2.320

Can a sale meet the change in statutory/regulatory requirements safe harbor if a regulator instructs a specific entity to dispose of certain securities?

Excerpt from ASC 320-10

• >Circumstances Consistent with Held-to-Maturity Classification

25-8 If a regulator directs a particular institution (rather than all institutions supervised by that regulator) to sell or transfer held-to-maturity securities (for example, to increase liquid assets), those sales or transfers are not consistent with paragraph 320-10-25-6(d), which describes a change in regulations applicable to all entities affected by the legislation or regulator enacting the change. (The same is true of paragraph 320-10-25-6(e) through (f).) However, it is possible that the circumstances causing a regulator to direct an institution to sell securities could be considered an event that is isolated, nonrecurring, and unusual that could not have been reasonably anticipated as described in the following paragraph and paragraph 320-10-25-6.

Interpretive response: Generally, no. The change in statutory/regulatory requirements safe harbor exemption applies when a regulator changes statutory or regulatory requirements that impact all entities affected by the statute or regulation; other circumstances cannot be analogized to this scenario. Therefore, if a regulator directs a specific entity (as opposed to all entities) to sell or transfer securities, such a scenario does not meet the safe harbor exemption. [320-10-25-8]

Question 4.2.330

Can selling an HTM debt security to meet regulatory capital requirements meet the increase in industry-wide capital requirements safe harbor?

Excerpt from ASC 320-10

• • > Other Circumstances Consistent with Held-to-Maturity Classification

25-18 Specific scenarios in which a debt security may be classified as held to maturity (or where sale or transfer of a held-to-maturity security will not call into question an investor's stated intent to hold other debt securities to maturity in the future) are as follows: …

b. The sale of one or more held-to-maturity securities if an entity chooses to downsize to comply with a significant increase in the industry's capital requirements would not call into question the classification of other held-to-maturity securities.

Interpretive response: It depends on whether regulatory capital requirements have been significantly increased. The safe harbor exemptions applies when a sale is made in response to a significant increase in the industry's regulatory capital requirements. Other circumstances cannot be analogized to this scenario, such as selling an HTM debt security to meet current unaltered capital requirements, improve capital positions or respond to an insignificant change in regulatory capital requirements. [320-10-25-5(e), 25-6(e), 25-18(b)]

Question 4.2.340#

If a sale or transfer is not deemed to be at maturity and does not meet a safe harbor, does it automatically taint the entity's intent to hold debt securities to maturity?

Excerpt from ASC 320-10

• > Circumstances Consistent with Held-to-Maturity Classification

25-9 In addition to the changes in circumstances listed in paragraph 320-10-25-6(a) through (f), certain other events may cause the entity to sell or transfer a held-to-maturity security without necessarily calling into question (tainting) its intent to hold other debt securities to maturity. Such events must meet all of the following four conditions to avoid tainting its intent to hold other debt securities to maturity in the future:

a. The event is isolated.
b. The event is nonrecurring.
c. The event is unusual for the reporting entity.
d. The event could not have been reasonably anticipated.

25-10 Other than extremely remote disaster scenarios (such as a run on a bank or an insurance entity), very few events would meet all four of those conditions.

25-11 Extremely remote disaster scenarios shall not be anticipated by an entity in deciding whether it has the positive intent and ability to hold a debt security to maturity.

Interpretive response: Not necessarily. Even if a sale or transfer of an HTM debt security is not deemed to be at maturity (see Question 4.2.200) and does not meet one of the safe harbor exemptions in Question 4.2.230, it nonetheless may not taint the entity's intent and ability to hold debt securities to maturity if the event that causes the sale or transfer: [320-10-25-9]

- is isolated;
- is nonrecurring;
- is unusual for the entity; and
- could not have been reasonably anticipated.

As discussed in Question 4.2.60, Topic 320 specifies certain circumstances that are not consistent with HTM classification, including a scenario in which securities would be available to be sold in response to actual or anticipated changes in the entity's liquidity needs (e.g. due to the withdrawal of deposits by a bank's depositors). However, a run on a bank or insurance entity is provided as an example of a remote scenario that would not taint HTM classification. A run on a bank would also involve the withdrawal of deposits. Judgment may be necessary to determine whether deposit withdrawals rose to the level of a run on a bank. Given previous assertions regarding an entity's intent and ability to hold HTM securities to maturity, we would generally expect that in the event of a run on the bank, HTM securities would be sold only after all other sources of available liquidity were exhausted.

Other than extremely remote disaster scenarios (e.g. a run on a bank or insurance entity), very few events would meet all four conditions. An entity will need to evaluate the facts and circumstances of the event in relation to its own business to determine if the conditions are met.

Depending on the facts and circumstances, the COVID-19 pandemic could cause specific events or situations that may meet all of the conditions. [320-10-25-10]

Question 4.2.350
Do permitted sales or transfers taint remaining securities in an HTM portfolio?

Interpretive response: It depends. Even if the circumstances causing the sale or transfer are consistent with HTM classification (see Question 4.2.190), an entity assesses and documents the impact to all other HTM securities in the portfolio. [320-10-35-5]

A permitted sale or transfer may still potentially call into question the entity's intent and ability to hold a portion of or the entire remaining HTM portfolio to maturity. For example, an entity may sell several debt securities due to the issuer being placed on a 'credit watch' list and have the sales qualify for the credit deterioration safe harbor exemption (see Question 4.2.240). However, these sales may call into question the entity's intent to hold other securities with the same issuer to maturity. [320-10-25-1(c), 25-6(a)]

Similarly, if an entity transfers several debt securities due to a tax law change that eliminates the tax-exempt status of municipal bond interest, this may call into question the entity's intent to hold other municipal bonds to maturity even though the transfers qualify for the change in tax law safe harbor exemption. [320-10-25-1(c), 25-6(b)]

On their own, such sales are not likely to taint other HTM debt securities not affected by the tax law change or credit watch as long as the entity concludes that its intent and ability to hold the remaining HTM securities remains unchanged. [320-10-25-1(c)]

Question 4.2.360

Is an intercompany sale or transfer of an HTM debt security consistent with the intent to hold to maturity?

Interpretive response: It depends on whether an entity is evaluating consolidated or stand-alone financial statements.

Financial statements	Consistent with intent to hold to maturity?
Consolidated	Sales or transfers within the consolidated group do not affect the consolidated financial statements. As such, we do not believe an entity's intent has changed. Therefore, it does not need to assess whether the sale or transfer causes the remaining (and future) HTM debt securities to be tainted (see Question 4.3.10).
Stand-alone	Sales or transfers impact the stand-alone financial statements of the transferor. If the transfer is accounted for as a sale under Topic 860 (see KPMG Handbook, Transfers and servicing of financial assets), the transfer needs to meet the circumstances listed in Question 4.2.190 to not call into question the transferor's intent or ability to hold the remaining (and future) debt securities to maturity.

Question 4.2.370

What are the consequences of selling or transferring an HTM debt security as a result of a circumstance that is not consistent with HTM classification?

Interpretive response: A sale or transfer outside of the circumstances permitted by Topic 320 (see Question 4.2.190) may call into question the entity's intent to hold remaining HTM securities to maturity as well as its previous assertions regarding the classification of those securities. The entity needs to assess and document whether the sale or transfer represents a material contradiction of its stated intent to hold the security to maturity. Judgment is required in making this determination. [320-10-35-8 – 35-9]

If the entity determines the sale or transfer represents a material contradiction to its stated intent to hold the security to maturity – or if the entity has a pattern of sales or transfers not consistent with HTM classification – all remaining securities within the HTM category are reclassified to AFS and future acquisitions of securities may not be classified as HTM until the entity reestablishes its credibility regarding intent and ability (see Question 4.2.380). Reclassification resulting from a non-permitted sale or transfer applies to an entity's entire HTM portfolio. The impact is not limited to the type of security that was sold or transferred. [320-10-35-8 – 35-9]

Additionally, the entity will need to assess the impact of the sale or transfer on its previous assertions about the intent to hold HTM securities to maturity and whether there were errors in previously issued financial statements, see chapter 4 of KPMG Handbook, Accounting changes and error corrections. [FAS 115.BC69]

Question 4.2.380

After an HTM portfolio is tainted, how long does it take to reestablish credibility as to intent and ability to hold debt securities to maturity?

Excerpt from ASC 320-10

> Reassessment of Classification

35-7 After securities are reclassified to available-for-sale in response to a taint, judgment is required in determining when circumstances have changed such that management can assert with a greater degree of credibility that it now has the intent and ability to hold debt securities to maturity.

Interpretive response: Topic 320 does not provide specific guidance about the length of time required to reestablish credibility as to intent and ability to hold debt securities to maturity. The SEC staff has previously indicated that it may take approximately two years before an entity can resume use of HTM classification.

During this period, we believe an entity will need to demonstrate that circumstances have adequately changed since the tainting event. This includes activities such as rebuilding historical experience, restoring policies and procedures, and ensuring that the circumstance(s) causing the sale (e.g. liquidity needs) are no longer present. [320-10-35-7]

Question 4.2.390

Can a debt security be reclassified back into the HTM category once credibility has been reestablished?

Interpretive response: Yes. Once credibility has been reestablished, an entity may reclassify debt securities for which it has the positive intent and ability to hold to maturity into the HTM category and resume use of the category for new purchases. [320-10-35-7]

The ability to reclassify applies to both:

- debt securities previously reclassified to AFS as a result of the tainting; and
- AFS debt securities acquired during the tainting period.

Securities purchased before, during and after the tainting period are all assessed similarly for the purpose of determining HTM intent and ability.

4.2.50 Available-for-sale debt securities

Question 4.2.400
When is a debt security classified as AFS?

Interpretive response: A debt security that is not classified as trading or HTM is classified as AFS. An entity's intent to trade debt securities or hold debt securities to maturity requires evidential support such as documented investment strategies, historical experience and/or business plans. See Questions 4.2.15 and 4.2.50. [320-10-25-1(b)]

4.3 Reassessment of classification

Excerpt from ASC 320-10

> Reassessment of Classification

35-5 At each reporting date, the appropriateness of the classification of an entity's investments in debt securities shall be reassessed. For example, if an entity no longer has the ability to hold debt securities to maturity, their continued classification as held-to-maturity would not be appropriate.

35-6 Because an entity is expected not to change its intent about a held-to-maturity security, the requirement to reassess the appropriateness of a security's classification focuses on the entity's ability to hold a security to maturity. The preceding paragraph acknowledges that facts and circumstances can change; for example, an entity can lose the ability to hold a debt security to maturity. However, that acknowledgment in no way diminishes the restrictive nature of the held-to-maturity category.

35-7 After securities are reclassified to available-for-sale in response to a taint, judgment is required in determining when circumstances have changed such that management can assert with a greater degree of credibility that it now has the intent and ability to hold debt securities to maturity.

Question 4.3.10
When does the classification of a debt security need to be reassessed?

Interpretive response: Entities holding debt securities reassess classification at each reporting date. As discussed in section 4.2.10, entities determine and document initial classification upon acquisition of the security. However, as facts and circumstances change over time, they are required to reevaluate the initial classification and update documentation (if necessary) at each reporting date. [320-10-35-5]

Although the initial designation as trading (see Question 4.2.40) or HTM is expected to be retained until the security is sold or matures, there may be circumstances that trigger a transfer out of these categories. For HTM debt securities, because an entity is not expected to change its intent, the requirement to reassess classification focuses on ability to hold a security to maturity. For example, certain factors or events may impair an entity's ability to hold a debt security to maturity (e.g. capital shortage, liquidity needs). As such, we believe an entity should consider whether its classifications are consistent with its investment strategies, liquidity projections, capital adequacy, tax planning strategies, asset/liability management strategies, etc. [320-10-35-6]

4.4 Transfers between categories of debt securities

4.4.10 Overview

Excerpt from ASC 320-10

• > Sales and Transfers that Taint the Entity's Held-to-Maturity Intent

35-9 When a sale or transfer of held-to-maturity securities represents a material contradiction with the entity's stated intent to hold those securities to maturity or when a pattern of such sales has occurred, any remaining held-to-maturity securities shall be reclassified to available-for-sale. The reclassification shall be recorded in the reporting period in which the sale or transfer occurred and accounted for as a transfer under the following paragraph.

• > Transfers of Securities between Categories

35-10 Transfers of a debt security from or into the trading category shall be accounted for at fair value. At the date of the transfer, the security's unrealized **holding gain or loss** shall be accounted for as follows:

a. For a security transferred from the trading category, the unrealized holding gain or loss at the date of the transfer will have already been recognized in earnings and shall not be reversed.
b. For a security transferred into the trading category, the portion of the unrealized holding gain or loss at the date of the transfer that has not been previously recognized in earnings shall be recognized in earnings immediately.

35-10A For a debt security that is transferred into the available-for-sale category from the held-to-maturity category, an entity shall:

a. Reverse in earnings any allowance for credit losses previously recorded on the held-to-maturity debt security at the transfer date
b. Reclassify and transfer the debt security to the available-for-sale category at its **amortized cost basis** (which is reduced by any previous writeoffs but excludes any allowance for credit losses)
c. Determine if an allowance for credit losses is necessary by following the guidance in Subtopic 326-30
d. Report in other comprehensive income any unrealized gain or loss on the available-for-sale debt security at the date of transfer, excluding the amount recorded in the allowance for credit losses in accordance with paragraph (c)
e. Consider whether the transfer of a debt security from the held-to-maturity category to the available-for-sale category calls into question the entity's intent and ability to hold securities that remain in the held-to-maturity category to maturity in accordance with paragraphs 320-10-35-8 through 35-9.

35-10B For a debt security that is transferred into the held-to-maturity category from the available-for-sale category, an entity shall:

a. Reverse in earnings any allowance for credit losses previously recorded on the available-for-sale debt security at the transfer date
b. Reclassify and transfer the debt security to the held-to-maturity category at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses) plus or minus the amount of any remaining unrealized holding gain or loss reported in accumulated other comprehensive income
c. Evaluate the debt security for an allowance for credit losses by following the guidance in Subtopic 326-20
d. Continue to report the unrealized holding gain or loss at the date of the transfer in a separate component of shareholders' equity, such as accumulated other comprehensive income, but that gain or loss shall be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount. The amortization of an unrealized holding gain or loss reported in equity will offset or mitigate the effect on interest income of the amortization of the premium or discount (discussed in the following sentence) for that held-to-maturity security. For a debt security transferred into the held-to-maturity category, the transfer may create a premium or discount that, under amortized cost accounting, shall be amortized thereafter as an adjustment

of yield in accordance with Subtopic 310-20 on receivables—nonrefundable fees and other costs.

35-15 When a security is transferred from held-to-maturity to available-for-sale, the security's **amortized cost basis** carries over to the available-for-sale category for all of the following purposes:

a. The subsequent amortization of the historical premium or discount
b. The comparisons of fair value and amortized cost for the purpose of determining unrealized holding gains and losses under paragraph 320-10-35-1
c. The required disclosures of amortized cost.

35-16 When a security is transferred from available-for-sale to held-to-maturity, the transfer may create a premium or discount that, under amortized cost accounting, shall be amortized as a yield adjustment in accordance with Subtopic 310-20. The security's amortized cost basis is determined as the amortized cost basis at the transfer date (which is reduced by any previous writeoffs but excludes any allowance for credit losses) plus or minus the amount of any remaining unrealized holding gain or loss reported in accumulated other comprehensive income.

The following table details how to account for transfers between the three categories of debt securities (see section 3.7 for disclosures). The reclassification is accounted for as of the transfer date. [320-10-35-10 – 35-10B, 35-15—35-16]

<table>
<tr><th>Transfer type:</th><th>Transferred at:</th><th>Treatment of unrealized gain/loss at transfer date:</th><th>Treatment of allowance for credit losses:</th></tr>
<tr><td>Trading → AFS
(section 4.4.20)</td><td rowspan="3">Fair value at transfer date</td><td rowspan="2">N/A – already included in earnings and not reversed</td><td>Evaluate the AFS securities under Subtopic 326-30</td></tr>
<tr><td>Trading → HTM
(section 4.4.20)</td><td>Evaluate the HTM securities under Subtopic 326-20</td></tr>
<tr><td>AFS → Trading
(section 4.4.20)</td><td>Reverse associated AOCI and report in earnings</td><td>Reverse previously recorded amounts with an offset to credit loss expense</td></tr>
<tr><td>AFS → HTM
(section 4.4.40)</td><td>Amortized cost[1] at transfer date plus/minus unrealized gain/loss in AOCI</td><td>Amortize amounts in AOCI over remaining life as a yield adjustment</td><td rowspan="2">Reverse previously recorded amounts with an offset to credit loss expense
Evaluate under Subtopic 326-20 (HTM) or Subtopic 326-30 (AFS)</td></tr>
<tr><td>HTM → AFS
(section 4.4.30)</td><td>Amortized cost[1] at transfer date</td><td>Report in OCI (and accumulated in AOCI)</td></tr>
</table>

Transfer type:	Transferred at:	Treatment of unrealized gain/loss at transfer date:	Treatment of allowance for credit losses:
HTM → Trading (section 4.4.20)	Fair value at transfer date	Report in earnings	Reverse previously recorded amounts with an offset to credit loss expense

Note:
1. Section 3.3.10 discusses the definition of amortized cost. This amount is reduced by previous writeoffs but excludes the allowance for credit losses.

Question 4.4.10
How is the reversal and establishment of the allowance for credit losses presented?

Excerpt from ASC 320-10

45-8B An entity shall present the amounts reversed or established for the allowance for credit losses related to the transfer of debt securities between categories (see paragraphs 320-10-35-10A through 35-10B) on a gross basis in the income statement. An entity may present those amounts on the income statement or in the notes to financial statements, if applicable.

Interpretive response: An entity presents the amounts reversed or established for an allowance for credit losses, as applicable, on a gross basis in the income statement or in the notes to the financial statements. [320-10-45-8B]

4.4.20 Transfers to or from trading

Excerpt from ASC 320-10

• > Transfers of Securities between Categories

35-12 In addition, given the nature of a trading security, transfers into or from the trading category also should be rare.

35-13 Available-for-sale securities shall not be automatically transferred to the trading category because the passage of time has caused the maturity date to be within one year or because management intends to sell the security within one year. Similarly, if an entity plans to sell a security from the held-to-maturity category in response to one of the conditions in paragraphs 320-10-25-6 and 320-10-25-9, the security shall not be automatically reclassified to available-for-sale or trading before the sale.

35-14 Paragraph 860-10-55-75 gives an Example addressing whether a transferor has the option to classify debt securities as trading at the time of a transfer.

Topic 320 contemplates that transfers into or from the trading category will be rare. [320-10-35-12]

Question 4.4.20

When assessing a transfer to or from the trading category, how is the concept of 'rare' evaluated?

Interpretive response: The SEC staff has highlighted that 'rare' seems to establish a very high threshold and motives for transfers, such as the following, are frequently present and not consistent with the notion of rare. [2004 AICPA Conf]

- changes in investment strategies;
- achieving accounting results that more closely match economic hedging activities; and
- repositioning portfolios due to anticipated changes in economic outlook.

There may be facts and circumstances in which a transfer may be acceptable. An entity needs to demonstrate that those facts and circumstances clearly indicate an event that is unusual and highly unlikely to recur in the near term. Further, the SEC staff has indicated that it may be acceptable to transfer securities between the trading and AFS categories due to a change in statutory or regulatory requirements or if a significant business combination or other event greatly alters the company's liquidity position or investing strategy. [2004 AICPA Conf]

Question 4.4.30

Is an AFS debt security to be sold in the near term reclassified as trading?

Interpretive response: No. AFS securities are not reclassified because an entity intends to sell the security or due to the passage of time – e.g. the security will mature in one year. These factors do not change the original AFS designation. [320-10-35-12—35-13]

4.4.30 Transfers from HTM

Excerpt from ASC 320-10

• > Transfers of Securities between Categories

35-11 Transfers from the held-to-maturity category should be rare, except for transfers due to the changes in circumstances identified in paragraph 320-10-25-6(a) through (f).

As discussed in section 4.2.40, transfers and sales of HTM securities are presumed to taint the remaining portfolio unless they meet certain limited exceptions provided under Topic 320 (see Question 4.2.190). As such, transfers from the HTM category are rare. [320-10-35-11]

Question 4.4.40
How is the transfer of a debt security from HTM to AFS accounted for?

Interpretive response: An entity accounts for a transfer of a debt security from HTM to AFS as follows. [320-10-35-10A]

Step 1	Reverse (in earnings) any allowance for credit losses previously recorded on the HTM debt security.
Step 2	Reclassify and transfer the debt security to the AFS category at its amortized cost basis.[1]
Step 3	Determine if an allowance for credit losses is necessary by following the guidance in Subtopic 326-30.
Step 4	Report in OCI any unrealized gain or loss on the AFS debt security at the date of transfer, excluding the amount recorded in the allowance for credit losses in the immediately preceding step.
Step 5	Evaluate whether the transfer calls into question the entity's intent and ability to hold to maturity securities that remain in the HTM category under paragraphs 320-10-35-8 and 35-9 (see section 4.2.40).

Note:

1. The amortized cost basis that is transferred is reduced by any previous writeoffs but excludes any allowance for credit losses, as applicable.

See chapter 19 in KPMG Handbook, Credit impairment, for Topic 326-30 guidance on determining the allowance for credit losses on AFS securities.

4.4.40 Transfers from AFS

Question 4.4.50
How is the transfer of a debt security from AFS to HTM accounted for?

Excerpt from ASC 320-10

• > Example 4: Transfer from Available-for-Sale to Held-to-Maturity

55-24 The following table illustrates the accounting for a transfer from available-for-sale to held-to-maturity.

		Amortized Cost							
		Par	Premium (Amorti-zation)	Total	Fair Value	Unrealized Holding Gain in Other Comprehensive Income (Amortization)	Deferred Tax Adjustment in Other Comprehen-sive Income @ 30% [(a)]Credit (Debit)	Unrealized Holding Gain, Net of Tax, in Other Comprehen-sive Income Credit (Debit)	Cumulative Effect on Interest Income Credit (Debit)
1/1/X1	Bond purchased, 6 years from maturity, classified as available for sale	100	6	106	106				
19X1	Amortization of premium, bringing amortized cost to 105		(1)	(1)	(1)				(1)
19X1	Bond appreciates to 120 Balances				15	15	(4.5)	10.5	
12/31/X1	Balances	100	5	105	120	15	(4.5)	10.5	(1)
1/1/X2	Bond transferred to held-to-maturity at amortized cost basis plus unrealized holding gain	100	20	120	120	15	(4.5)	10.5	

19X2	Amortization of premium and equity component		(4)	(4)		(3)	0.9	(2.1)	(1)
12/31/X2	Balances	100	16	116	119	12	(3.6)	8.4	(2)
19X3	Amortization of premium and equity component		(4)	(4)		(3)	0.9	(2.1	(1)
12/31/X3	Balances	100	12	112	114	9	(2.7)	6.3	(3)
19X4	Amortization of premium and equity component		(4)	(4)		(3)	0.9	(2.1)	(1)
12/31/X4	Balances	100	8	108	107	6	(1.*)	4.2	(4)
19X5	Amortization of premium and equity component		(4)	(4)		(3)	0.9	(2.1)	(1)
12/31/X5	Balances	100	4	104	102	3	(0.9)	2.1	(5)
19X6	Amortization of premium and equity component		(4)	(4)		(3)	0.9	(2.1)	(1)
12/31/X6	Maturity at 100	(100)		(100)	100				
12/31/X6	Balances	-	-	-		-	-	-	(6)

(a) The Offsetting accounting entry would be to record or adjust a deferred tax liability

55-25 For illustrative purposes, amortization of the premium and the unrealized holding gain was computed on a straight-line basis. Premiums and discounts on debt securities should be amortized pursuant to Subtopic 310-20. Paragraph 320-10-35-10B requires that the unrealized **holding gain or loss** at the date of transfer be amortized in a manner consistent with any premium or discount. The Cumulative Effect on Interest Income column represents the difference between the amortization of the premium and the unrealized holding gain over the life of the security, and does not reflect any coupon interest received.

Interpretive response: An entity accounts for a transfer of a debt security from AFS to HTM as follows. [320-10-35-10B, 35-16]

Step 1	Reverse (in earnings) any allowance for credit losses previously recorded on the AFS debt security.
Step 2	Reclassify and transfer the debt security to the HTM category at its amortized cost basis[1] plus or minus the amount of any remaining unrealized holding gain or loss reported in AOCI.
Step 3	Amortize, as an adjustment of yield under Subtopic 310-20 (see section 3.3.40), any premium or discount that is created by adjusting the cost basis by the amount of the unrealized holding gain or loss.
Step 4	Determine if an allowance for credit losses is necessary by applying Subtopic 326-20.

Note:

1. The amortized cost basis that is transferred is reduced by any previous writeoffs but excludes any allowance for credit losses, as applicable.

See above FASB excerpt for an example illustrating how to account for a transfer of an AFS debt security to HTM.

See KPMG Handbook, Credit impairment, for Topic 326-20 guidance on determining the allowance for credit losses on HTM securities.

Example 4.4.10
Transferring a debt security from AFS to HTM

ABC Corp transfers a debt security from its AFS portfolio to its HTM portfolio on January 1, Year 2. The debt security was purchased for its $1,000,000 par value (i.e. no premium or discount was recorded).

On December 31, Year 1 (i.e. immediately before transfer from AFS to HTM), the debt security's fair value is $990,000. Also on that date, it has:

- an allowance for credit losses of $2,000, which ABC estimates using a discounted cash flow method as required by Subtopic 326-30; and
- an unrealized holding loss recorded in AOCI of $8,000.

ABC uses a non-discounted cash flow method for estimating expected credit losses for its HTM debt securities under Subtopic 326-20. Under that method, ABC estimates an allowance for credit losses of $13,000 on January 1, Year 2.

For simplicity, this example ignores the effect of income taxes.

Journal entries to record the transfer from AFS to HTM

ABC records the following journal entries upon transfer.

	Debit	*Credit*
Allowance for credit losses – AFS	2,000	
Provision for credit losses – AFS		2,000
To reverse existing allowance for credit loss on AFS debt security.		

	Debit	Credit
HTM debt security	992,000	
AFS debt security – Unrealized holding gain or loss	8,000	
AFS debt security		1,000,000
To record transfer of debt security from AFS to HTM at amortized cost basis ($1,000,000) plus unrealized holding gain or loss at that date ($8,000).		
Provision for credit losses – HTM	13,000	
Allowance for credit losses – HTM		13,000
To establish allowance for credit loss for debt security once classified as HTM.		

The effect of the above journal entries is to transfer the debt security from AFS to HTM at $992,000, which becomes its amortized cost basis. This amount differs from the debt security's fair value at the date of transfer ($990,000).

Effect of transfer on subsequent periods

In subsequent periods, ABC measures the allowance for credit losses under Subtopic 326-20 and recognizes changes in the allowance in earnings.

ABC amortizes the $8,000 unrealized loss in AOCI at the time of transfer over the remaining life of the security as an adjustment to yield (i.e. interest income) using the guidance for amortizing premiums or discounts. Further, the unrealized loss results in the debt security's amortized cost basis having a discount of $8,000, which is also amortized as an adjustment to yield. Amortization of the amount in AOCI offsets amortization of the discount in the income statement.

For example, ABC amortizes $4,000 of the amount in AOCI in Year 2 – i.e. it decreases interest income and increases AOCI for $4,000. ABC also amortizes $4,000 of the discount in Year 2 – i.e. it increases the HTM security's amortized cost basis and increases interest income.

5. Accounting for investments in equity securities

Detailed contents

New item added to this edition: **

Questions

Examples

5.1 How the standard works

The initial and subsequent measurement of equity securities is summarized in the following table. The measurement issues in particular can require significant judgment because an entity has to apply the fair value measurement principles.

Type of equity security	Initial measurement[1]	Subsequent measurement
With a readily determinable fair value or Without a readily determinable fair value when measurement alternative not elected	Transaction price or fair value	At fair value with changes reported in earnings
Without a readily determinable fair value when measurement alternative is elected	Cost	Using the measurement alternative[2]

Notes:

1. Unless other US GAAP applies.
2. Cost - any impairment +/- fair value changes when there are observable prices.

5.2 Recognition and initial measurement

5.2.10 Recognition

Topic 321 does not provide specific guidance on the recognition of equity securities.

Question 5.2.10
Is the purchase of equity securities reported on the trade date or settlement date?

Excerpt from ASC 815-10

> Regular-Way Security Trades

15-15 Regular-way security trades are defined as contracts that provide for delivery of a security within the period of time (after the trade date) generally established by regulations or conventions in the marketplace or exchange in which the transaction is being executed. For example, a contract to purchase or sell a publicly traded equity security in the United States customarily requires settlement within three business days. If a contract for purchase of that type of security requires settlement in three business days, the regular-way security trades scope exception applies, but if the contract requires settlement in five days, the regular-way security trades scope exception does not apply unless the reporting entity is required to account for the contract on a trade-date basis.

Interpretive response: Equity securities are recognized either on the trade date or settlement date. [FAS 133.BC274]

- Trade date is the date when an order to purchase or sell a financial instrument occurs.
- Settlement date is the date the seller is required to deliver, and the purchaser is required to pay for, the financial instrument(s).

Entities in certain industries are required to apply trade date accounting to regular-way security trades. For example, broker dealers in the scope of Topic 940 and depository and lending institutions in the scope of Topic 942 apply trade date accounting to regular-way security trades. [860-20-25-2, 940-320-25-1, 942-325-25-2]

Regular-way security trades

Regular-way security trades are contracts that provide for delivery of a security within the period generally established by regulations or conventions in the marketplace or exchange in which the transaction is being executed. [815-10-15-15]

If industry-specific guidance requiring trade date accounting does not apply to the purchase in such trades, we believe the investor/purchaser may elect an accounting policy to use either trade date or settlement date accounting. However, we do not believe trade date accounting should be applied if there are any conditions required for closing that have not been met; in that case, settlement date accounting should be applied in these scenarios.

Trades that are not regular-way

We do not believe trade date accounting should be applied to trades that are not regular-way. In that case, settlement date accounting should be applied.

Applying settlement date accounting

A purchaser/investor that applies settlement date accounting to a security underlying a contract is required to recognize the purchase contract itself when:

- When the purchase contract is required to be accounted for as a derivative under Topic 815. Derivative accounting is not required if the contract does not meet the definition of a derivative or qualifies for the scope exception for regular-way securities trades. See chapter 2 of KPMG Handbook, Derivatives and hedging.
- When Topic 815 requires the purchase contract to be accounted for as if it is in the scope of Topic 321. See section 2.5. [815-10-15-141]

Example 5.2.10
Trade date vs. settlement date

Scenario 1: Entity records equity securities on trade date

On January 1, Year 1 (trade date), Investor purchases publicly traded equity securities for $1,000. The purchase is a regular-way trade. The transaction settles on January 3, Year 1 (settlement date). For simplicity, this example disregards transaction costs.

Investor is a depository institution subject to Topic 942, which requires that regular-way purchases be recorded on the trade date.

Investor records the following journal entries for the purchase in Year 1.

	Debit	*Credit*
Equity securities	1,000	
Payable to seller[1]		1,000
To record purchase of equity securities on trade date (Jan 1).		
Payable to seller	1,000	
Cash		1,000
To record payment of cash and remove payable on settlement date (Jan 3).		

Note:
1. A payable to the seller is recorded because the transaction has not yet settled.

Scenario 2: Entity records equity securities on settlement date

On January 1, Year 1 (trade date), Investor purchases publicly traded equity securities for $1,000. The purchase is a regular-way trade. The transaction settles on January 3, Year 1 (settlement date). For simplicity, this example:

- disregards transaction costs; and
- ignores the accounting for the forward purchase contract that arose at the trade date.

Investor is in an industry that does not require the purchase of regular-way securities to be recorded on the trade date. Investor's accounting policy is to record equity security purchases on the settlement date. The trade qualifies for the regular-way trades scope exception from derivative accounting.

Investor records the following journal entry for the purchase. No journal entry is recorded on the trade date (January 1, Year 1).

	Debit	*Credit*
Equity securities[1]	1,000	
Cash		1,000
To record equity security and payment of cash to seller on settlement date (Jan 3).		

Note:
1. Equity securities acquired under a forward purchase contract subject to Subtopic 815-10 are initially measured at their fair value at the settlement date (see Question 5.4.340).

5.2.20 Initial measurement

Topic 321 does not provide specific guidance on initial measurement of equity securities.

Question 5.2.20
How are equity securities initially measured?

Excerpt from ASC 946-320

30-1 An investment company shall initially measure its investments in debt and equity securities at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction.

Background: In most cases, an equity security's transaction price (excluding transaction costs) and fair value will be the same. However, there are a limited number of circumstances in which the amounts will differ. For example, this could be the case when the: [820-10-30-3A]

- transaction is between related parties;
- transaction was entered into in a market other than the entity's principal market; or
- transaction takes place under duress or the seller is forced to accept the price in the transaction.

See Question I10 in KPMG Handbook, Fair value measurement, for further discussion of differences between the transaction price and fair value.

Interpretive response: Topic 321 does not provide specific guidance on recognition and initial measurement of equity securities. In some situations, other Topics provide specific guidance – e.g. equity securities acquired under certain forward or option contracts (see Question 5.4.320) or in a business combination (Topic 805).

Entities other than investment companies

We believe an entity (except for an investment company) may elect an accounting policy, to be applied consistently, to initially measure equity securities for which the measurement alternative is not applied at either transaction price or fair value. For equity securities for which the measurement alternative is not applied, the practical effect of either measurement (i.e. transaction price or fair value) is the same because such securities are remeasured at fair value through earnings immediately following initial recognition. As a result, any difference between fair value and transaction price at initial recognition is reported in earnings immediately.

We believe equity securities for which the measurement alternative is applied are initially measured at cost.

Investment companies

An investment company is required to measure equity securities at transaction price and therefore cannot elect to measure them at fair value. The securities are remeasured at fair value through earnings immediately following initial recognition. As such, the difference between transaction price and fair value is reported in earnings immediately. [946-320-30-1, 35-1]

5.3 Subsequent measurement: At fair value with changes reported in earnings

Excerpt from ASC 321-10

20 Glossary

Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Related Parties

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

35-1 Except as provided in paragraph 321-10-35-2, investments in **equity securities** shall be measured subsequently at **fair value** in the statement of financial position. Unrealized **holding gains and losses** for equity securities shall be included in earnings.

Equity securities are subsequently measured at fair value with changes in fair value reported in earnings when: [321-10-35-1 – 35-2]

- they have readily determinable fair values; or

- they do not have readily determinable fair values and the entity does not elect the measurement alternative (see section 5.4).

Because changes in fair value are reported in earnings, these securities are not evaluated for impairment.

Question 5.3.10
When does an equity security have a readily determinable fair value?

Excerpt from ASC 321-10

20 Glossary

Readily Determinable Fair Value

An equity security has a readily determinable fair value if it meets any of the following conditions:

a. The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group Inc. Restricted stock meets that definition if the restriction terminates within one year.
b. The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to above.
c. The fair value of an equity security that is an investment in a mutual fund or in a structure similar to a mutual fund (that is, a limited partnership or a venture capital entity) is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.

Interpretive response: An equity security has a readily determinable fair value if it meets any of the conditions in the following table. [321-10 Glossary]

	Condition	Description/explanation
1	Sales prices or bid and ask quotations are currently available on a securities exchange registered with the SEC or in the over-the-counter (OTC) market.	If in the OTC market, for this condition to be met the sales prices or quotations must be publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group Inc.
2	For an equity security traded only in a foreign market, that foreign market is	We believe there is a rebuttable presumption that the primary

	Condition	Description/explanation
	of a breadth and scope comparable to one of the US markets referred to in (1).	exchange in a foreign market has a breadth and scope comparable to one of the US markets.
3	For an equity security that is an investment in a mutual fund or a structure similar to a mutual fund (i.e. a limited partnership or venture capital entity), the fair value per share (unit) is determined and published and is the basis for current transactions.	See Question Q15 in KPMG Handbook, Fair value measurement, for further discussion about an equity security that is an investment in a structure similar to a mutual fund.

Question 5.3.20

Does a restriction on the sale/transfer of an equity security affect whether it has a readily determinable fair value?

Excerpt from ASC 820-10

> Fair Value Measurements of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

15-5 The definition of readily determinable fair value indicates that an equity security would have a readily determinable fair value if any one of three conditions is met. One of those conditions is that sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group Inc. The definition notes that restricted stock meets that definition if the restriction expires within one year. If an investment otherwise would have a readily determinable fair value, except that the investment has a restriction expiring in more than one year, the reporting entity shall not apply paragraphs 820-10-35-59 through 35-62 and 820-10-50-6A to the investment.

Interpretive response: It depends. If the equity security would otherwise have a readily determinable fair value, we believe whether the restriction would cause the security to not have a readily determinable fair value depends on the nature and duration of the restriction.

Nature of restriction

The nature of the restriction(s) affects whether the restriction is considered in measuring fair value.

- If the restriction is security-specific, the fair value of the security generally includes an adjustment to the quoted price of similar but unrestricted securities.
- If the restriction is entity-specific, the price of the security is not adjusted because the restriction is not considered to be an attribute of the asset being valued.

If a restriction is not considered in measuring fair value, we believe it should not affect the determination of whether the equity security has a readily determinable fair value.

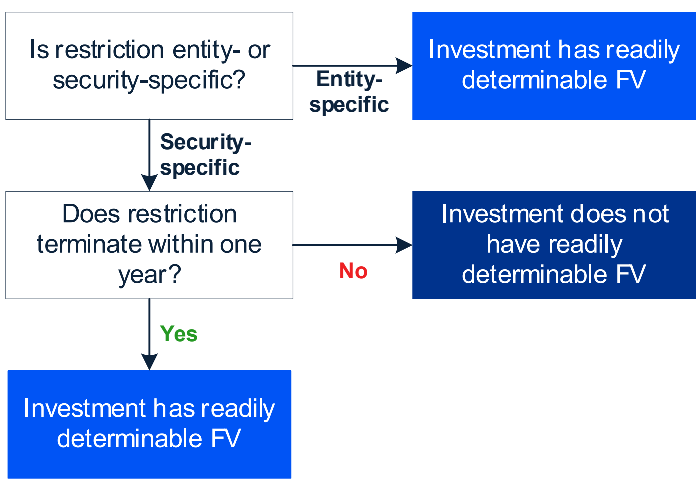
For more information on determining if a restriction is security- or entity-specific, see Question C40 in KPMG Handbook, Fair value measurement.

Duration of restriction

If a security-specific restriction terminates within one year, the equity security can have a readily determinable fair value if one of the three conditions in Question 5.3.10 is met. [820-10-15-5]

Summary of analysis

If the equity security met one of the three conditions, the following decision tree summarizes the above analysis to help determine whether an equity security with a restriction can have a readily determinable fair value.



If an equity security does not have a readily determinable fair value, the entity may be able to subsequently measure it using a measurement alternative instead of at fair value. See section 5.4.

Forthcoming requirements

The FASB issued ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Restrictions, in June of 2022. The amendments to Topic 820:

- clarify that contractual restrictions on the sale of an equity security are not considered in measuring the fair value of the equity security;
- indicate that an entity cannot recognize a contractual sale restriction as a separate unit of account; and
- require new disclosures for all entities with equity securities subject to a contractual restriction.

See KPMG Defining Issues, Clarifications to fair value measurement implications of contractual sale restrictions.

Question 5.3.30

Does an entity evaluate whether an equity security has a readily determinable fair value at each reporting period?

Interpretive response: Yes. If an entity determines an equity security has a readily determinable fair value, it evaluates whether the security continues to have a readily determinable fair value at each reporting period. [321-10-35-2]

We believe an equity security does not need to be traded on the reporting date to be considered to have a readily determinable fair value. Question 5.3.10 discusses how an entity determines if an equity security has a readily determinable fair value.

Question 5.3.40

How does an entity remeasure foreign-currency denominated equity securities when the measurement alternative is not elected?

Interpretive response: At each reporting date, an entity remeasures foreign-currency denominated assets and liabilities from the foreign currency to the entity's functional currency. The rate used to remeasure the asset or liability depends on whether it is a monetary or nonmonetary asset or liability. [830-10-45-17 – 45-18]

Equity securities for which the measurement alternative is not elected are monetary assets. Monetary assets are remeasured at the current exchange rate. [830-10-45-17]

See section 3 of KPMG Handbook, Foreign currency, for additional guidance.

5.4 Subsequent measurement: Measurement alternative elected

5.4.10 Overview

Excerpt from ASC 321-10

> Equity Securities without Readily Determinable Fair Values

35-2 An entity may elect to measure an equity security without a **readily determinable fair value** that does not qualify for the practical expedient to estimate fair value in accordance with paragraph 820-10-35-59 at its cost minus impairment, if any. If an entity identifies observable price changes in **orderly transactions** for the identical or a similar investment of the same issuer, it shall measure the equity security at fair value as of the date that the observable transaction occurred. An election to measure an equity security in accordance with this paragraph shall be made for each investment separately. Once an entity elects to measure an equity security in accordance with this paragraph, the entity shall continue to apply the measurement guidance in this paragraph until the investment does not qualify to be measured in accordance with this paragraph (for example, if the investment has a readily determinable fair value or becomes eligible for the practical expedient to estimate fair value in accordance with paragraph 820-10-35-59). The entity shall reassess at each reporting period whether the equity investment without a readily determinable fair value qualifies to be measured in accordance with this paragraph. If an entity measures an equity security in accordance with this paragraph (and the security continues to qualify for measurement in accordance with this paragraph), the entity may subsequently elect to measure the equity security at fair value. If an entity subsequently elects to measure an equity security at fair value, the entity shall measure all identical or similar investments of the same issuer, including future purchases of identical or similar investments of the same issuer, at fair value. The election to measure those securities at fair value shall be irrevocable. Any resulting gains or losses on the securities for which that election is made shall be recorded in earnings at the time of the election.

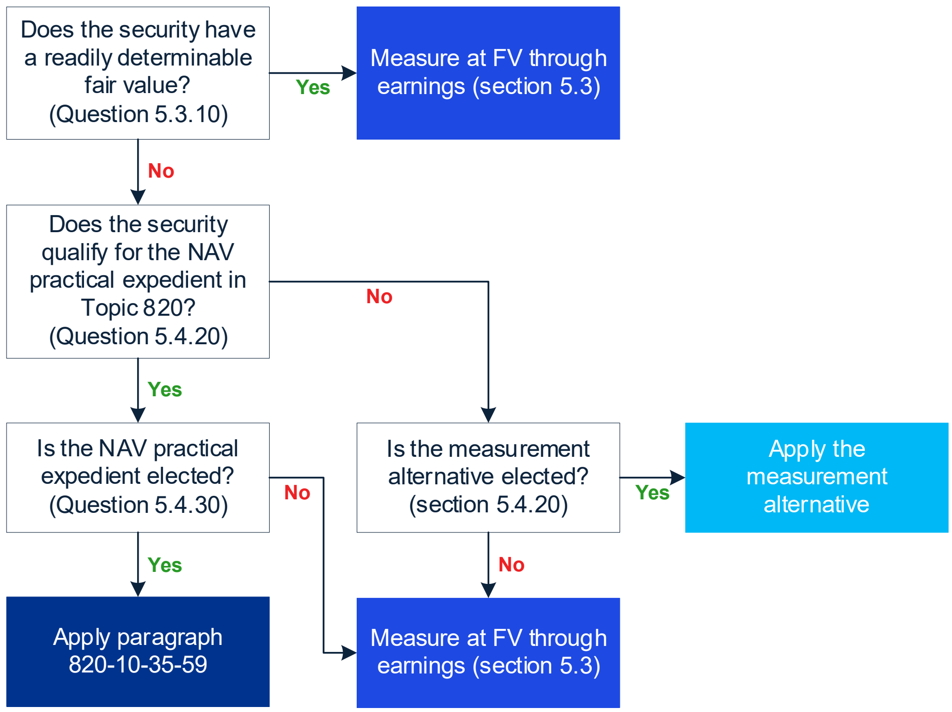
An entity may elect to subsequently measure equity securities without readily determinable fair values at: [321-10-35-1 – 35-2]

- fair value with changes in fair value reported in earnings (see section 5.3); or
- cost +/- fair value adjustments if there are observable prices minus impairment (if any). This approach is referred to as the measurement alternative.

Question 5.4.40 and section 5.5 discuss the remeasurement of foreign-currency denominated equity securities and income recognition, respectively.

Question 5.4.10
Which securities in the scope of Topic 321 are eligible for the measurement alternative?

Interpretive response: The following decision tree highlights the steps involved in analyzing whether equity securities in the scope of Topic 321 are eligible for the measurement alternative.



Question 5.4.20
What securities qualify for the NAV practical expedient?

Excerpt from ASC 820-10

• > Fair Value Measurements of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

15-4 Paragraphs 820-10-35-59 through 35-62 and 820-10-50-6A shall apply only to an investment that meets both of the following criteria as of the reporting entity's measurement date:

a. The investment does not have a **readily determinable fair value**
b. The investment is in an investment company within the scope of Topic 946 or is an investment in a real estate fund for which it is industry practice to measure investment assets at fair value on a recurring basis and to issue financial statements that are consistent with the measurement principles in Topic 946.

> Measuring the Fair Value of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

35-59 A reporting entity is permitted, as a practical expedient, to estimate the fair value of an investment within the scope of paragraphs 820-10-15-4 through 15-5 using the net asset value per share (or its equivalent, such as member units or an ownership interest in partners' capital to which a proportionate share of net assets is attributed) of the investment, if the net asset value per share of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of Topic 946 as of the reporting entity's measurement date.

Excerpt from ASC 946-10

> Entities

15-2 The accounting principles discussed in this Topic apply to all investment companies. An investment company as discussed in this Topic is an entity that meets the assessment described in paragraphs 946-10-15-4 through 15-9.

Interpretive response: The net asset value (NAV) practical expedient applies if the security does not have a readily determinable fair value and it is an investment in either: [820-10-15-4, 35-59, 946-10-15-2]

- an investment company in the scope of Topic 946; or
- a real estate fund that measures investments at fair value and issues financial statements consistent with the measurement principles in Topic 946.

Question 5.4.30
Can an entity apply the measurement alternative to a security that is eligible for, but for which the entity has not elected, the NAV practical expedient?

Interpretive response: No. If the security is eligible for the NAV practical expedient but the entity chooses not to apply it, the measurement alternative cannot be applied, and the security is measured at fair value with changes in fair value reported through earnings. [321-10-35-2]

Question 5.4.40
How does an entity remeasure foreign-currency denominated equity securities when the measurement alternative is elected?

Interpretive response: Equity securities for which the measurement alternative is elected are non-monetary assets. Non-monetary assets are remeasured at the historical exchange rate. The historical exchange rate used is as of the later of: [830-10-45-18]

- the acquisition date; or
- the most recent date on which the equity security was adjusted to fair value due to:
  - observable price changes in orderly transactions for a similar investment of the same issuer; or
  - impairment.

Therefore, if the carrying amount of an equity security is adjusted, the current exchange rate at that date is used to measure the fair value of the equity security. The difference between a security's functional-currency-equivalent fair value (based on the current exchange rate) on the date of remeasurement and the security's carrying amount (based on the historical exchange rate) is reported in earnings. See section 3 of KPMG Handbook, Foreign currency, for additional guidance.

5.4.20 Electing the measurement alternative

Question 5.4.50
When does an entity elect the measurement alternative?

Interpretive response: We believe the election to apply the measurement alternative is available only:

- at initial recognition of an equity security without a readily determinable fair value;
- when the fair value of an equity security ceases to be readily determinable; or
- when an existing security without a readily determinable fair value initially becomes subject to Topic 321 – e.g. if a security no longer qualifies to be accounted for under the equity method.

An entity that elects the measurement alternative is required to do so separately for each security. [321-10-35-2]

Question 5.4.60

What documentation is required to support an election to apply the measurement alternative?

Interpretive response: Topic 321 does not provide guidance on how to document an election to apply the measurement alternative. We believe an entity should document its election concurrently with its decision to elect this alternative. We believe an entity may choose to:

- separately document its election for each eligible security; or
- document the election as part of a policy that applies to specific securities and that includes sufficient criteria to determine which securities are subject to the election.

Question 5.4.70

Does an entity need to evaluate if an equity security continues to qualify for the measurement alternative?

Interpretive response: Yes. If an entity elects the measurement alternative, it evaluates whether the security continues to qualify for the alternative at each reporting period. For example, a security would no longer qualify if it has a readily determinable fair value or it becomes eligible for the NAV practical expedient. An entity should have processes and controls to determine how to monitor that each equity security under the measurement alternative continues to meet the qualifying criteria. [321-10-35-2]

Question 5.4.80

If an entity elects the measurement alternative, can it subsequently elect to measure the equity security at fair value?

Interpretive response: Yes. An entity that elects the measurement alternative may subsequently elect to measure the equity security at fair value. The subsequent fair value election applies to the equity security and all identical or similar investments of the same issuer. Question 5.4.130 discusses whether investments are similar. [321-10-35-2]

Once the election is made to measure the equity security at fair value, it is irrevocable and also applies to all future purchases of identical or similar investments of the same issuer. Any resulting gains and losses on the securities for which that election is made are reported in earnings at the time of the election. [321-10-35-2]

Once the election is made to measure at fair value, an entity will need processes and controls to identify future purchases of identical or similar investments of the same issuer and ensure that they are also measured at fair value.

Question 5.4.90

Can an entity elect the measurement alternative if it previously elected the fair value option under Topic 825?

Excerpt from ASC 825-10

> Overall Guidance

25-2 The decision about whether to elect the fair value option:

a. Shall be applied instrument by instrument, except as discussed in paragraph 825-10-25-7
b. Shall be irrevocable (unless a new election date occurs, as discussed in paragraph 825-10-25-4)
c. Shall be applied only to an entire instrument and not to only specified risks, specific cash flows, or portions of that instrument.

• > Election Dates

25-4 An entity may choose to elect the fair value option for an eligible item only on the date that one of the following occurs:

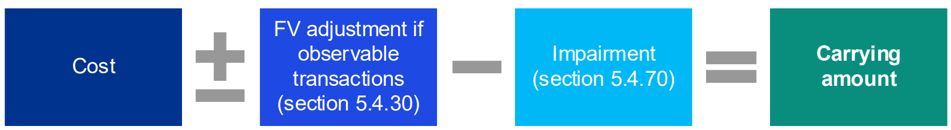
a. The entity first recognizes the eligible item.
b. The entity enters into an eligible **firm commitment**.
c. Financial assets that have been reported at fair value with unrealized gains and losses included in earnings because of specialized accounting principles cease to qualify for that specialized accounting (for example, a transfer of assets from a subsidiary subject to Subtopic 946-10 to another entity within the consolidated reporting entity not subject to that Subtopic).
d. The accounting treatment for an investment in another entity changes because the investment becomes subject to the equity method of accounting.
e. An event that requires an eligible item to be measured at fair value at the time of the event but does not require fair value measurement at each reporting date after that, excluding the recognition of impairment under lower-of-cost-or-market accounting or accounting for securities in accordance with either Topic 321 on investments—equity securities or Topic 326 on measurement of credit losses.

Interpretive response: No. If an entity elected the fair value option under Topic 825, the equity security must be measured at fair value and is not eligible for the measurement alternative. This is the case even if the fair value of an equity security ceases to be readily determinable; the entity has to continue to apply Topic 825 and is not permitted to elect the measurement alternative. The fair value option is irrevocable unless a new election date occurs. There is not a new election date as a result of the fair value no longer being readily determinable. [825-10-25-2, 25-4]

5.4.30 Applying the measurement alternative: Overview

Question 5.4.100
How is an equity security subsequently measured using the measurement alternative?

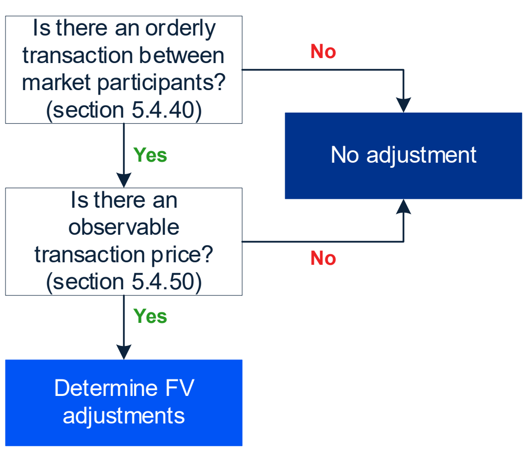
Interpretive response: If the measurement alternative is elected, an entity subsequently measures an equity security as follows. [321-10-35-2]



Therefore, in applying the measurement alternative, an entity starts with the cost (see Question 5.2.20) but makes fair value adjustments to the cost for any observable transactions and for any impairments. Once the first adjustments are made to the cost, any subsequent adjustments are made to the new carrying amount.

Question 5.4.110
What is the process for determining if adjustments for observable transactions are needed?

Interpretive response: The following decision tree summarizes what an entity considers when determining if adjustments for observable transactions are needed. There is no requirement to evaluate these in any particular sequence. [321-10-35-2]



5.4.40 Applying the measurement alternative: Orderly transaction between market participants

Question 5.4.120
What types of transactions does an entity identify to determine if they are orderly transactions between market participants?

Interpretive response: An entity determines whether there are orderly transactions between market participants for the identical or a similar investment of the same issuer. [321-10-35-2]

Question 5.4.130
How does an entity determine whether two securities are similar?

Excerpt from ASC 321-10

• • > Identifying Similar Investment of Same Issuer

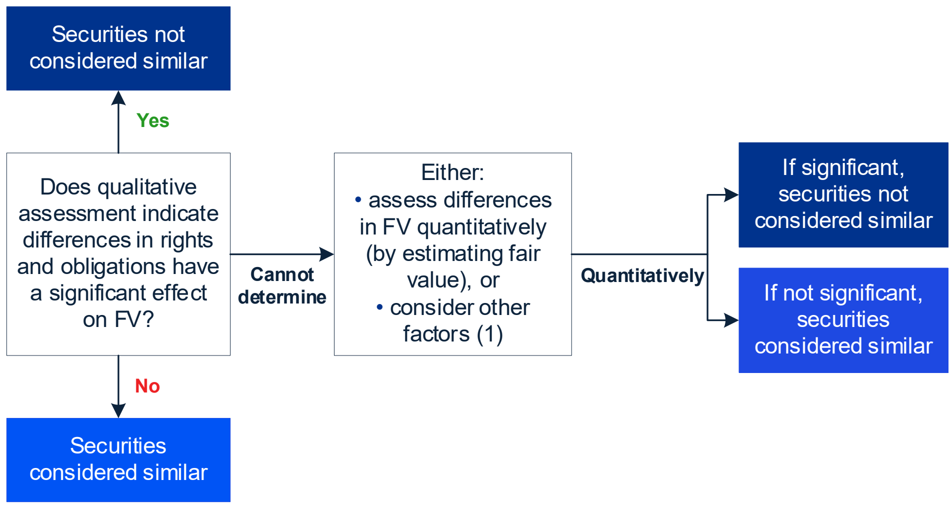
55-9 To identify whether a security issued by the same issuer is similar to the equity security held by the entity, the entity should consider the different rights and obligations of the securities. Differences in rights and obligations could include characteristics such as voting rights, distributions rights and preferences, and conversion features. The entity should adjust the observable price of a similar security for the different rights and obligations to determine the amount that should be recorded as an upward or downward adjustment in the carrying value of the security measured in accordance with paragraph 321-10-35-2 to reflect the current fair value of the security as of the date that the observable transaction for the similar security took place.

Background: Investor owns Series A preferred shares of an investee and recently observed a transaction in Series B preferred shares of the same investee. The two series have different liquidation preferences, different dividend rates and neither has voting rights. All other rights and obligations are the same.

Interpretive response: Determining whether a security issued by the same issuer is similar to the equity security held by the entity is a matter of judgment.

We believe an entity should consider the extent of differences in rights and obligations between the securities, including the extent to which those differences affect the fair values of those securities. In the background example, the rights and obligations considered by Investor include the differences in liquidation preferences and dividend rates. An entity will need to develop a consistent process to determine if two securities are similar.

The following decision tree summarizes the steps we believe are followed to determine whether two securities issued by the same issuer are similar.



Note:

1. Based on discussions with the FASB staff, these 'other' factors could include the complexity of the calculation (i.e. the degree of difficulty) required to adjust the observable price for the differences in rights and obligations. If an entity chooses this approach and concludes that the degree of difficulty is high, it will generally conclude that the security is not similar. Alternatively, if the entity determines that the degree of difficulty is low, we generally believe it should calculate the adjustment and assess the significance quantitatively. Question 5.4.210 discusses adjustments to the observed transaction price of identical or similar instruments.

Question 5.4.140

What is an orderly transaction?

Excerpt from ASC 321-10

20 Glossary

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Interpretive response: An orderly transaction assumes sufficient time to market the asset or liability in the usual and customary manner – i.e. it is not forced. For certain types of assets, including liquid financial instruments (e.g. actively traded equity securities), the usual and customary market exposure may be short. In other situations (e.g. illiquid equity securities), a longer market exposure might be required to generate interest, contact potential buyers, conduct negotiations and complete legal agreements. Therefore, the amount of time that is considered customary depends on the type of equity security. [321-10 Glossary]

Question 5.4.150

What are the characteristics of a transaction that is forced or not orderly?

Excerpt from ASC 820-10

> Measuring Fair Value When the Volume or Level of Activity for an Asset or a Liability Has Significantly Decreased

35-54D If a reporting entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if a reporting entity determines that a transaction or quoted price does not represent fair value (for example, there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the reporting entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (for example, when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).

> Identifying Transactions That Are Not Orderly

35-54I The determination of whether a transaction is orderly (or is not orderly) is more difficult if there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances, it is not appropriate to conclude that all transactions in that market are not orderly (that is, forced liquidations or distress sales). Circumstances that may indicate that a transaction is not orderly include the following:

a. There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.

b. There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
c. The seller is in or near bankruptcy or receivership (that is, the seller is distressed).
d. The seller was required to sell to meet regulatory or legal requirements (that is, the seller was forced).
e. The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

A reporting entity shall evaluate the circumstances to determine whether, on the weight of the evidence available, the transaction is orderly.

Interpretive response: Generally, a forced transaction occurs under duress or when the seller is otherwise forced to accept a price that a willing market participant would not accept. Whether a transaction is forced is based on the facts and circumstances of the specific transaction and the parties participating in that transaction. Forced transactions are not considered orderly. [321-10 Glossary]

Circumstances that may indicate that a specific transaction is not orderly include the following. [820-10-35-54I]

- There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary under current market conditions.
- There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- The seller is in, or near, bankruptcy or receivership.
- The seller was required to sell to meet regulatory or legal requirements – i.e. was forced to sell.
- The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

A decrease in the volume or level of activity for an asset or liability on its own may not indicate that a transaction or a quoted price in that market is not orderly. It is not appropriate to presume that all transactions in a market in which there has been a decrease in the volume or level of activity are not orderly. [820-10-35-54D]

Even in periods of economic downturn and market volatility, an entity cannot disregard observable prices identified unless those prices are from transactions that are determined not to be orderly.

Question 5.4.160

How extensive should an entity's analysis be to support a conclusion that a transaction is orderly?

Excerpt from ASC 820-10

> Identifying Transactions That Are Not Orderly

35-54J A reporting entity need not undertake exhaustive efforts to determine whether a transaction is orderly, but it shall not ignore information that is reasonably available. When a reporting entity is a party to a transaction, it is presumed to have sufficient information to conclude whether the transaction is orderly.

Interpretive response: We believe an entity can generally assume that all transactions are orderly transactions unless there is evidence to suggest otherwise. An entity is not required to undertake exhaustive efforts to determine whether a transaction is orderly, but it cannot ignore contrary evidence that is reasonably available. [820-10-35-54J]

It is not appropriate to assume all transactions in a relatively illiquid market are forced and therefore not orderly. For example, transactions between market participants executed in a manner that is usual and customary under current market conditions generally are considered orderly, even in a relatively illiquid market. The fact that the current market conditions broadly are described as illiquid should not dictate that a specific transaction is not orderly. [820-10-35-54I]

Question 5.4.170

What does an entity do if it has evidence that an observed transaction is not orderly?

Interpretive response: An entity ignores an observed transaction price if it is from a transaction that is not orderly. Therefore, the entity does not adjust the carrying amount of the equity investment based on that observed transaction when using the measurement alternative.

Question 5.4.180
What are the characteristics of a market participant?

Excerpt from ASC 321-10

20 Glossary

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Interpretive response: A market participant includes buyers and sellers in the principal (or most advantageous) market for the asset or liability with the following characteristics: [321-10 Glossary]

- independent of each other (i.e. not related parties);
- knowledgeable, having a reasonable understanding about the asset or liability and the transaction;
- able to enter into the transaction for the asset or liability; and
- willing to enter into the transaction for the asset or liability (not forced or otherwise compelled).

5.4.50 Applying the measurement alternative: Observable transaction price

Question 5.4.190
What types of transactions are potential sources for observable prices?

Excerpt from ASC 321-10

> Equity Securities without Readily Determinable Fair Values

• > Identifying Observable Price Changes

55-8 To identify observable price changes, an entity should consider relevant transactions that occurred on or before the balance sheet date that are known or can reasonably be known. To identify price changes that can reasonably be known, the entity should make a reasonable effort (that is without expending undue cost and effort) to identify any observable transactions that it may not be readily aware of. The entity need not conduct an exhaustive search for all observable price changes.

Interpretive response: In general, we believe that observable prices will be obtained from orderly transactions between market participants involving the purchase and sale of equity securities. Question 5.4.180 discusses the characteristics of a market participant. Examples of such transactions could include purchases and sales in secondary market transactions or, in certain circumstances, new issuances of equity securities.

An entity should make a reasonable effort without expending undue cost and effort to identify price changes that are known or that can be reasonably known. Judgment should be exercised when determining the level of 'reasonable effort' required to identify an observable price change. [321-10-55-8]

When there is a reasonable expectation that there could be third-party transactions involving identical or similar securities, we generally believe an entity should conduct a search for observable prices for these transactions. We do not believe an entity should limit its search to identifying whether the entity itself had purchased or sold these securities in the reporting period. However, we believe that if an entity sells some of its equity securities, but continues to hold the same equity securities, the sale would generally be considered an observable transaction.

Third-party sources may provide management with data points for measuring equity securities. However, management is responsible for understanding the source of information obtained from third parties and for determining whether a price is obtained from an observable transaction.

An entity will need to design processes and controls to:

- determine the sources of information for observable transactions; and
- identify third-party transactions of identical or similar securities.

We believe an entity will need to reevaluate its processes and controls, including third-party sources used to identify observable transactions, based on changes in the market or equity security.

The following are some transactions and whether we believe they are potential sources for observable transaction prices.

Type of transaction	Observable transaction price?	Analysis
An entity issues equity securities to employees as share-based compensation	No	Transactions with employees do not involve market participants purchasing or selling shares. In addition, there is no exposure to the market to allow for marketing activities that are usual and customary.
Exercise of a preexisting option to buy equity securities at a fixed price	No	We believe the exercise of an option to buy equity securities at a fixed price is not considered an observable transaction price. This is because it involves the exercise of a preexisting right to purchase an equity security at a previously negotiated price.
Acquisition of a group of assets that includes equity securities	It depends	We believe the acquisition of equity securities in a multi-element exchange that also involves dissimilar assets constitutes an observable price for the equity securities if each asset in the group is (1) known and (2) has a readily determinable fair value. In contrast, if the composition of the group is not known or if one or more of the assets exchanged does not have a readily determinable fair value, we do not believe the acquisition constitutes an observable price for the equity securities.
An entity issues equity securities in exchange for assets that do not have a readily determinable fair value	No	We believe that if the assets exchanged do not have a readily determinable fair value, the transaction does not constitute an observable price for the equity securities.

Type of transaction	Observable transaction price?	Analysis
Bona fide offer to purchase or sell an equity security	No	We believe that a bona fide offer to purchase or sell an equity security is not an observable transaction price because it does not represent an actual transaction.
Broker quote	No	We believe a broker quote is not an observable transaction price because it does not represent an actual transaction.

5.4.60 Applying the measurement alternative: Fair value adjustments for observable transactions

Question 5.4.200
Does Topic 820 apply when observable price changes are identified?

Interpretive response: Yes. If an entity identifies observable price changes in orderly transactions for the identical or a similar investment of the same issuer, the security is measured at fair value under Topic 820 – which may or may not be the observed transaction price. The fair value measurement is as of the date the observable transaction took place (the measurement date). Once it determines the security's fair value as of the measurement date, the entity adjusts the security's carrying amount to reflect this fair value; therefore, the adjustment is the difference between this fair value and the security's carrying amount. [321-10-35-2]

Judgment is required to determine what (if any) adjustments need to be made to the observed transaction price. For further discussion of potential adjustments an entity might make to the observed transaction price when measuring fair value under Topic 820, see Question 5.4.210.

In addition, Question 5.4.230 discusses the period in which an entity adjusts the carrying amount of an equity security if an observable transaction occurs.

Question 5.4.210
Can an observed transaction price of the identical or similar instrument be adjusted?

Excerpt from ASC 820-10

30-3 In many cases, the transaction price will equal the fair value (for example, that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold).

> Inputs to Valuation Techniques

• > General Principles

35-36B A reporting entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability (see paragraphs 820-10-35-2B through 35-2C). In some cases, those characteristics result in the application of an adjustment, such as a premium or discount (for example, a control premium or noncontrolling interest discount). However, a fair value measurement shall not incorporate a premium or discount that is inconsistent with the unit of account in the Topic that requires or permits the fair value measurement. Premiums or discounts that reflect size as a characteristic of the reporting entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity, as described in paragraph 820-10-35-44) rather than as a characteristic of the asset or liability (for example, a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement. In all cases, if there is a quoted price in an active market (that is, a Level 1 input) for an asset or a liability, a reporting entity shall use that quoted price without adjustment when measuring fair value, except as specified in paragraph 820-10-35-41C.

Background: When an entity observes a transaction for a similar (but not identical) security, it considers the guidance in Question 5.4.130 to determine whether the two securities are similar. If the security is identical or similar, the entity considers whether adjustments to the observed transaction price need to be made.

Interpretive response: Yes. In many cases, the observed transaction price for an identical or similar security is a reliable indication of fair value for the equity security. However, we believe there may be circumstances in which fair value under Topic 820 differs from the observed transaction price, even if the identical security was exchanged. [820-10-30-3]

Judgment is required to determine what (if any) adjustments need to be made to the observed transaction price. The guiding principle from Topic 820 is that any adjustments that would be applied by a market participant are to be considered in the fair value measurement.

The following table includes examples of potential adjustments to consider (not exhaustive).

Factor	Considerations when measuring fair value under Topic 820
Blockage factors, control premiums and other differences in marketability (or liquidity)	An entity may not consider blockage factors in a fair value measurement. This is because they are specific to the size of an entity's holding and its decision to transact in a block (i.e. they are entity-specific considerations). [820-10-35-36B] If the price paid in the observed transaction included a blockage factor that was incurred by the seller, the entity adjusts the transaction price to remove the impact of the block discount. [820-10-35-36B] If an investor paid a premium to acquire a controlling interest in the investee, the entity adjusts the transaction price to remove the control premium. [820-10-35-36B] In addition, if there are other differences between the marketability (or liquidity) of the equity security sold in the observed transaction and the equity security held by the entity, an adjustment is necessary to reflect those differences. For more discussion on these adjustments, see Questions G30 and G40 in KPMG Handbook, Fair value measurement.
Principal (or most advantageous) market	Equity securities may be transacted at different prices in different markets. An adjustment to the transaction price may be necessary if the market in which the observed transaction takes place is different from the entity's principal (or most advantageous) market.
Other indications of value	If the evidence indicates that the transaction is orderly, an entity considers that transaction price when measuring fair value. The weighting placed on the transaction price (when compared to other indicators of fair value) depends on the facts and circumstances of the transaction and the nature and quality of other available inputs. [820-10-35-54J(b)]
Rights and obligations	If an entity identifies an observable transaction for a similar (but not identical) security, it adjusts the observable price of the similar security to reflect differences in the rights and obligations between the equity security that was transacted, and the equity security held by the entity. Examples of differences include, but are not limited to, voting rights, distribution rights and preferences, liquidation preferences, conversion ratios, dividends and anti-dilution provisions. [321-10-55-9]

See KPMG Handbook, Fair value measurement, for additional guidance and examples for determining fair value.

Question 5.4.220
What adjustments are made when no observable prices are available during a reporting period?

Interpretive response: If an entity applies the measurement alternative and there are no observable prices available during a reporting period, a fair value adjustment is not made to the carrying amount of the equity security. However, even if there are no observable prices, an entity still needs to assess the security for impairment and adjust the carrying amount for any impairment loss (see section 5.4.70).

Question 5.4.230
In what period is a fair value adjustment made to the carrying amount of an equity security?

Excerpt from ASC 855-10

> Recognized Subsequent Events

• > Evidence about Conditions That Existed at the Date of the Balance Sheet

25-1 An entity shall recognize in the financial statements the effects of all **subsequent events** that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. See paragraph 855-10-55-1 for examples of recognized subsequent events.

25-1A An entity that meets either of the following criteria shall evaluate subsequent events through the date the financial statements are issued:

a. It is an **SEC filer**.
b. It is a conduit bond obligor for **conduit debt securities** that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets).

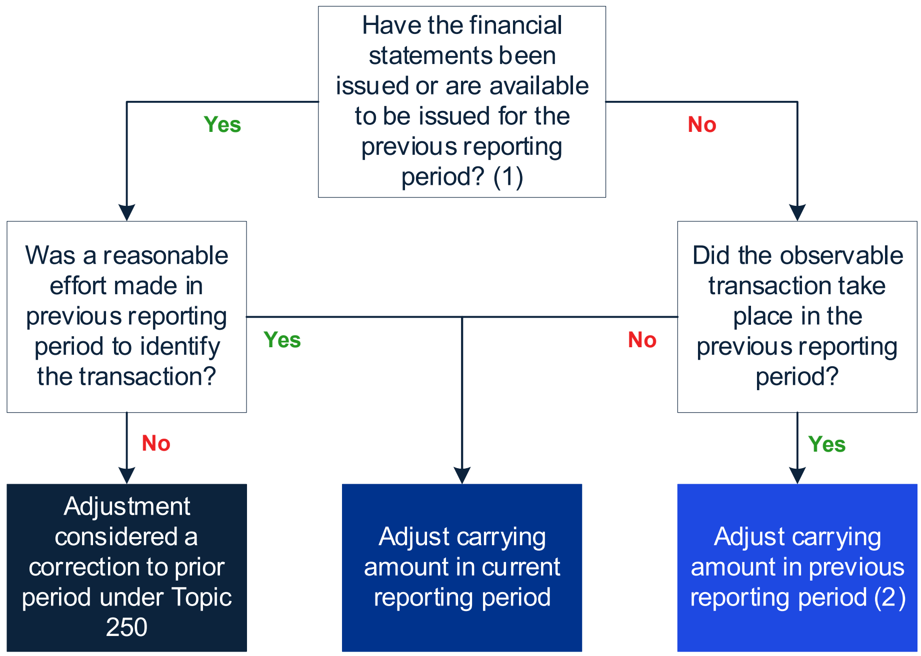
25-2 An entity that meets neither criteria in the preceding paragraph shall evaluate subsequent events through the date that the financial statements are available to be issued.

Interpretive response: It depends. We believe that if an observable transaction takes place before the reporting date, but the entity only becomes aware of the transaction price after the reporting date, the period in which the carrying amount is adjusted depends on whether:

- the entity's financial statements have been issued or are available to be issued;[1] and

- the entity is able to demonstrate it made a reasonable effort to identify observable transactions in the period in which the observable transaction took place.

The following decision tree summarizes what we believe an entity should consider to determine the reporting period in which it should adjust the carrying amount of an equity security. [855-10-25-1 – 25-2]



Notes:

1. SEC filers and conduit bond obligors for conduit debt securities that are traded on an exchange evaluate subsequent events through the date the financial statements are issued. All other entities evaluate subsequent events through the date the financial statements are available to be issued.
2. The entity's receipt of information about an observable transaction price represents a recognized subsequent event. As a result, the financial statements for the previous reporting period (i.e. the period in which the transaction occurred) are required to include the effect of the observed transaction price. [855-10-25-1]

For nonrecognized subsequent events that take place after the reporting date, but before the financial statements have been issued, disclosures under Topic 855 may be required. See chapter 9 of KPMG Handbook, Financial statement presentation, for additional guidance on nonrecognized subsequent events.

Example 5.4.10
Observable transaction price obtained before financial statements are issued

Investor is a calendar year-end company that invests in common shares issued by Issuer in January, Year 1. The common shares do not have a readily determinable fair value and Investor elects to measure its investment using the measurement alternative.

In January, Year 2 (before issuance of its Year 1 financial statements), Investor obtains transaction price information for a third-party sale of identical shares of Issuer. The observable transaction took place in November, Year 1. Investor determines that the fair value of Issuer shares as of November, Year 1 was different from Investor's cost basis. Investor is unaware of any subsequent observable transactions in these shares.

Because Investor identified the observable price before issuing its Year 1 financial statements, it adjusts the carrying amount of its investment in those financial statements. The carrying amount is adjusted to equal the fair value as of November, Year 1 (i.e. the measurement date). Investor also performs a qualitative assessment considering impairment indicators to evaluate whether the investment is impaired (see section 5.4.70).

Example 5.4.20
Observable transaction price obtained after financial statements were issued

Investor is a calendar year-end company that invests in common shares issued by Issuer in January, Year 1. The common shares do not have a readily determinable fair value and Investor elects to measure its investment using the measurement alternative.

When preparing its Year 1 financial statements, Investor demonstrated that it used reasonable efforts to identify whether there were any transactions in the identical or similar security of Issuer. Investor did not become aware of any transactions before it issued its Year 1 financial statements.

In December, Year 2, Investor becomes aware of a sale in November, Year 1 of the identical shares of Issuer. The fair value of Issuer shares as of November, Year 1 was different from Investor's cost basis. Investor is unaware of any other observable transactions in these shares.

Because Investor used reasonable efforts to identify observable prices before the Year 1 financial statements were issued it adjusts the carrying amount of its investment in Issuer's common shares in the period in which it identifies the observable transaction.

As a result, Investor takes the following actions.

- It adjusts the carrying amount of its investment to equal the fair value as of November, Year 1 (i.e. the measurement date) in Year 2.
- It performs a qualitative assessment considering impairment indicators to evaluate whether the investment is impaired at each reporting period (see section 5.4.70).

Question 5.4.240

Is there a remeasurement when an observable transaction results in an investment moving between the equity method and the measurement alternative?

Excerpt from ASC 323-10

> Change in Level of Ownership or Degree of Influence

• > Increase in Level of Ownership or Degree of Influence

35-33 Paragraph 323-10-15-12 explains that an investment in common stock of an investee that was previously accounted for on other than the equity method may become qualified for use of the equity method by an increase in the level of ownership described in paragraph 323-10-15-3 (that is, acquisition of additional voting stock by the investor, acquisition or retirement of voting stock by the investee, or other transactions). If an investment qualifies for use of the equity method (that is, falls within the scope of this Subtopic), the investor shall add the cost of acquiring the additional interest in the investee (if any) to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. The current basis of the investor's previously held interest in the investee shall be remeasured in accordance with paragraph 321-10-35-1 or 321-10-35-2, as applicable, immediately before adopting the equity method of accounting. For purposes of applying paragraph 321-10-35-2 to the investor's previously held interest, if the investor identifies observable price changes in orderly transactions for an identical or similar investment of the same issuer that results in it applying Topic 323, the entity shall remeasure its previously held interest at fair value immediately before applying Topic 323.

35-34 The carrying amount of an investment in common stock of an investee that qualifies for the equity method of accounting as described in paragraph 323-10-15-12 may differ from the underlying equity in net assets of the investee. The difference shall affect the determination of the amount of the investor's share of earnings or losses of an investee as if the investee were a consolidated subsidiary. However, if the investor is unable to relate the difference to specific accounts of the investee, the difference shall be recognized as goodwill and not be amortized in accordance with Topic 350.

• > Decrease in Level of Ownership or Degree of Influence

35-35 Sales of stock of an investee by an investor shall be accounted for as gains or losses equal to the difference at the time of sale between selling price and carrying amount of the stock sold.

35-36 An investment in voting stock of an investee may fall below the level of ownership described in paragraph 323-10-15-3 from sale of a portion of an investment by the investor, sale of additional stock by an investee, or other transactions and the investor may thereby lose the ability to influence policy, as described in that paragraph. An investor shall discontinue accruing its share of the earnings or losses of the investee for an investment that no longer qualifies for the equity method. The earnings or losses that relate to the stock retained by the investor and that were previously accrued shall remain as a part of the carrying amount of the investment. The investment account shall not be adjusted retroactively under the conditions described in this paragraph. Upon the discontinuance of the equity method, an investor shall remeasure the retained investment in accordance with paragraph 321-10-35-1 or 321-10-35-2, as applicable. For purposes of applying paragraph 321-10-35-2 to the investor's retained investment, if the investor identifies observable price changes in orderly transactions for the identical or a similar investment of the same issuer that results in it discontinuing the equity method, the entity shall remeasure its retained investment at fair value immediately after discontinuing the equity method. Topic 321 also addresses the subsequent accounting for investments in equity securities that are not consolidated or accounted for under the equity method.

Excerpt from ASC 321-10

> Equity Securities Previously Accounted for under the Equity Method

• > Equity Method Is No Longer Appropriate

30-1 If an **equity security** no longer qualifies to be accounted for under the equity method (for example, due to a decrease in the level of ownership), the security's initial basis for which subsequent changes in fair value are measured shall be the previous carrying amount of the investment. Paragraph 323-10-35-36 states that the earnings or losses that relate to the stock retained by the investor and that were previously accrued shall remain as a part of the carrying amount of the investment and that the investment account shall not be adjusted retroactively. Upon discontinuance of the equity method, an entity shall remeasure the equity security in accordance with paragraph 321-10-35-1 or 321-10-35-2, as applicable. For purposes of applying paragraph 321-10-35-2 to the investor's retained investment, if the investor identifies observable price changes in orderly transactions for the identical or a similar investment of the same issuer that results in it discontinuing the equity method, the entity shall remeasure its retained investment at fair value immediately after it no longer applies the guidance in Topic 323.

> Investment in Equity Securities of an Equity Method Investee

35-5 Paragraphs 323-10-35-23 through 35-26 identify circumstances in which an entity must adjust the basis of its investment in equity securities of an equity method investee for the amount of an equity method loss based on the investment's seniority. For investments accounted for in accordance with this Subtopic, the adjusted basis resulting from the application of paragraphs 323-10-35-23 through 35-26 becomes the equity security's basis from which subsequent changes in fair value are measured.

Background: Equity investments accounted for under the equity method are not in the scope of Topic 321. [321-10-15-5, 323-10-15-12, 35-36]

- A decrease in the level of ownership (or degree of influence) may result in an investment no longer qualifying for use of the equity method and falling in the scope of Topic 321.
- An increase in the level of ownership (or degree of influence) may result in an investment in the scope of Topic 321 subsequently qualifying for use of the equity method. If an equity investment does not have a readily determinable fair value, an entity may elect the measurement alternative.

Interpretive response: Yes. When applying the measurement alternative, the previously held equity interests are remeasured to fair value both immediately before, and on discontinuation of, the equity method using the observable transaction that triggered the change in applicability of the equity method.

In contrast, if application or discontinuation of the equity method is not the result of an observable transaction that would require remeasurement of equity securities – e.g. because the investor obtained significant influence by means other than the acquisition of an additional equity interest in the investee – there would be no remeasurement of those securities upon acquisition, or discontinuation, of equity method accounting.

The following table describes the accounting following a sale or purchase that causes a change from the equity method to the measurement alternative (or vice versa).

Change	Accounting
Move from equity method to measurement alternative following sale of a portion of the equity securities	When an investment no longer qualifies for the equity method, the entity (investor) establishes its initial basis for applying Topic 321 based on the carrying amount of its retained interest when it stopped applying the equity method. [321-10- 30-1] The investment is not adjusted retroactively. The carrying amount of the retained interest established at the end of equity method accounting is not adjusted before applying the measurement alternative. If the investor is required to discontinue applying the equity method because it sold identical or similar investments of the same issuer in an orderly transaction, it remeasures its retained investment at fair value immediately after it no longer applies the equity method. [321-10-30-1, 323-10-35-36]
Move from measurement alternative to equity method following purchase of additional equity securities	When an investment initially qualifies for the equity method, an entity adds the amount paid for the additional interest to the current basis of its previously held interest. [323-10-35-33] The current basis of the previously held interest that was accounted for under the measurement alternative is remeasured to fair value immediately before applying the equity method if the investor is required to apply the equity method because it has acquired additional identical or similar investments of the same issuer in an orderly transaction. [323-10-35-33]

An investor's basis in equity securities that moved from the measurement alternative to the equity method following acquisition of an additional equity interest in the investee comprises the following.

Basis of previously held shares before observed transaction + Remeasurement of previously held shares to FV as a result of observed transaction + Transaction price for newly acquired shares = Total basis for equity securities

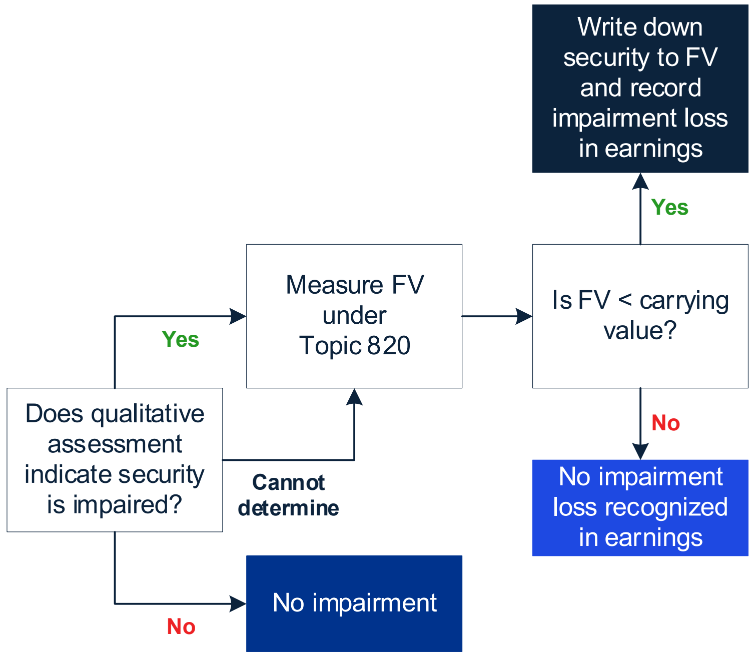
See chapter 6 of KPMG Handbook, Equity method of accounting, for further discussion and examples about moving to and from equity method to the measurement alternative.

5.4.70 Applying the measurement alternative: Impairment

Question 5.4.250
How does an entity evaluate an equity security for impairment?

Interpretive response: Topic 321 provides a one-step analysis for determining whether an equity security without a readily determinable fair value is impaired. An entity performs a qualitative assessment each reporting period to evaluate whether it believes the fair value of the security is less than the carrying amount – i.e. whether the security is impaired. If a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than its carrying amount (see Question 5.4.260), the investment is written down to its fair value. [321-10-35-3]

The following decision tree summarizes how we believe an entity should evaluate impairment.



Question 5.4.260

How does an entity perform a qualitative impairment assessment on an equity security?

Excerpt from ASC 321-10

• > Impairment of Equity Securities without Readily Determinable Fair Values

35-3 An equity security without a readily determinable fair value that does not qualify for the practical expedient to estimate fair value in accordance with paragraph 820-10-35-59 and is measured in accordance with paragraph 321-10- 35-2 shall be written down to its fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than its carrying value, as determined using the guidance in paragraph 321-10-35-2. At each reporting period, an entity that holds an equity security shall make a qualitative assessment considering impairment indicators to evaluate whether the investment is impaired. Impairment indicators that an entity considers include, but are not limited to, the following:

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 geographical area or the industry in which the investee operates

d. A bona fide offer to purchase, an offer by the investee to sell, or a completed auction process for the same or similar investment for an amount less than the carrying amount of that 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.

Interpretive response: To perform a qualitative assessment, an entity examines relevant indicators. The following are indicators an equity security may be impaired (not exhaustive): [321-10-35-3]

- significant deterioration in the earnings, credit rating, asset quality or business prospects of the investee;
- significant adverse change in the regulatory, economic or technological environment of the investee;
- significant adverse change in geographical area or industry in which the investee operates;
- bona fide offer to purchase, an offer by the investee to sell, or a completed auction process for the same or similar investment for an amount less than the carrying amount; and
- significant concern about an investee's ability to continue as a going concern.

Because this list focuses on significant factors or events and is not exhaustive, we believe an entity should apply judgment to determine whether a security is impaired. We believe a transaction that is not an observable orderly transaction may still be information that is considered when qualitatively evaluating if there is impairment.

Question 5.4.270
How does an entity measure an impairment loss?

Excerpt from ASC 321-10

• > Impairment of Equity Securities without Readily Determinable Fair Values

35-4 If an equity security without a readily determinable fair value is impaired, an entity shall include an impairment loss in net income equal to the difference between the fair value of the investment and its carrying amount. That is, if the investment is deemed to be impaired after conducting the evaluation required by paragraph 321-10-35-3, the entity shall estimate the fair value of the investment to determine the amount of the impairment loss.

Interpretative response: If a qualitative assessment indicates that the security is impaired (fair value is less than its carrying amount) or the entity cannot determine qualitatively that the security is impaired, the entity measures the fair value of the security under Topic 820. If the fair value of the security is less than its carrying amount, the entity writes down the security to its fair value and recognizes an impairment loss in earnings. [321-10-35-4]

See Question 5.4.300 for guidance when multiple impairment indicators are identified.

Question 5.4.280

Can changes in foreign currency exchange rates affect when foreign-currency denominated equity securities are impaired?

Interpretive response: Yes. As discussed in Question 5.4.270, if a qualitative assessment indicates that a security is impaired (fair value is less than its carrying amount) or the entity cannot determine qualitatively that the security is impaired, the entity measures the fair value of the security under Topic 820.

If a foreign-currency denominated equity security accounted for using the measurement alternative is impaired, the exchange rate at the date of impairment is used to measure the security's fair value in the entity's functional currency. Because changes in the exchange rate affect the fair value of a foreign-currency denominated equity security, we believe an entity should consider changes in the exchange rate along with other qualitative factors to determine whether the security is impaired. Question 5.4.260 discusses other qualitative factors an entity may consider. [830-10-45-18(a)]

Section 3.019b of KPMG Handbook, Foreign currency, discusses the accounting for foreign-currency denominated equity securities accounted for using the measurement alternative.

Question 5.4.290

Can an observable transaction be an impairment indicator in a previous reporting period?

Interpretive response: Yes. We believe an observable transaction for an identical or similar security of the same issuer may be an indicator of impairment if the observable transaction price is less than the carrying amount of the security held by the entity. The entity considers the observable transaction as part of its qualitative assessment to determine if impairment existed. See Question 5.4.260 for additional qualitative considerations.

Question 5.4.300

When multiple impairment indicators are identified, does the entity quantitatively measure the fair value of the investment at each reporting period?

Interpretive response: Generally, yes. When multiple impairment indicators are identified, we believe that, in most cases, entities will not be able to determine qualitatively that the fair value of the investment exceeds its carrying amount. As a result, we believe that, in most cases, the fair value of these investments will need to be quantitatively measured at each reporting period. A common example of when multiple impairment indicators may exist is when there is a severe economic downturn.

Question 5.4.310

Can impairment losses be subsequently reversed?

Interpretive response: Yes, but only if there is an observable transaction price for the identical or similar investment of the same issuer at a higher amount than the carrying amount established when the impairment was reported. This is because only fair value adjustments for observable transactions can increase or decrease the carrying amount; adjustments based on the impairment analysis can only decrease the carrying amount. [321-10-35-2, ASU 2016-01.BC89]

Section 5.4.60 discusses what an entity considers when determining if adjustments for observable transactions should be made.

5.4.80 Forward contracts and purchased options

Question 5.4.320

Can an entity elect the measurement alternative for contracts, such as options, forwards or warrants, to acquire or sell equity securities?

Excerpt from ASC 815-10

35-6 Changes in the fair value of forward contracts and purchased options on equity securities within the scope of this Subsection shall be recognized in earnings as they occur. Changes in observable price or impairment of forward contracts and purchased options on equity securities without readily determinable fair value within the scope of this Subsection measured in accordance with paragraph 321-10-35-2 shall be recognized in earnings as they occur. A change in observable price or impairment of the underlying securities of forward contracts and purchased options on equity securities shall result in a remeasurement of the entire fair value of the forward contracts and purchased options as of the date that the observable transaction took place. Equity securities within the scope of this Subsection purchased under a forward contract or by exercising an option shall be recorded at their fair values at the settlement date.

Background: As discussed in Question 2.5.50, an investment in a contract is in the scope of Topic 321 if the contract: [321-10-15-6, 321-10 Glossary, 321-10-55-3, 815-10-15-141 – 142]

- is not accounted for as a derivative under Topic 815 (derivatives and hedging); and
- provides the entity with either:
  - the right (i.e. an option) or the right and obligation (i.e. a forward) to acquire an ownership interest in another entity at a fixed or determinable price when such interest, once acquired, will be either in the scope of Topic 321 or Topic 323, or accounted for under the fair value option in Topic 825 (if those securities otherwise would have been accounted for under Topic 323); or
  - the right or the right and obligation to dispose of an ownership interest in another entity at a fixed or determinable price.

Interpretive response: Yes. An entity may elect the measurement alternative for contracts (e.g. options, forwards, warrants) to acquire equity securities without readily determinable fair values. Like other securities in the scope of Topic 321 for which the measurement alternative is elected, changes in observable prices or impairment for such contracts are reported in earnings as they occur. [815-10-35-6]

We believe this guidance also applies to forward contracts and purchased options that are in the scope of Topic 321 and involve the sale (disposition) of equity securities without readily determinable fair values.

In addition, an entity applies the presentation and disclosure requirements for equity securities to contracts to acquire or sell equity securities in the scope of Topic 321. See sections 5.7 and 5.8, respectively.

Question 5.4.330

How are observable transactions considered when applying the measurement alternative for contracts to acquire or sell equity securities?

Interpretive response: When the measurement alternative is elected for a contract (e.g. option, forward, warrant) to acquire or sell an equity security without a readily determinable fair value, if the entity identifies an observable transaction in the underlying equity security, it determines the contract's fair value at the date the observable transaction took place. It does not adjust the carrying amount of the contract based only on the observable transaction in the underlying equity security. Instead, it updates all of the inputs/assumptions used in the fair value measurement of the contract. [815-10-35-6]

Question 5.4.340
How are equity securities recognized upon settlement or exercise of a contract to acquire them?

Interpretive response: An entity recognizes equity securities at fair value upon settlement or exercise of a contract to acquire such equity securities. The difference between the (a) amount recorded for the contract to acquire such securities, including any amounts paid to exercise the contract, and (b) the fair value of the equity securities is reported in earnings. [815-10-35-6]

Example 5.4.40
Purchased option

On January 1, Year 1, Investor enters into a purchased option to acquire common shares of Investee. Investee is a private company and its common shares do not have a readily determinable fair value. Once the shares are acquired, they will be in the scope of Topic 321.

The purchased option allows Investor to purchase 100 common shares of Investee at $10 per share. Investee shares are worth $10 per share as of January 1, Year 1. The fair value of the purchased option is $150 on January 1, Year 1.

The purchased option is in the scope of Topic 321 because it does not meet the definition of a derivative instrument in Topic 815 and the shares, once acquired, will be in the scope of Topic 321. Investor has elected to account for the purchased option using the measurement alternative.

On September 15, Year 1, Investor identifies a third-party observable transaction of identical common shares of Investee. The observable transaction is for $25 per share. Because Investor identifies an observable transaction in the underlying equity securities, it remeasures the entire fair value of purchased option. Investor determines the fair value of the purchased option at the date the observable transaction occurs was $1,800 (an increase of $1,650).

Investor records the following journal entry on January 1, Year 1.

	Debit	*Credit*
Purchased option	150	
Cash		150
To recognize purchased option.		

Investor records the following journal entry on September 15, Year 1.

	Debit	*Credit*
Purchased option	1,650	
Gain/loss – Earnings		1,650
To recognize increase in fair value of purchased option.		

The settlement date of the purchased option contract is December 31, Year 1. Investor is unaware of any subsequent observable transactions in Investee shares. Investor determines that the fair value of the Investee shares at the settlement dates was $25. Investor also performs a qualitative assessment considering impairment indicators to evaluate whether the investment was impaired at the settlement date and determines there was no impairment.

Investor records the following journal entries on December 31, Year 1.

	Debit	*Credit*
Gain/loss – Earnings	300	
Equity security	2,500	
Cash		1,000
Purchased option		1,800
To recognize settlement of purchased option.		

5.5 Income recognition

Excerpt from ASC 321-10

> Dividend Income from Investments in Equity Securities

35-6 Dividend income from investments in equity securities shall be included in earnings.

Investments in equity securities may generate dividend income, which is included in earnings. [321-10-35-6]

Question 5.5.10
When does an entity accrue dividend income?

Interpretive response: Investment companies are required to record dividend income on the ex-dividend date. However, there is no explicit guidance on when an entity in other industries should accrue dividend income. We believe such entities should consistently apply an accounting policy election to accrue for dividend income on one of the following dates. [946-320-25-4]

- **Declaration date.** Date on which the board of directors declares a dividend.
- **Ex-dividend date.** Date on which the shares start trading without the value of the next dividend payment.

We believe it is not appropriate to accrue dividend income before the dividend has been declared.

Question 5.5.20
Are all distributions received recorded as dividend income?

Excerpt from ASC 505-20

> Recipient's Accounting for a Stock Dividend or Stock Split

30-7 A shareholder's interest in the corporation remains unchanged by a stock dividend or stock split except as to the number of share units constituting such interest. Therefore, the cost of the shares previously held shall be allocated equitably to the total shares held after receipt of the stock dividend or stock split. When any shares are later disposed of, a gain or loss shall be determined on the basis of the adjusted cost per share.

Interpretive response: No. The following types of distributions received are not recorded as dividend income.

Distribution type	Proper accounting treatment
Distributions that represent returns of capital	Recorded as a reduction in (i.e. a credit to) investment cost rather than to dividend income
Stock dividends and stock splits	The cost of the shares previously held are allocated equitably to the total shares held after the stock dividend or split. When any shares are later disposed of, a gain or loss is determined on the basis of the adjusted cost per share. [505-20-30-7]

Question 5.5.30
How does an entity account for dividends received that are in the form of noncash assets?

Interpretive response: We believe a distribution of noncash assets (i.e. a distribution-in-kind) should be recorded at fair value. Further, the entity should consistently apply its accounting policy election for determining when to accrue for dividend income on the declaration or ex-dividend date (see Question 5.5.10).

5.6 Derecognition

Excerpt from ASC 321-10

> Accounting for Sales of Securities

40-1 Section 860-10-40 provides guidance on determining whether a transfer of **securities** shall be accounted for as a sale. With respect to **equity securities**, because all changes in an equity security's **fair value** are reported in earnings as they occur, the sale of an equity security does not necessarily give rise to a gain or loss. Generally, a debit to cash (or trade date receivable) is recorded for the sales proceeds, and a credit is recorded to remove the security at its fair value (or sales price). If the entity is not taxed on the changes in fair value, the deferred tax accounts would be adjusted. An entity that has not yet recorded the security's change in fair value to the point of sale (perhaps because fair value changes are recorded at the end of each day) will need to adjust this procedure.

An entity applies the guidance in Topic 860 to determine if the transfer of an equity security qualifies as a sale thereby requiring that the security be derecognized. KPMG Handbook, Transfers and servicing of financial assets, provides guidance on the transfer of financial assets.

The following table describes the impact of selling an equity security measured at fair value and when the measurement alternative is elected.

Securities	Impact
Equity securities with readily determinable fair values or for which the measurement alternative was not elected	Because securities are reported at fair value with changes in fair value reported in earnings, there is generally not a gain or loss recognized upon derecognition.
Equity securities for which the measurement alternative was elected	Because the fair value is adjusted only when there is an observable transaction or when the equity security is impaired, there may be a gain or loss recognized upon derecognition.

Example 5.6.10
Sale of equity security with readily determinable fair value

On January 1, Year 1, Investor purchases 100 common shares of Investee for $1,000 on the New York Stock Exchange. The common shares have a readily determinable fair value and are subsequently measured at fair value with changes in fair value reported in earnings. For simplicity, this example assumes Investor does not incur any transaction costs to acquire the equity securities.

On March 31, Year 1, Investor determines that there was a $200 increase in the fair value of the common shares of Investee and records an unrealized holding gain of $200 in earnings.

On April 1, Year 1, Investor transfers the equity securities to a third party for cash. Investor determines that the transfer qualifies as a sale under Topic 860. The sales price is $1,200. Because the fair value equals the sales price, there is no gain or loss reported upon the sale of the equity securities.

Investor records the following journal entries in Year 1.

	Debit	*Credit*
Equity securities	1,000	
Cash		1,000
To recognize purchase of equity securities on Jan 1.		
Equity securities	200	
Gain/loss – Earnings		200
To recognize gain/loss in earnings as of Mar 31.		
Cash	1,200	
Equity securities		1,200
To recognize transfer of equity securities on Apr 1.		

Example 5.6.20
Sale of equity security measured using the measurement alternative

On January 1, Year 1, Investor purchases 100 common shares of Investee for $1,000. The common shares do not have a readily determinable fair value and Investor elects to measure its investment using the measurement alternative. For simplicity, this example assumes Investor does not incur any transaction costs to acquire the equity securities.

On April 1, Year 1, Investor decides to transfer the equity securities to a third party for cash. Investor determines that the transfer qualifies as a sale under Topic 860. Between January 1 and April 1, Year 1, Investor did not identify any observable transactions for identical or a similar investment of the same issuer and did not identify any impairment. Therefore, the equity securities' carrying amount remains at $1,000.

The sales price is $1,200. Therefore, at the time of sale, Investor recognizes a gain on sale in earnings of $200.

Investor records the following journal entries in Year 1.

	Debit	*Credit*
Equity securities	1,000	
Cash		1,000
To recognize purchase of equity securities on Jan 1.		
Cash	1,200	
Equity securities		1,000
Gain on sale		200
To recognize transfer of equity securities and gain on sale on Apr 1.		

5.7 Presentation

5.7.10 Balance sheet

Question 5.7.10
How are equity securities disaggregated on the balance sheet?

Excerpt from ASC 321-10

> Statement of Financial Position

45-2 An entity also shall refer to guidance in paragraph 825-10-45-1A on disaggregation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables).

Excerpt from ASC 825-10

> Statement of Financial Position

• > Disaggregation of Financial Assets and Financial Liabilities by Measurement Category and Form of Financial Asset

45-1A An entity shall separately present **financial assets** and **financial liabilities** by measurement category and form of financial asset (that is, securities or loans and receivables) in the statement of financial position or the accompanying notes to the financial statements.

Interpretive response: An entity separately presents financial assets by measurement category and form of financial asset on the balance sheet or in the notes to the financial statements. [321-10-45-2, 825-10-45-1A]

We believe an entity separately presents equity securities measured at fair value through earnings and equity securities measured using the measurement alternative on the balance sheet or in the notes to the financial statements because they are different measurement categories.

Question 5.7.15**

In a classified balance sheet, are marketable equity securities classified as current or noncurrent?

Excerpt from ASC 210-10

> Classification of Current Assets

45-1 Current assets generally include all of the following:

a. Cash available for current operations and items that are **cash equivalents**…

f. Marketable securities representing the investment of cash available for current operations...

45-4 The concept of the nature of current assets contemplates the exclusion from that classification of such resources as the following: …

b. Investments in securities (whether marketable or not) or advances that have been made for the purposes of control, affiliation, or other continuing business advantage.

Interpretive response: An entity presents its investments in marketable equity securities as current or noncurrent on the balance sheet based on the guidance in Topic 210 (balance sheet). [210-10-45]

Investments in securities (whether marketable or not) or advances that have been made are excluded from current assets if they are for the purposes of control, affiliation or other continuing business advantage. [210-10-45-4(b)]

For investments in securities that are not for the purposes of control, affiliation, or other continuing business advantage, we believe that either of the following approaches are acceptable as an accounting policy that is applied consistently.

- **Present marketable equity securities as current if the entity reasonably expects to sell or redeem them within one year (or its normal operating cycle if longer) to fund current operations**. This approach focuses on the definition of current assets. [210-10-20]
- **Present marketable equity securities as current if they represent the investment of cash available for current operations.** A marketable equity security is presented as current if it is available to fund current operations, regardless of whether the entity reasonably expects to sell or redeem it within one year (or normal operating cycle if longer) to fund current operations. This approach focuses on the inclusion of marketable securities in the list of assets generally included in current assets in paragraph 210-10-45-1. [210-10-45-1(f)]

5.7.20 Cash flow presentation

Excerpt from ASC 321-10

> Cash Flow Presentation

45-1 An entity shall classify cash flows from purchases and sales of **equity securities** on the basis of the nature and purpose for which it acquired the **securities**.

An entity classifies cash flows from purchases and sales of equity securities based on the nature and purpose for which the securities were acquired. See section 9.2.20 of KPMG Handbook, Statement of cash flows. [321-10-45-1]

5.8 Disclosure

Question 5.8.10
What disclosures are required for equity securities under Topic 321?

Excerpt from ASC 321-10

50-1 This Section provides disclosure guidance on information about **equity securities** that is required to be presented in the financial statements.

50-2 The disclosures in this Section are required for all interim and annual periods.

50-2A The disclosure guidance in paragraph 321-10-50-4 is not required for entities that are within the scope of Topic 958 on not-for-profit entities.

50-4 For each period for which the results of operations are presented, an entity shall disclose the portion of unrealized gains and losses for the period that relates to equity securities still held at the reporting date. The portion of unrealized gains and losses for the period related to equity securities still held at the reporting date is calculated as follows.

Net gains and losses recognized during the period on equity securities	$ 105
Less: Net gains and losses recognized during the period on equity securities sold during the period	(80)
Unrealized gains and losses recognized during the reported period on equity securities still held at the reporting date	$ 25

Interpretive response: For interim and annual periods, an entity (except for NFP entities in the scope of Topic 958) discloses the portion of the unrealized gain or loss for the period that relates to all equity securities still held at the reporting date. Such amount may be calculated as the net gains and losses reported during the period less the net gains or losses reported during the period on equity securities sold during the period. [321-10-50-2A, 50-4]

Question 5.8.20

What disclosures are only required for equity securities for which the measurement alternative is elected?

Excerpt from ASC 321-10

50-2B To the extent that the disclosure requirements in this Subtopic achieve the fair value disclosure requirements described in Section 820-10-50 on disclosing fair value measurement, an entity need not duplicate the related fair value disclosure.

50-3 An entity that applies the guidance in paragraph 321-10-35-2 for equity securities without **readily determinable fair values** shall disclose all of the following:

a. The carrying amount of investments without readily determinable fair values
b. The amount of impairments and downward adjustments, if any, both annual and cumulative
c. The amount of upward adjustments, if any, both annual and cumulative
d. As of the date of the most recent statement of financial position, additional information (in narrative form) that is sufficient to permit financial statement users to understand the quantitative disclosures and the information that the entity considered in reaching the carrying amounts and upward or downward adjustments resulting from observable price changes.

Interpretive response: For interim and annual periods, an entity that elects the measurement alternative for equity securities (including contracts to acquire or sell equity securities without readily determinable fair values that are in the scope of Topic 321) discloses the following quantitative information: [321-10-50-2, 50-3]

- carrying amount;
- impairments and downward adjustments due to observable transactions (both annual and cumulative); and
- upward adjustments due to observable transactions (both annual and cumulative).

Although the carrying amount is required to be disclosed, an entity is not required to provide a rollforward of the carrying amount.

Because quarter-to-date and year-to-date income statement information is provided in interim periods, the disclosures of impairments and adjustments due to observable price changes are also provided for such periods.

An entity cannot combine upward and downward adjustments and only disclose a net number.

As of the most recent reporting date, an entity provides additional narrative information to enable financial statement users to understand the quantitative disclosures and the information that the entity considered in reaching the carrying amounts and upward or downward adjustments resulting from observable price changes. An entity is not required to provide comparative narrative disclosures. [321-10-50-3]

Question 5.8.30
Are Topic 820 disclosures required?

Interpretive response: Yes, Topic 820 disclosures are required for equity securities. However, to the extent that the disclosures provided under Topic 321 satisfy Topic 820's fair value disclosure requirements, an entity does not need to duplicate the related fair value disclosures. [321-10-50-2B]

When the measurement alternative is applied, an entity provides the disclosures required by Topic 820 for assets and liabilities that are measured at fair value on a nonrecurring basis. These disclosures include the valuation techniques and inputs used to develop those measurements. This requires consideration of unobservable inputs used in the fair value measurement and the corresponding levels in the fair value hierarchy. The fair value disclosures are required only when a transaction price is observed for the identical or similar security, or when an impairment is reported. [820-10-50-1C, 50-2]

When the measurement alternative is not applied, an entity provides the disclosures required by Topic 820 for assets and liabilities that are measured at fair value on a recurring basis.

6. Fair value option**

Detailed contents

6.1 How the standard works

An entity may irrevocably elect the fair value option for certain financial assets and liabilities upon the occurrence of certain election events. This election is made for the entire instrument and cannot be applied to only specified risks, specified cash flows or portions of an instrument.

If the fair value option is elected for a financial instrument, the instrument is initially and subsequently measured at fair value. The treatment of unrealized gains and losses depends on the nature of the financial instrument.

Instrument	Treatment of unrealized gains and losses
Financial liabilities	Changes in fair value due to instrument-specific credit risk included in OCI. All other changes in fair value included in earnings.
All other items	Included in earnings.

On the balance sheet, an entity is required to distinguish financial assets and financial liabilities that are subsequently measured at fair value pursuant to the fair value option from those that are subsequently measured using another measurement attribute.

Subtopic 825-10 requires disclosures related to the fair value option as well as other financial instrument disclosure related to fair value, credit risk and market risk.

6.2 Fair value option scope and scope exceptions

Question 6.2.10
What instruments are eligible for the fair value option in Topic 825?

Excerpt from ASC 825-10

Fair Value Option

05-5 The Fair Value Option Subsections of this Subtopic address both of the following:

a. Circumstances in which entities may choose, at specified election dates, to measure eligible items at **fair value** (the fair value option)
b. Presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities.

05-6 See Topic 820 for guidance on fair value measurements.

10-1 The objective of the guidance in the Fair Value Option Subsections of this Subtopic is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions.

General

> Overall Guidance

15-1 The General Subsection of this Section establishes the pervasive scope for this Subtopic, with specific exceptions noted in the other Subsections of this Section.

> Entities

15-2 The guidance in this Subtopic applies to all entities.

Fair Value Option

> Overall Guidance

15-3 The Fair Value Option Subsections follow the same Scope and Scope Exceptions as outlined in the General Subsection of this Subtopic, with specific qualifications and exceptions noted below.

> Instruments

15-4 All entities may elect the **fair value** option for any of the following eligible items:

a. A recognized **financial asset** and **financial liability**, except any listed in the following paragraph
b. A **firm commitment** that would otherwise not be recognized at inception and that involves only financial instruments (for example, a forward purchase contract for a loan that is not readily convertible to cash—that commitment involves only financial instruments—a loan and cash—and would not otherwise be recognized because it is not a derivative instrument)
c. A written loan commitment
d. The rights and obligations under an insurance contract that has both of the following characteristics:
    1. The insurance contract is not a **financial instrument** (because it requires or permits the insurer to provide goods or services rather than a cash settlement).
    2. The insurance contract's terms permit the insurer to settle by paying a third party to provide those goods or services.
e. The rights and obligations under a warranty that has both of the following characteristics:
    1. The warranty is not a financial instrument (because it requires or permits the warrantor to provide goods or services rather than a cash settlement).
    2. The warranty's terms permit the warrantor to settle by paying a third party to provide those goods or services.
f. A host financial instrument resulting from the separation of an embedded nonfinancial derivative from a nonfinancial hybrid instrument under paragraph 815-15-25-1, subject to the scope exceptions in the following paragraph (for example, an instrument in which the value of the bifurcated embedded derivative is payable in cash, services, or merchandise but the debt host is payable only in cash).

Interpretive response: All entities may elect the fair value option in Topic 825 for instruments listed in the following table as long as the instruments are not specifically scoped out of the guidance. See Question 6.2.20 for instruments for which the fair value option in Topic 825 may not be elected. [825-10-15-4]

Instrument	Description
Financial assets	Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following: [825-10 Glossary] • receive cash or another financial instrument from a second entity; or • exchange other financial instruments on potentially favorable terms with the second entity. Examples of financial assets include accounts receivable, mutual funds and equity securities held by an investor.

<table>
<tr><th>Instrument</th><th>Description</th></tr>
<tr><td>Financial liabilities</td><td>A contract that imposes on one entity an obligation to do either of the following: [825-10 Glossary]
deliver cash or another financial instrument to a second entity; or
exchange other financial instruments on potentially unfavorable terms with the second entity.
Examples of financial liabilities include accounts payable and debt issued by an issuer.</td></tr>
<tr><td>Firm commitments</td><td>A firm commitment that would not have otherwise been recognized at inception and only includes financial instruments.
A firm commitment is a (legally) binding agreement between unrelated parties that specifies all significant terms and includes a disincentive for nonperformance that is sufficiently large to make performance probable. The key features of a firm commitment are the specificity of its terms (i.e. the quantity, fixed price and timing), probability of occurrence and enforceability. [825-10 Glossary]</td></tr>
<tr><td>Issuer (lender) of a written loan commitment</td><td>A loan origination commitment is a legally binding commitment to extend credit to a counterparty under certain pre-specified terms and conditions. Although the terms of a loan commitment can vary, loan commitments typically possess the following characteristics: [815-10 Glossary]
fixed expiration dates;
either fixed or variable rates;
revolving or non-revolving;
can be distributed through syndication arrangements, in which one entity acts as a lead and an agent on behalf of other entities that will each extend credit to a single borrower; and
the lender is generally permitted to terminate the arrangement under the terms of the covenants negotiated under the agreement.</td></tr>
<tr><td>Certain rights and obligations under an insurance contract</td><td>Rights and obligations under an insurance contract that has both of the following characteristics:
the insurance contract is not a financial instrument (because it requires or permits the insurer to provide goods or services instead of a cash settlement); and
the contract can be settled by paying a third party to provide those goods or services.</td></tr>
<tr><td>Certain rights and obligations under a warranty</td><td>Rights and obligations under a warranty that has both of the following characteristics:
the warranty is not a financial instrument (because it requires or permits the warrantor to provide goods or services instead of a cash settlement); and
the warranty can be settled by paying a third party to provide those goods or services.</td></tr>
<tr><td>Financial instrument host</td><td>A financial instrument host that results from bifurcating a nonfinancial embedded derivative from a nonfinancial hybrid instrument under paragraph 815-15-25-1, subject to the scope exceptions in paragraph 825-10-15-5 (see Question 6.2.50).</td></tr>
</table>

Question 6.2.20
What instruments are not eligible for the fair value option in Topic 825?

Excerpt from ASC 825-10

Fair Value Option

> Overall Guidance

15-5 No entity may elect the fair value option for any of the following financial assets and financial liabilities:

a. An investment in a subsidiary that the entity is required to consolidate.
b. An interest in a variable interest entity (VIE) that the entity is required to consolidate.
c. Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in Topics 420; 710; 712; 715; 718; and 960.
d. Financial assets and financial liabilities recognized under leases as defined in Subtopic 842-10. (This exception does not apply to a guarantee of a third-party lease obligation or a contingent obligation arising from a cancelled lease.)
e. Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions.
f. Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholders' equity (including temporary equity)

Interpretive response: The fair value option cannot be elected for the following instruments. [825-10-15-5]

Instrument	Applicable guidance and rationale for exclusion
An interest in an entity (investment in a subsidiary or an interest in a variable interest entity) that is required to be consolidated	Topic 810 See KPMG Handbook, Consolidation These interests were excluded because the FASB believes the fair value option should not be used to make significant changes to consolidation practices. [FAS159.A8(a)]
Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred	Topic 420, 710, 712, 715, 718 and 960 See KPMG Handbook, Employee benefits The asset or liability that represents the net overfunded or underfunded status of a benefit plan were excluded because the FASB believes any changes to existing guidance should be part of a

Instrument	Applicable guidance and rationale for exclusion
compensation arrangements, as defined in Topics 420, 710, 712, 715, 718 and 960	reconsideration of those individual areas. [FAS159.A8(b)]
Financial assets and financial liabilities recognized under leases except for guarantees of a third-party lease obligation or a contingent obligation arising from a cancelled lease	Topic 842 See KPMG Handbook, Leases These financial assets and financial liabilities were excluded because the FASB did not believe the lease accounting provisions should be changed by the fair value option project without a comprehensive reconsideration of the accounting for lease contracts. [FAS159.A8(c)]
Deposit liabilities of banks, savings and loan associations, credit unions and other similar depository institutions that are withdrawable on demand	Topic 405 and 942 These liabilities were excluded because their fair value is often significantly affected by nonfinancial components. [FAS159.A8(d)]
Financial instruments that are, in whole or in part, recorded as a component of shareholders' equity (including temporary equity)	Topic 470 and 505 See KPMG Handbook, Debt and equity financing These instruments were excluded because the FASB believes changes in the fair value of any contract that is reported in shareholder's equity should not affect earnings. [FAS159.A8(e)]

Question 6.2.30

Does the observability of the inputs used in a fair value measurement impact whether the fair value option may be elected?

Interpretive response: No. Using unobservable inputs in the fair value measurement does not preclude an entity from electing the fair value option for an eligible item. The FASB decided to allow for the recognition of items at fair value even when the measurement uses significant unobservable inputs. However, there are enhanced disclosure requirements for instruments whose fair value measurement uses significant unobservable inputs. [FAS157.C13-C16]

For additional guidance on required disclosures, see section N of KPMG Handbook, Fair value measurement.

Question 6.2.40

Can the fair value option be elected for a hybrid financial instrument that only has financial elements?

Interpretive response: Yes. The fair value option in Subtopic 825-10 is available for hybrid financial instruments. If an entity makes the election for a hybrid instrument, it is not required to determine whether the financial instrument has an embedded derivative that would otherwise require bifurcation. [825-10-15-4]

The scope of Subtopic 825-10's fair value option is broader than that of Subtopic 815-15. Subtopic 815-15 provides a fair value option only for hybrid financial instruments that contain an embedded derivative that Subtopic 815-15 would require to be bifurcated if the instrument was not otherwise measured at fair value.

Therefore, in practice, most entities elect Subtopic 825-10's fair value option, if applicable, because its election does not require an entity to determine that the subject financial instrument has an embedded derivative that would require bifurcation. [815-15-25-4- 25-6]

See chapter 4 of KPMG Handbook, Derivatives and hedging, for additional information on analyzing embedded features for bifurcation.

Question 6.2.50

Can the fair value option be elected for a hybrid instrument that has both financial and nonfinancial elements?

Background: In some cases, hybrid instruments may have both financial and nonfinancial elements. The terms of these instruments may vary. For example, the instrument may be a debt contract with either the host contract or the embedded derivative payable in cash, services or merchandise. See chapter 4 of KPMG Handbook, Derivatives and hedging, for additional information on analyzing embedded features for bifurcation.

Interpretive response: It depends on the nature of the embedded feature and if it is bifurcated.

Instrument	May an entity elect the fair value option?
Hybrid with a nonfinancial embedded feature that is not bifurcated	No. An entity may not elect the fair value option. In this case, the nonfinancial embedded feature prevents the hybrid instrument from meeting the definition of a financial asset or a financial liability. [825-10-15-4(a)]
Hybrid with an embedded feature that is bifurcated and the nonfinancial feature of the hybrid is	Yes. The resulting host contract is a financial instrument that is accounted for separately

Instrument	May an entity elect the fair value option?
entirely included in the embedded derivative	and is eligible for the fair value option. [FAS159.A6, 825-10-15-4(f)]
Hybrid with an embedded feature that is bifurcated and the nonfinancial feature of the hybrid is not entirely included in the embedded derivative	No. If the resulting host has any nonfinancial features it is not a financial instrument. Therefore, it is not eligible for the fair value option. [825-10-15-4(f)]

Example 6.2.10
Fair value option election for hybrid instrument with an embedded nonfinancial feature

XYZ Corp. enters into a prepaid contract to sell barrels of oil to ABC. The contract provides for XYZ to deliver fixed quantities of barrels of oil every quarter for the next three years in exchange for a $5 million payment at inception of the contract. The contract can only be settled through physical delivery. The contract is not a derivative instrument in its entirety based on the guidance in Topic 815. Instead, it is a hybrid instrument.

XYZ determines the contract contains an embedded forward contract that will be settled with the delivery of oil. The embedded forward contract is required to be bifurcated and accounted for at fair value based on the guidance in Subtopic 815-15. The remaining host contract is a financial liability of $5 million that will decrease over time as deliveries of the barrels of oil are made. The nonfinancial feature is entirely included in the embedded feature (i.e. the forward contract). Therefore, the resulting host contract (i.e. the financial liability) is eligible for the fair value option upon initial recognition.

Question 6.2.60
Can the fair value option be elected for convertible debt?

Interpretive response: It depends. The fair value option is not available for instruments, including convertible debt, accounted for, in whole or in part, in equity. Therefore, the fair value option is available for convertible debt only if the conversion option does not require separate accounting in equity (e.g. a substantial premium is recognized in equity). See KPMG Handbook, Debt and equity financing, for additional guidance on evaluating convertible debt. [825-10-15-4, 15-5(f)]

Question 6.2.70

Can the fair value option be elected for preferred stock that is classified as temporary or permanent equity?

Interpretive response: No. The fair value option is not available for instruments accounted for, in whole or in part, in equity. Therefore, if the preferred stock is classified as temporary or permanent equity, it is not eligible for the fair value option. For guidance on determining how preferred stock is classified see Question 5.4.10 of KPMG Handbook, Debt and equity financing. [825-10-15-5(f)]

Question 6.2.80

Can a loan issuer elect the fair value option for a loan commitment?

Background: A loan commitment is a legally binding commitment to extend credit to a counterparty under certain pre-specified terms and conditions. [815-10 Glossary]

Interpretive response: Yes, if the loan commitment is not accounted for as a derivative under Topic 815. A loan commitment is not accounted for as a derivative under Topic 815 if it: [815-10-15-69 – 15-71, 815-10-15-83]

- meets a scope exception in Topic 815; or
- does not meet the definition of a derivative.

See Question 2.11.20 and chapter 3 in KPMG Handbook, Derivatives and hedging, for further guidance on the scope exceptions and the definition of a derivative.

Question 6.2.90

Can the fair value option be elected for an investment that would otherwise be accounted for under the equity method of accounting?

Interpretive response: It depends. Generally, an entity may elect the fair value option for an investment that would otherwise be accounted for under the equity method because it is a financial asset that is not excluded from the scope of Subtopic 825-10. However, the SEC staff has indicated it may not be appropriate to elect the fair value option for certain equity method investments that have embedded nonfinancial performance obligations, such as carried interests. See Question 6.2.120 for additional guidance. [323-10-15-3, 825-10-15-4, 2007 AICPA Conf]

See the following Questions in KPMG Handbook, Equity method of accounting, for additional guidance for entities electing the fair value option for equity method investments.

Question number	Question
2.3.20	How does a would-be equity method investor apply the fair value option when it has other interests in the investee?
2.3.120	If an investor accounts for a carried interest under Topic 323, may it elect the fair value option?
2.3.125	Can an investor with a carried interest elect the fair value option for other would-be equity method investments in the same investee?

Question 6.2.100
Does an entity consider the nature of the underlying assets held by the investee to determine if its investment is eligible for the fair value option?

Background: ABC Corp. holds debt and equity securities in Entity B. Substantially all of Entity B's assets consist of investments in real estate.

Interpretive response: No. If an investment meets the definition of a debt or equity security, it is considered a financial asset and therefore eligible for the fair value option. It is not appropriate for an entity to look through the form of its investment to the nature of the underlying assets held by the investee when determining if the fair value option may be elected.

Question 6.2.110
Can the fair value option be elected for contract assets?

Background: A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time. [606-10 Glossary]

Interpretive response: No. A contract asset is not a financial asset and is therefore not eligible for the fair value option. For a contract asset to be a financial asset, it must convey a contractual right to receive payments from another party (i.e. the right to bill and collect). Once the entity is entitled to invoice the customer for these amounts, the contract asset amount to which entity has a right to bill is recorded as a financial asset (specifically, a customer receivable).

Example 6.2.20
Fair value option election for contract assets

ABC Corp. has a long-term construction contract under which it will invoice based on predetermined milestone dates beginning in Year 2. ABC satisfies its performance obligation over time, recognizing revenue before the date it is eligible to invoice the customer. As a result, ABC records a contract asset and corresponding revenue under Topic 606 as its performance obligation is satisfied over time.

ABC may not elect the fair value option for the contract asset as it is recognized. However, it may elect the fair value option for the customer receivable first recognized in Year 2 when it is entitled to invoice the customer for these amounts.

Question 6.2.120
Can the fair value option be elected for a financial instrument with an embedded nonfinancial performance obligation?

Interpretive response: It depends. The SEC staff has indicated it may not be appropriate to elect the fair value option for financial instruments that have a significant embedded nonfinancial performance obligation. Applying the fair value option to these instruments may accelerate the recognition of revenue that would have been prohibited under other applicable US GAAP. The staff indicated that careful consideration is required to determine whether these arrangements are eligible for the fair value option. [2007 AICPA Conf]

When evaluating whether an entity is precluded from electing the fair value option for a financial instrument that includes a nonfinancial performance obligation, we believe an entity should evaluate whether fees associated with the nonfinancial performance obligation are significant in relation to the financial instrument's fair value at origination and throughout the life of the instrument.

If an entity determines the fees are not significant, it may elect the fair value option for the financial instrument.

Example 6.2.30
Financial instrument with a nonfinancial performance obligation

Management fees

ABC Corp. has a 20% equity interest in XYZ Corp that allows it to exercise significant influence. The partnership agreement includes an embedded feature that provides for ABC, as the general partner, the right to receive a disproportionate allocation of returns (i.e. carried interest) as compensation for providing management services.

ABC determines the nonfinancial performance obligation (i.e. providing management services) is significant. Because the fair value measurement includes the carried interest, which would result in the accelerated recognition of a gain for profits associated with future performance obligations, ABC may not elect the fair value option for the interest.

Question 6.2.130

Can the fair value option be elected for recognized financial guarantees?

Interpretive response: Yes. A recognized financial guarantee under Topic 460 is eligible for the fair value option as it (1) meets the definition of a financial liability and (2) is not scoped out of Topic 825.

Topic 460 indicates that a financial guarantee cannot be subsequently measured using a fair value method unless that method can be justified under US GAAP. We do not believe that Topic 460 precludes the use of the fair value option under Topic 825. [460-10-35-2]

Additionally, if an investor elects the fair value option for investments that would otherwise be accounted for under the equity method, it must apply the election to all of its interests in the investee, including guarantees, that are eligible for the fair value option. See Question 6.3.130. We believe this further supports the ability to elect the fair value option for financial guarantees. [825-10-15-4(a), 25-7(b)]

Question 6.2.140

Are fractional shares of an equity security eligible for the fair value option?

Excerpt from ASC 825-10

Fair Value Option

• > Unit of Accounting

25-12 An investor in an equity security may elect the fair value option for its entire investment in that equity security, including any fractional shares issued by the investee (for example, fractional shares that are acquired in a dividend reinvestment program).

Interpretive response: Yes. An entity may elect the fair value option for its investment in an equity security, including any fractional shares. [825-10-25-12]

Question 6.2.150

Can the fair value option be elected for a liability recognized as part of a failed sale leaseback transaction?

Background: In a failed-sale leaseback transaction, the seller-lessee: [842-40-25-5]

- does not derecognize the transferred asset; and
- accounts for any amounts received from the buyer-lessor as a finance liability under Topics other than Topic 842.

See chapter 9 of KPMG Handbook, Leases, for additional information.

Interpretive response: Yes. If there is a failed sale leaseback transaction, there is no lease asset or liability recognized under Topic 842. Instead, a seller-lessee recognizes a financial liability and applies Topics other than Topic 842 to the liability. Since the liability is not recognized under lease accounting, the scope exception for financial liabilities recognized under leases as defined in Subtopic 842-10 does not apply. [825-10-15-5(d)]

Question 6.2.160

Can a nonpublic entity that elects not to provide certain fair value disclosures still elect the fair value option for eligible items?

Background: Public business entities are required to comply with the disclosure requirements in paragraphs 825-15-50-10 to 50-15 by disclosing the fair value of all of their financial instruments, even those for which they have not elected the fair value option. Nonpublic entities are not required to provide such disclosures, but may elect to. See section 6.5 for further guidance on the disclosure requirements. [825-10-50-10 – 50-15]

Interpretive response: Yes. A nonpublic entity may elect the fair value option for eligible items even if it does not elect to provide the fair value disclosures in paragraphs 825-15-50-10 to 50-15. The FASB noted there is a significant difference between a nonpublic entity's election not to provide fair value disclosures of its financial assets and liabilities (if practicable) and a nonpublic entity's desire to elect the fair value option for selected financial assets and liabilities. Because the fair value option may be applied on an instrument-by-instrument basis, the FASB believes the fair value option should be available to nonpublic entities that have elected not to provide fair value disclosures. [FAS159.A11]

If an entity elects the fair value option, it must provide the disclosures in paragraphs 825-15-50-24 to 50-32, including those disclosures that provide information about fair value. See section 6.5.50. [FAS159.A28]

Question 6.2.170

Is a debt or equity security for which an entity has elected the fair value option in the scope of Topic 320 or Topic 321?

Excerpt from ASC 825-10

Fair Value Option

> Other considerations

• > Interaction with other Topics

15-6 The Fair Value Option Subsections:

a. Do not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value
b. Do not establish requirements for recognizing and measuring dividend income, interest income, or interest expense
c. Do not eliminate disclosure requirements included in other Subtopics, including requirements for disclosures about fair value measurements included in Topic 820.

Background: Subtopic 825-10 allows an entity to irrevocably elect to subsequently measure certain financial instruments at fair value with changes in fair value reported in earnings. However, it does not: [825-10-15-6]

- establish requirements for recognizing and measuring dividend income, interest income or interest expense; or
- eliminate the disclosures required by other Subtopics.

Interpretive response: Yes. Neither Topic 320 nor Topic 321 provide a scope exclusion for instruments for which the fair value option has been elected. If an entity elects to measure a debt or equity security under the fair value option that would otherwise be in the scope of Topic 320 or Topic 321, we believe the debt or equity security continues to be in the scope of the respective Topic. As a result, an entity applies the guidance in Topic 320 or Topic 321 - e.g. for recognizing and measuring interest or dividend income and preparing disclosures (see chapters 3 and 5, respectively).

Question 6.2.180
Can a NFP elect the fair value option for eligible items?

Excerpt from ASC 825-10

Fair Value Option

> Other considerations

• > Application by Not-for-Profit Entities

15-7 Not-for-profit entities (NFPs) shall apply the provisions of the Fair Value Option Subsections with the following modifications:

a. References to an income statement shall be replaced with references to a statement of activities, statement of changes in net assets, or statement of operations.
b. References to earnings shall be replaced with references to changes in net assets, except as indicated in (c).
c. Paragraph 954-825-45-1 explains that health care entities subject to Topic 954 shall report unrealized gains and losses on items for which the fair value option has been elected within the performance indicator or as a part of discontinued operations, as appropriate. Unlike other NFPs, health care entities subject to that Topic present performance indicators analogous to income from continuing operations. Consistent with the provisions of Subtopic 958-10, NFPs may present such gains and losses either within or outside of other intermediate measures of operations unless such gains or losses are part of discontinued operations. This includes intermediate measures of operations presented by NFPs other than health care entities and any additional intermediate measures of operations presented within the performance indicator by not-for-profit health care entities.
d. The disclosure requirements in paragraph 825-10-50-30 shall apply not only with respect to the effect on performance indicators or other intermediate measures of operations, if presented, but also with respect to the effect on the change in each of the net asset classes (without donor restrictions or with donor restrictions), as applicable.

Background: Yes. A NFP may elect the fair value option in Topic 825 for eligible items. However, the following modifications apply. [825-10-15-7]

- References to income statement are replaced with references to a statement of activities, statement of changes in net assets, or statement of operations.
- References to earnings are replaced with references to changes in net assets, except as indicated in the next bullet.
- Health care entities in the scope of Topic 954 report unrealized gains and losses on items for which the fair value option has been elected within the

performance indicator or as a part of discontinued operations, as appropriate.

- NFPs (other than health care entities) present unrealized gains and losses either within or outside of other intermediate measures of operations unless such gains or losses are part of discontinued operations.
- The disclosure requirements in paragraph 825-10-50-30 apply to the effect on performance indicators or other intermediate measures of operations, if presented, and the effect on the change in each of the net asset classes (without donor restrictions or with donor restrictions), as applicable.

6.3 Electing the fair value option

6.3.10 Documentation and election events

Question 6.3.10
What documentation is required to support the fair value option election?

Background: As discussed in Question 6.3.20, an entity may elect the fair value option for each eligible item on an instrument-by-instrument basis or according to a preexisting policy on certain election dates (referred to throughout as election events). [825-10-25-2]

Interpretive response: We believe an entity's documentation supporting the fair value option may be in the form of:

- a broad policy that includes sufficient information to determine which items are included; or
- instrument-specific documentation.

In both scenarios, the documentation needs to be sufficiently clear on the items for which the fair value option has been elected and must be in place when the election event occurs (see Question 6.3.30).

Question 6.3.20
How is the fair value option elected?

Excerpt from ASC 825-10

Fair Value Option

> Overall Guidance

25-1 This Subtopic permits all entities to choose, at specified election dates, to measure eligible items at **fair value** (the fair value option).

25-2 The decision about whether to elect the fair value option:

a. Shall be applied instrument by instrument, except as discussed in paragraph 825-10-25-7
b. Shall be irrevocable (unless a new election date occurs, as discussed in paragraph 825-10-25-4)
c. Shall be applied only to an entire instrument and not to only specified risks, specific cash flows, or portions of that instrument.

An entity may decide whether to elect the fair value option for each eligible item on its election date. Alternatively, an entity may elect the fair value option according to a preexisting policy for specified types of eligible items.

Interpretive response: An entity may irrevocably elect the fair value option on an instrument-by-instrument basis or according to a preexisting policy for specified types of eligible items on certain election events (see Question 6.3.30). This election is made for the entire instrument and cannot be applied to only specified risks, specific cash flows or portions of an instrument. See section 6.3.20 for a discussion of when an entity is not permitted to elect the fair value option for a single eligible item without electing it for other identical items. [825-10-25-1 – 25-2]

Question 6.3.30
At what point in time can the fair value option be elected?

Excerpt from ASC 825-10

Fair Value Option

• > Election Dates

25-4 An entity may choose to elect the fair value option for an eligible item only on the date that one of the following occurs:

a. The entity first recognizes the eligible item.
b. The entity enters into an eligible **firm commitment**.
c. Financial assets that have been reported at fair value with unrealized gains and losses included in earnings because of specialized accounting principles cease to qualify for that specialized accounting (for example, a transfer of assets from a subsidiary subject to Subtopic 946-10 to another entity within the consolidated reporting entity not subject to that Subtopic).
d. The accounting treatment for an investment in another entity changes because the investment becomes subject to the equity method of accounting.
e. An event that requires an eligible item to be measured at fair value at the time of the event but does not require fair value measurement at each reporting date after that, excluding the recognition of impairment under lower-of-cost-or-market accounting or accounting for securities in accordance with either Topic 321 on investments – equity securities or Topic 326 on measurement of credit losses.

25-5 Some of the events that require remeasurement of eligible items at fair value, initial recognition of eligible items, or both, and thereby create an election date for the fair value option as discussed in paragraph 825-10-25-4(e) are:

a. At what point in time can the fair value option be elected? Business combinations, as defined in Subtopic 805-10
b. Consolidation or deconsolidation of a subsidiary or VIE
c. Significant modifications of debt, as defined in Subtopic 470-50.

Interpretive response: An entity can elect the fair value option when one of the following election events occur: [825-10-25-2, 25-4]

Election event	Example(s)
The eligible item is first recognized	An entity purchases a loan that is held for investment
An entity enters into a firm commitment	An entity enters into a firm commitment to purchase a loan that is not readily convertible to cash at a fixed price and date
Financial assets cease to qualify for specialized accounting treatment that require them to be recorded at fair value with unrealized gains and losses recognized through earnings	An entity ceases to qualify as an investment company under specialized accounting principles
Investment in another entity becomes subject to the equity method	An entity purchases additional ownership in an investee that provides it with significant influence over the operating and financial decisions of the investee and therefore requires the equity method to be applied
Event that requires an instrument to be initially measured at fair value but does not require fair value measurement in	• Business combinations, as defined in Subtopic 805-10;

Election event	Example(s)
subsequent reporting dates, excluding impairments	• Consolidation or deconsolidation of a subsidiary or variable interest entity; • Significant modifications of debt, as defined in Subtopic 470-50; • Fresh-start reporting after bankruptcy; and • Adoption of liquidation basis of accounting

Question 6.3.40
Can the fair value option be elected when impairment is recognized?

Interpretive response: No. The recognition of impairment under lower-of-cost-or-market accounting or accounting for securities in accordance with either Topic 321 (equity securities) or Topic 326 (credit losses) does not create an election event that would permit an entity to elect the fair value option. [825-10-25-4(e)]

Question 6.3.50
Can the fair value option be elected for a financial instrument initially recognized through the correction of an error?

Interpretive response: Yes. We believe an entity may elect the fair value option for an eligible item that is first recognized due to the correction of an accounting error since that is the first time the entity recognizes the financial instrument. [825-10-25-4(a)]

Example 6.3.10
Electing the fair value option following the correction of an error

ABC Corp. transfers a commercial loan to DEF for cash on October 1, Year 1. ABC determines the transfer meets the criteria to be accounted for as a sale and its Year 1 financial statements reflects the transfer as a sale. In June, Year 2, ABC determines that the transfer did not meet the criteria to be accounted for as a sale and should have been accounted for as a secured borrowing. ABC restates its Year 1 financial statements to correct the error, including the recognition of a liability to DEF on October 1, Year 1.

Upon initial recognition of the liability as a result of the correction of an accounting error, ABC chooses to elect the fair value option. The fair value option is applied retroactively to the date the liability was initially recognized (October 1, Year 1).

Question 6.3.60

If an entity applies trade date accounting, can it elect the fair value option on the settlement date?

Background: Debt and equity securities are first recognized either on the trade date (i.e. date when an order to purchase or sell a financial instrument occurs) or the settlement date (i.e. date the seller is required to deliver, and the purchaser is required to pay for the financial instrument). For additional guidance on trade versus settlement date accounting, see Questions 3.2.10 and 5.2.10.

Interpretive response: No. If trade date accounting is applied, an entity cannot elect the fair value option on the settlement date because it is not the date when the instrument is first recognized. The instrument would have been eligible for the fair value option only at the trade date (or another election event if more recent). See Question 6.3.30 for guidance on election events. [825-10-25-4(a)]

Question 6.3.70

Can an entity that applies US GAAP for the first time elect the fair value option for an instrument it has previously recognized?

Interpretive response: Yes. We believe an entity that applies US GAAP for the first time can elect the fair value option for an instrument that it has previously recognized prior to the date US GAAP financial statements are first issued. Further, if elected, the fair value option would be applied retroactively to the date the financial instrument was first acquired (or another election event if more recent). See Question 6.3.30 for guidance on election events.

Example 6.3.20

Fair value option election when first applying US GAAP

ABC Corp., is a calendar year-end private company that has an equity method investment it acquired on June 30, Year 1. It has historically maintained accounting records following the tax basis of accounting.

ABC is adopting US GAAP for the first time. It is issuing financial statements for Year 2 and Year 1 under US GAAP.

ABC elects the fair value option for the equity method investment prior to the date it first issues US GAAP financial statements. It applies the election retroactively to June 30, Year 1 because that is the date it first recognized the instrument.

Question 6.3.80
Can the fair value option be elected for a previously sold financial asset when it is rerecognized?

Background: A seller evaluates Topic 860's derecognition criteria and applies sale accounting if certain criteria are met. These criteria are required to be met not only at the time a financial asset is transferred, but also subsequent to the transfer.

Subsequent analysis is required when the seller initially applies sale accounting because events may occur that result in a seller regaining control of the previously transferred financial asset. For example, this can occur when a seller has a unilateral call option that is contingent on the underlying borrower's default and the underlying borrower subsequently defaults. The seller accounts for such an event as the purchase of a new financial asset. [860-20-25-8 – 25-9]

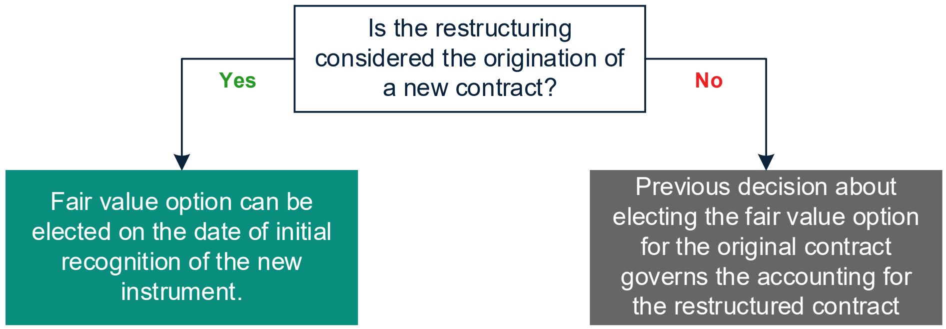
Interpretive response: Yes. An entity can elect the fair value option for previously sold financial assets. The rerecognition of the previously sold financial asset is accounted for in the same manner as a purchase (i.e. a new acquisition). Therefore, we believe that the fair value option can be elected at the time of rerecognition.

Question 6.3.90
Can the fair value option be elected upon the restructuring of a contract for the related asset or liability?

Interpretive response: It depends. The FASB decided that the availability of the fair value option should be based on whether the restructuring (i.e. a modification or exchange) is a: [FAS 159.BC.A15, 825-10-25-5(c)]

- continuation of the original contract; or
- termination (extinguishment) of the original contract and the origination of a new contract.

The ability to apply the fair value option is illustrated in the following decision tree.



Subtopic 310-20 provides guidance on modifications of receivables and Subtopic 470-60 provides guidance for modifications of liabilities. For additional guidance on determining if the restructuring of a liability is an extinguishment or modification of the original debt instrument, see section 4.4.10 of KPMG Handbook, Debt and equity financing.

Parent company considerations

Question 6.3.100

Can a parent company elect the fair value option at the consolidated level if the subsidiary did not apply it for stand-alone reporting?

Excerpt from ASC 825-10

Fair Value Option

• > Consolidation

25-6 An acquirer, parent, or primary beneficiary decides whether to apply the fair value option to eligible items of an acquiree, subsidiary, or consolidated VIE, but that decision applies only in the consolidated financial statements. Fair value option choices made by an acquired entity, subsidiary, or VIE continue to apply in separate financial statements of those entities if they issue separate financial statements.

Interpretive response: Yes. A parent and subsidiary may have different fair value option elections. Therefore, a parent company may elect the fair value option for eligible items of a consolidated subsidiary in its consolidated financial statements even if the subsidiary did not elect the fair value option for stand-alone reporting.

If a subsidiary is acquired, the parent company may elect the fair value option once it obtains control and is required to include the subsidiary in its consolidated financial statements. However, regardless of whether the parent elects the fair value option, the fair value option elections made for the subsidiary's stand-alone financial statements prior to the acquisition cannot be changed unless pushdown accounting is applied as of the date of a change in control. An entity's election to apply pushdown accounting on a change-in-control event results in the entity applying a new basis of accounting, using the principles in Topic 805. As a consequence, an entity that elects pushdown accounting also may, at that same date, elect the fair value option. [825-10-35-4(e), 825-10-25-6, 805-50-30-10]

Subsequent to a subsidiary being acquired, the fair value option may be elected for eligible items when those items are first recognized by the subsidiary (or another election event if more recent). In our experience subsequent to initial acquisition, entities generally make consistent fair value option elections for consolidated financial statements and subsidiary stand-alone financial statements. However, entities may choose to apply the fair value option in the consolidated financial statements but not the subsidiary stand-alone financial statements, or vice versa.

Discontinuation of the fair value option

Question 6.3.110
Can fair value accounting be discontinued after initial election?

Interpretive response: Generally, no. To minimize the potential for abuse, the FASB decided that once an entity elects the fair value option for an asset or liability, it cannot subsequently discontinue the use of fair value measurement. Therefore, the fair value option is irrevocable unless a new election event occurs. If a new election event occurs, the entity may elect to discontinue fair value accounting. See Question 6.3.30. [FAS159.BC.A19; 825-10-25-2(b)]

Example 6.3.30
Losing significant influence over an investee for which the fair value option has been elected

On January 1, Year 1, Entity A obtains a 25% investment in Entity B. Entity A has concluded that it has significant influence over Entity B based on its percentage of ownership. Entity A decides to elect the fair value option for its investment in Entity B that would otherwise be accounted for under the equity method. On Year 2, Entity A sells 15% of its ownership in Entity B and loses significant influence over the investee.

Entity A must continue to recognize its investment in Entity B at fair value. Losing significant influence over an investee does not represent a new election event. The fair value election is irrevocable unless a new election event occurs, see Question 6.3.30.

6.3.20 Unit of account

With exceptions explained below, the fair value option can be elected on an instrument-by-instrument basis, meaning it can be elected for a single eligible item without electing it for identical items. See Question 6.3.20. [825-10-25-7]

If the fair value option is not elected for all eligible items in a group of similar instruments, certain disclosures are required. See Question 6.5.160. [825-10-50-28(b)]

Instrument-by-instrument election

Question 6.3.120
Can the fair value option be elected for only some eligible instruments acquired in a single transaction?

Excerpt from ASC 825-10

Fair Value Option

• > Unit of Accounting

25-10 The fair value option need not be applied to all instruments issued or acquired in a single transaction (except as required by paragraph 825-10-25-7(a) through (b)). For example, investors in shares of stock and registered bonds might apply the fair value option to only some of the shares or bonds issued or acquired in a single transaction. For this purpose, an individual bond is considered to be the minimum denomination of that debt security.

Interpretive response: Generally, yes. When an entity acquires or issues multiple instruments in a single transaction it may elect the fair value option on an instrument-by-instrument basis except for: [825-10-25-10]

- multiple advances made to one borrower in a single contract; and
- other interests in an investee in addition to an investment that would otherwise be accounted for under the equity method (see Question 6.3.130).

For example, an entity may elect the fair value option for only some of the shares or bonds issued or acquired in a single transaction. In this example, an individual bond is considered to be the minimum denomination of that debt security. [825-10-25-10]

Example 6.3.40
Fair value option election and multiple advances

On January 1, Year 1, ABC Corp. obtains a $10 million construction loan from Bank. The loan is a single contract. Bank makes the following advances as agreed to with ABC. Upon the second advance on May 8, Year 1, ABC wants to elect the fair value option for the construction loan.

Date	Advance amount
January 1, Year 1	$0 – origination date
March 8, Year 1	$1 million
May 8, Year 1	$3 million

ABC cannot elect the fair value option on May 8, Year 1 because the construction loan represents a single contract under which each individual advance loses its identity and becomes part of a larger loan balance. Therefore, the transaction was eligible for the fair value option when it was first recognized (March 8, Year 1) and subsequent advances do not create a new election event. Likewise, if ABC had elected the fair value option upon the first advance (March 8, Year 1), all subsequent advances under the same contract would become part of the larger loan balance and be measured at fair value.

Question 6.3.130
When can the fair value option not be elected on an instrument-by-instrument basis?

Excerpt from ASC 825-10

Fair Value Option

• > Unit of Accounting

25-7 The fair value option may be elected for a single eligible item without electing it for other identical items with the following four exceptions:

a. If multiple advances are made to one borrower pursuant to a single contract (such as a line of credit or a construction loan) and the individual advances lose their identity and become part of a larger loan balance, the fair value option shall be applied only to the larger balance and not to each advance individually.
b. If the fair value option is applied to an investment that would otherwise be accounted for under the equity method of accounting, it shall be applied to all of the investor's financial interests in the same entity (equity and debt, including guarantees) that are eligible items.

c. If the fair value option is applied to an eligible insurance or **reinsurance** contract, it shall be applied to all claims and obligations under the contract.
d. If the fair value option is elected for an insurance contract (base contract) for which integrated or nonintegrated contract features or coverages (some of which are called riders) are issued either concurrently or subsequently, the fair value option also must be applied to those features or coverages. The fair value option cannot be elected for only the nonintegrated contract features or coverages, even though those features or coverages are accounted for separately under Subtopic 944-30. Paragraph 944-30-35-30 defines a nonintegrated contract feature in an insurance contract. For purposes of applying this Subtopic, neither an integrated contract feature or coverage nor a nonintegrated contract feature or coverage qualifies as a separate instrument.

Interpretive response: The following table lists specific types of instruments that are eligible for the fair value option election but for which the election cannot be made on an instrument-by-instrument basis. The unit of account for eligible instruments is determined under other applicable US GAAP. [825-10-25-7]

Exception	Additional guidance
Multiple advances to one borrower in a single contract	If multiple advances are made to one borrower under a single contract (such as a line of credit or a construction loan) and the individual advances lose their identity and become part of a larger loan balance, the fair value option is applied to the larger balance and not to each advance individually. See Question 6.3.120 and Example 6.3.30.
Investments that would otherwise be accounted for under the equity method of accounting	If the fair value option is elected for an investment that would otherwise be accounted for under the equity method, it is applied to: • the entire equity method interest (including additional interests purchased in the future); and • other financial interests in the investee that are eligible items (e.g. other equity securities, debt securities and guarantees). See Question 6.3.140 and Example 6.3.40.
Eligible insurance or reinsurance contracts	If the fair value option is elected for an eligible insurance or reinsurance contract, it is applied to all claims and obligations under the contract.
Insurance contracts with integrated or nonintegrated contract features or coverages	If the fair value option is elected for an insurance contract, it must be applied to both the integrated or nonintegrated contract features or coverages. Therefore, it cannot be applied to only the nonintegrated contract features or coverages. See Question 6.3.150.

Example 6.3.50
Investment accounted for under the equity method

Investor purchases 100 common shares of Investee that provide Investor with significant influence over the operating and financial policies of Investee. Instead of applying the equity method, Investor elects the fair value option for the 100 common shares. Investor subsequently provides a loan to Investee.

Because Investor elected the fair value option for its investment that would have otherwise been accounted for under the equity method, it must apply the fair value option to all other interests in Investee that are eligible items. Therefore, it applies the fair value option to the loan.

Question 6.3.140
How does an investor account for the acquisition of an additional interest if it previously elected the fair value option for an investment that otherwise would have been accounted for under the equity method?

Interpretive response: It depends on whether the additional interest results in the investor obtaining a controlling financial interest in the investee. See sections 5 and 6 of KPMG Handbook, Consolidation for guidance on determining if an investor consolidates an investee.

Impact of additional interest	Additional guidance
Additional interest does not result in investor obtaining a controlling financial interest	The fair value option must be applied to the additional interest. Therefore, such interest is initially and subsequently measured at fair value. [825-10-25-7(b)]
Additional interest results in investor gaining a controlling financial interest	The fair value option cannot be applied to the additional investment because the investor records the underlying assets and liabilities of the investee. However, the consolidation of an investee is a remeasurement event, which allows the investor to elect the fair value option for some or all of the eligible assets and liabilities of the new subsidiary in the consolidated financial statements. [825-10-25-7(b)]

Question 6.3.150

Is the fair value option applied to all features in an insurance contract for which the option has been elected?

Background: A base insurance contract may have integrated or nonintegrated contract features or coverages (some of which are called riders). The nonintegrated feature may be accounted for in a manner similar to a separately issued contract based on the guidance in Subtopic 944-30. [944-30-35-30 -35]

Interpretive response: Yes. For purposes of applying Topic 825, neither an integrated nor a nonintegrated contract feature or coverage is considered a separate instrument. Therefore, if an entity elects the fair value option for an eligible insurance contract, it must be applied to all integrated or nonintegrated features or coverages in the contract. [825-10-25-7(d)]

Question 6.3.160

Can the borrower elect the fair value option for some but not all loans in a loan syndication?

Excerpt from ASC 825-10

Fair Value Option

• > Unit of Accounting

25-11 A **financial instrument** that is legally a single contract may not be separated into parts for purposes of applying the fair value option. In contrast, a loan syndication arrangement may result in multiple loans to the same borrower by different lenders. Each of those loans is a separate instrument, and the fair value option may be elected for some of those loans but not others.

Background: ABC Corp. requests a $100 million loan from Bank A. Bank A cannot provide the $100 million loan by itself due to internal credit risk management guidelines and therefore arranges for a loan syndication with three additional banks. Through the loan syndication, each bank will loan $25 million directly to ABC. Each bank will have the right to repayment of its loan from ABC.

Interpretive response: Yes. Each loan in a loan syndication is considered a separate instrument and the fair value option may be elected on a loan-by-loan basis. Therefore, ABC may elect the fair value option for any of these loans and not others. [825-10-25-11]

Considerations for portions of financial instruments

Question 6.3.170

Can the fair value option be elected for only the accrued interest portion of an interest-bearing financial instrument?

Interpretive response: No. Electing the fair value option for only specified risks, specific cash flows or portions of an eligible instrument is not permitted. Therefore, because accrued interest represents a specific future cash flow of the related interest-bearing financial instrument, the fair value option cannot be elected for just this accrued interest portion. Likewise, if an entity elects the fair value option for an eligible interest-bearing financial asset or financial liability, it may not exclude the accrued interest (payable or receivable) from the unit of account. [825-10-25-1- 25-2(c)]

Question 6.3.180

Does the issuer of a liability include credit enhancements in the liability's unit of account?

Excerpt from ASC 825-10

20 Glossary

Liability Issued with an Inseparable Third-Party Credit Enhancement

A liability that is issued with a credit enhancement obtained from a third party, such as debt that is issued with a financial guarantee from a third party that guarantees the issuer's payment obligation.

Fair Value Option

• > Unit of Accounting

25-13 For the issuer of a **liability issued with an inseparable third-party credit enhancement** (for example, debt that is issued with a contractual third-party guarantee), the unit of accounting for the liability measured or disclosed at fair value does not include the third-party credit enhancement. This paragraph does not apply to the holder of the issuer's credit-enhanced liability or to any of the following financial instruments or transactions:

a. A credit enhancement granted to the issuer of the liability (for example, deposit insurance provided by a government or government agency)
b. A credit enhancement provided between reporting entities within a consolidated or combined group (for example, between a parent and its subsidiary or between entities under common control).

Background: A liability with an inseparable third-party credit enhancement is a liability that is issued with a credit enhancement obtained from a third party, such as debt that is issued with a financial guarantee from a third party that guarantees the issuer's payment obligation. [825-10 Glossary]

Interpretive response: It depends. The issuer of a liability does not include an inseparable third-party credit enhancement in the liability's unit of account for measurement or disclosure purposes. However, when a credit enhancement is granted to the issuer of the liability or provided between reporting entities in a consolidated or combined group, the credit enhancement is considered in the unit of account for measurement and disclosure purposes. For additional guidance on the measurement of a liability when the fair value option is elected see Questions 6.3.200 through 6.3.240. [825-10-25-13]

Question 6.3.190

If an entity elects the fair value option does it need to determine if a hybrid instrument has an embedded feature that needs to be bifurcated?

Interpretive response: No. When the fair value option has been elected, an assessment of whether an embedded feature should be bifurcated under Topic 815 is not necessary. The fair value option election is made for the entire hybrid instrument, and an embedded feature cannot be bifurcated from a hybrid instrument under Topic 815 if the hybrid instrument is remeasured at fair value under other applicable GAAP with changes in fair value reported in earnings as they occur. [815-15-25-1(b)]

6.3.30 Subsequent measurement

Question 6.3.200

Are unrealized gains and losses resulting from changes in fair value reported in earnings?

Excerpt from ASC 825-10

Fair Value Option

> Statement of Comprehensive Income

45-4 A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date.

• > Financial Liabilities for Which Fair Value Option Is Elected

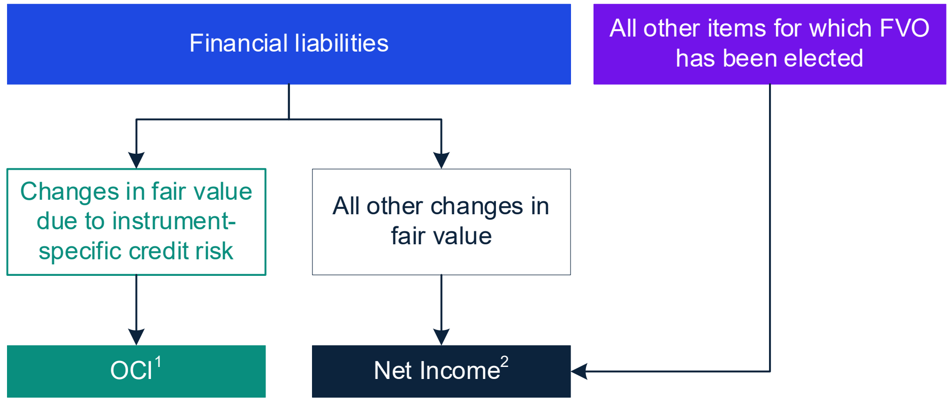
45-5 If an entity has designated a financial liability under the fair value option in accordance with this Subtopic or Subtopic 815-15 on embedded derivatives, the entity shall measure the financial liability at fair value with qualifying changes in fair value recognized in net income. The entity shall present separately in other comprehensive income the portion of the total change in the fair value of the liability that results from a change in the instrument-specific credit risk. The entity may consider the portion of the total change in fair value that excludes the amount resulting from a change in a base market risk, such as a risk-free rate or a benchmark interest rate, to be the result of a change in instrument-specific credit risk. Alternatively, an entity may use another method that it considers to faithfully represent the portion of the total change in fair value resulting from a change in instrument-specific credit risk. The entity shall apply the method consistently to each financial liability from period to period.

45-5A When changes in instrument-specific credit risk are presented separately from other changes in fair value of a liability denominated in a currency other than an entity's functional currency, the component of the change in fair value of the liability resulting from changes in instrument-specific credit risk shall first be measured in the liability's currency of denomination, and then the cumulative amount shall be adjusted to reflect the current exchange rate in accordance with paragraph 830-20-35-2. The remeasurement of the component of the change in fair value of the liability resulting from the cumulative changes in instrument-specific credit risk shall be presented in accumulated other comprehensive income.

45-6 Upon derecognition of a financial liability designated under the fair value option in accordance with this Subtopic, an entity shall include in net income the cumulative amount of the gain or loss on the financial liability that resulted from changes in instrument-specific credit risk.

45-7 The guidance in paragraph 825-10-45-5 does not apply to financial liabilities of a consolidated collateralized financing entity measured using the measurement alternative in paragraphs 810-10-30-10 through 30-15 and 810-10-35-6 through 35-8.

Interpretive response: It depends on whether the instrument is a financial liability. Unrealized gains or losses resulting from changes in the fair value of instruments for which an entity has elected the fair value option are reported as follows. [825-10-45-4 – 45-5]



1. We believe the result is different for non-recourse debt (see Question 6.3.230).
2. Or another performance indicator if the entity does not report net income (e.g. changes in net assets).

Changes in the fair value of financial liabilities attributed to instrument-specific credit risk are recognized in OCI until the financial liability is derecognized. Upon derecognition, the cumulative amount of gain or loss that resulted from instrument-specific credit risk is included in earnings. [825-10-45-6]

The guidance above does not apply to financial liabilities of consolidated collateralized financing entities that are measured using the measurement alternative in paragraphs 810-10-30-10 to 30-15 and 810-10-35-6 to 35-8; see section 7.7 of KPMG Handbook, Consolidation. [825-10-45-7]

Question 6.3.210
How is the portion of the total change in fair value that is attributable to instrument-specific credit risk determined?

Interpretive response: Paragraph 825-10-45-5 includes an example of a method an entity may use to determine the change in fair value attributable to instrument-specific credit risk. The method (referred to as the base method) calculates the change in fair value attributable to instrument-specific credit risk as the: [825-10-45-5]

- total change in fair value of a financial liability; less
- changes in fair value of the financial liability arising from a change in a base market risk, such as a risk-free rate or a benchmark interest rate.

We believe an entity is generally permitted to apply the base method when the financial liability:

- is plain vanilla; and
- provides recourse to the borrower in the event of nonperformance.

See Question 6.2.230 for instances in which the base method is not appropriate.

See Question 6.3.240 for additional considerations when the financial liability is denominated in a currency other than an entity's functional currency.

Question 6.3.220

Must the base method be used to determine instrument-specific credit risk?

Interpretive response: No. An entity is not required to use the base method to determine the change in fair value attributable to instrument-specific credit risk. It may elect to apply another method if that method provides a more faithful representation of the change in fair value resulting from a change in instrument-specific credit risk. We believe the method applied is a policy election that should be consistently applied from period to period. [825-10-45-5]

The FASB developed the base method because it did not want to require an entity to separate an instrument's credit risk into its own nonperformance risk and changes in the market pricing of credit risk. However, the FASB did not intend to permit an entity to exclude from earnings other types of changes in fair value. [ASU 2016-01.BC107]

Question 6.3.230

Can the base method be applied to nonrecourse debt or hybrid financial instruments that would have required bifurcation?

Interpretive response: No. Based on discussions with the FASB staff, we believe it is not appropriate to apply the base method to instruments such as nonrecourse debt or hybrid financial instruments containing embedded features that would have required bifurcation if the fair value option had not been elected.

Nonrecourse debt

Nonrecourse debt is debt in which the creditor does not have general recourse to the debtor, but instead has recourse only to the assets used as collateral in the transaction. Nonrecourse debt does not have instrument-specific credit risk. Through ASU 2016-01, the FASB replaced the guidance that required disclosure of changes in instrument-specific credit risk with a requirement to present those same amounts in OCI. The FASB observed that prior to that ASU an entity did not disclose changes in instrument-specific credit risk for nonrecourse debt, and that it did not intend to change how an entity identifies and measures changes in instrument-specific credit risk. Therefore, we believe all changes in the fair value of nonrecourse debt are recognized in earnings, not in OCI. [ASU 2016-01.BC112]

Hybrid financial instrument

When an entity elects the fair value option for a hybrid financial instrument that includes an embedded feature that would have otherwise required bifurcation, the entity should use an alternative method that faithfully reflects the portion of the total change in fair value resulting from a change in instrument-specific credit risk. We believe an entity should design the method to ensure that the portion of the total change in the fair value of the hybrid instrument that is associated with changes in the fair value of the embedded feature (unrelated to the issuer's credit risk) is included in earnings.

Question 6.3.240

How is instrument-specific credit risk determined when a liability is denominated in a currency other than the entity's functional currency?

Interpretive response: The change in fair value of a financial liability denominated in a currency other than the entity's functional currency includes changes in currency exchange rates and changes in other factors.

The changes in fair value attributable to changes in currency exchange rates is split between:

- the instrument-specific credit risk component (recognized in OCI); and
- the remaining changes in fair value (recognized in earnings).

We believe the following five-step approach can be used to determine how to identify each of these two elements.

Step 1	Determine the fair value of the instrument and the cumulative change in fair value due to instrument-specific credit risk since issuance in the financial liability's currency of denomination.
Step 2	Remeasure the financial liability using the period-end exchange rate, which will be the carrying amount in functional currency at the measurement date.
Step 3	Remeasure the cumulative instrument-specific credit risk component of the change in fair value since issuance (which will be recognized in AOCI) using the period-end exchange rate.
Step 4	Recognize in OCI for the current period the difference between the amount determined in Step 3 at the end of the current period, and the amount determined in Step 3 at the end of the previous period.
Step 5	Recognize in earnings for the current period the difference between the total change in fair value of the financial liability for the current period (in functional currency) and the amount determined in Step 4.

Question 6.3.250

Are upfront costs and fees included in unrealized gains and losses when the fair value option is elected?

Excerpt from ASC 825-10

Fair Value Option

> Overall Guidance

25-3 Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred.

Interpretive response: No. Upfront fees and costs related to items for which the fair value option is elected, including loan origination fees and costs on loan receivables, are recognized in earnings as incurred and not deferred. As a result, we believe that these fees and costs are not to be included in the cost basis of the item at initial recognition and are not to be included in unrealized gains and losses. Absent any specific guidance in US GAAP that would allow for net presentation, we believe these fees and costs are to be recorded in separate income statement line items. [825-10-25-3]

Question 6.3.260

How does the accounting under the fair value option compare to fair value hedge accounting?

Interpretive response: If the fair value option is elected, the entire change in fair value is recognized through earnings for financial assets and split between earnings and OCI for financial liabilities with instrument-specific credit risk.

In contrast, when an entity applies fair value hedge accounting, it generally hedges only a subset of the risks that result in changes in the fair value of a financial asset or liability. In these cases, fair value hedging results in recognition in earnings of only the portion of the change in fair value that relates to specified hedged risks. See section 8 of KPMG Handbook, Derivatives and hedging, for additional guidance on fair value hedge accounting.

6.4 Presentation matters

6.4.10 Balance sheet presentation

Excerpt from ASC 825-10

General

> Statement of Financial Position

• > Disaggregation of Financial Assets and Financial Liabilities by Measurement Category and Form of Financial Asset

45-1A An entity shall separately present financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) in the statement of financial position or the accompanying notes to the financial statements.

Financial assets and financial liabilities are separately presented by their measurement category (e.g. separately distinguish AFS from trading securities) and form of financial asset in the balance sheet or in the notes to the financial statements. There are specific requirements for presenting financial assets and financial liabilities for which the fair value option is elected. [825-10-45-1A]

Question 6.4.10
How are financial assets and financial liabilities for which the fair value option is elected presented on the balance sheet?

Excerpt from ASC 825-10

Fair Value Option

> Statement of Financial Position

45-1B Entities shall report assets and liabilities that are measured at fair value pursuant to the fair value option in this Subtopic in a manner that separates those reported fair values from the carrying amounts of similar assets and liabilities measured using another measurement attribute.

45-2 To accomplish that, an entity shall either:

a. Present the aggregate of fair value and non-fair value amounts in the same line item in the statement of financial position and parenthetically disclose the amount measured at fair value included in the aggregate amount
b. Present two separate line items to display the fair value and non-fair value carrying amounts.

Interpretive response: On the balance sheet, an entity is required to distinguish financial assets and financial liabilities that are subsequently measured at fair value pursuant to the fair value option from those that are subsequently measured using another measurement attribute. An entity makes that distinction by either of the following: [825-10-45-1B, 45-2]

- present the aggregate of fair value and non-fair value amounts in the same line item on the balance sheet with parenthetical disclosure of the amounts measured at fair value included in the aggregate amount; or
- present two separate line items to display the fair value and non-fair value carrying amounts.

6.4.20 Income statement presentation

Question 6.4.20
When the fair value option is elected, is the entire change in fair value reported in earnings?

Interpretive response: It depends. For financial assets the entire change in fair value is reported in earnings. However, when the fair value option is elected for financial liabilities, the portion of the change in fair value attributed to instrument-specific credit risk is presented in OCI (see Question 6.3.200). The rest of the change in fair value is reported in earnings. [825-10-45-4 – 45-5]

See Question 6.3.250 for additional guidance on treatment of upfront costs and fees. See Questions 6.3.210 through 6.3.240 for additional guidance on measuring financial liabilities when the fair value option is elected.

Question 6.4.30
When the fair value option is elected, how is interest income on interest-bearing financial instruments recognized?

Background: US GAAP does not provide specific guidance and does not require all entities to separately present interest income in their income statements. In our experience, some entities do not separately present interest income but instead present all changes in fair value – including the effect of interest – together in one line item.

Interpretive response: When an entity is required (or elects) to separately present interest income for financial instruments under the fair value option, we believe using the interest method is acceptable (see Question 3.3.80).

6.4.30 Cash flow presentation

Question 6.4.40
How are cash flows related to instruments for which the fair value option is elected classified?

Excerpt from ASC 825-10

Fair Value Option

> Statement of Cash Flows

45-3 Entities shall classify cash receipts and cash payments related to items measured at fair value according to their nature and purpose as required by Topic 230.

Interpretive response: Cash flows related to items measured at fair value are classified based on the nature and purpose for which the related items were acquired or incurred. The FASB chose not to require the classification of cash flows associated with items measured at fair value as operating activities because such securities may not be held for sale in the near term. The classification of cash flows is covered extensively in KPMG Handbook, Statement of cash flows. [825-10-45-3]

6.5 Disclosures

6.5.10 Overview

Question 6.5.10
Are the disclosures in Subtopic 825-10 required for interim financial statements?

Excerpt from ASC 270-10

> Disclosure of Summarized Interim Financial Data by Publicly Traded Companies

50-1 Many publicly traded companies report summarized financial information at periodic interim dates in considerably less detail than that provided in annual financial statements. While this information provides more timely information than would result if complete financial statements were issued at the end of each interim period, the timeliness of presentation may be partially offset by a reduction in detail in the information provided. As a result, certain guides as to minimum disclosure are desirable. (It should be recognized that the minimum disclosures of summarized interim financial data required of publicly traded companies do not constitute a fair presentation of financial position and results of operations in conformity with generally accepted accounting principles [GAAP].) If publicly traded companies report summarized financial information at interim dates (including reports on fourth quarters), the following data should be reported, as a minimum: …

m. The information about financial instruments as required by Section 825-10-50

Excerpt from ASC 825-10

Fair Value Option

> Applicability of This Subsection

50-26 Entities shall provide the disclosures required by paragraphs 825-10-50-28 through 50-32 in both interim and annual financial statements.

Interpretive response: Yes. The disclosures in Subtopic 825-10 are generally required when: [825-10-50-26, 270-10-50-1]

- an entity provides a complete set of interim or annual financial statements; or
- a publicly traded company provides summarized interim financial information.

However, for interim financial statements, the concentrations of credit risk (paragraphs 825-10-50-20 − 50-22) and market risk (paragraph 825-10-50-23) disclosures are optional for nonpublic business entities, see Question 6.5.20. [825-10-50-2A]

Question 6.5.20

Are all entities required to provide the disclosures in Subtopic 825-10?

Excerpt from ASC 825-10

> Applicability of This Subsection

50-2 This guidance discusses the applicability of the disclosure requirements in this Subsection to entities and transactions.

> Entities

50-2A The disclosure guidance in this Subsection applies to public business entities, except for the disclosure guidance in paragraphs 825-10-50-20 through 50-23, which applies to all entities. For interim reporting periods, the disclosure guidance in paragraphs 825-10-50-20 through 50-23 is optional for those entities that do not meet the definition of a public business entity.

Interpretive response: No. The disclosure requirements depend on whether an entity is a PBE as summarized in the following table.

Disclosure	PBE	Non-PBE
Fair value of financial instruments (see section 6.5.20) [825-10-50-10 – 50-15]	✓	
Concentrations of credit risk (see section 6.5.30) [825-10-50-20 – 50-22]	✓	✓[1]
Market risk [825-10-50-23]	✓	✓[1]
Fair value option[2] [825-10-50-23A – 50-30]	✓	✓
Other required disclosures[2] [825-10-50-31 – 50-32]	✓	✓

Notes:
1. These disclosure requirements are optional for interim reporting periods.
2. These disclosure requirements are applicable only for entities that have elected the fair value option.

Question 6.5.30
Are there additional disclosure requirements included in other Topics?

Excerpt from ASC 825-10

General

50-1 Paragraph 825-10-05-3 identifies various Topics within the Codification that address financial instruments matters. Those and other Topics in the

Codification require disclosures about specific financial instruments. This Subsection addresses incremental disclosures about all of the following:

a. **Fair value** of financial instruments
b. Concentrations of credit risk of all financial instruments
c. Market risk of all financial instruments.

Interpretive response: Yes. An entity also provides disclosures required by other relevant Topics. For example, an entity should consider disclosure requirements in the following Topics.

Topic	KPMG Handbook reference
Topic 275 (risks and uncertainties)	Chapter 7, Financial statement presentation
Topic 820 (fair value measurements)	Section N, Fair value measurement
Topic 855 (subsequent events)	Chapter 9, Financial statement presentation
Topic 470 (debt)	Chapter 3, Debt and equity financing

6.5.20 Fair value of financial instruments

Question 6.5.40
What transactions are subject to the required fair value disclosures in Subtopic 825-10?

Excerpt from ASC 825-10

General

• > Transactions

50-8 In part, this Subsection requires disclosures about fair value for all financial instruments, whether recognized or not recognized in the statement of financial position, except that the disclosures about fair value prescribed in paragraphs 825-10-50-10 through 50-13 and 825-10-50-15 are not required for any of the following:

a. Employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements (see Topics 710, 712, 715, 718, and 960)
b. Substantively extinguished debt subject to the disclosure requirements of Subtopic 405-20

c. Insurance contracts, other than financial guarantees (including financial guarantee insurance contracts within the scope of Topic 944) and investment contracts, as discussed in Subtopic 944-20
d. Lease contracts as defined in Topic 842 (a contingent obligation arising out of a cancelled lease and a guarantee of a third-party lease obligation are not lease contracts and are subject to the disclosure requirements in this Subsection)
e. Warranty obligations (see Topic 450 and the Product Warranties Subsections of Topic 460)
f. Unconditional purchase obligations as defined in paragraph 440-10-50-2
g. Investments accounted for under the equity method in accordance with the requirements of Topic 323
h. Noncontrolling interests and equity investments in consolidated subsidiaries (see Topic 810)
i. Equity instruments issued by the entity and classified in stockholders' equity in the statement of financial position (see Topic 505)
j. Receive-variable, pay-fixed interest rate swaps for which the simplified hedge accounting approach is applied (see Topic 815)
k. Fully benefit-responsive investment contracts held by an employee benefit plan
l. Investments in equity securities accounted for under the measurement guidance for equity securities without readily determinable fair values (see Topic 321)
m. Trade receivables and payables due in one year or less
n. Deposit liabilities with no defined or contractual maturities
o. Liabilities resulting from the sale of prepaid stored-value products within the scope of paragraph 405-20-40-3.

50-9 Generally accepted accounting principles (GAAP) require disclosure of or subsequent measurement at fair value for many classes of financial instruments. Those requirements are not superseded or modified by this Subsection.

Interpretive response: Subtopic 825-10 required certain disclosures about fair value for financial instruments, whether or not recognized on the balance sheet. See Questions 6.5.50 through 6.5.80 for additional information on the required fair value disclosures. [825-10-50-8]

However, such disclosures are not required for the following instruments.

Excluded instruments
Employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements (Topics 710, 712, 715, 718, and 960)
Substantively extinguished debt subject to the disclosure requirements of Subtopic 405-20
Insurance contracts, other than financial guarantees (including financial guarantee insurance contracts within the scope of Topic 944) and investment contracts, as discussed in Subtopic 944-20
Lease contracts as defined in Topic 842[1]

Excluded instruments
Warranty obligations (see Topic 450 and Product Warranties Subsections of Topic 460)
Unconditional purchase obligations as defined in paragraph 440-10-50-2
Investments accounted for using the equity method under Topic 323
Noncontrolling interests and equity investments in consolidated subsidiaries (see Topic 810)
Equity instruments issued by the entity and classified in stockholders' equity on the balance sheet (see Topic 505)
Receive-variable, pay-fixed interest rate swaps for which the simplified hedge accounting approach is applied (see Topic 815)
Fully benefit-responsive investment contracts held by an employee benefit plan
Investments in equity securities without readily determinable fair values accounted for under the measurement alternative (see Topic 321)
Trade receivables and payables due in one year or less
Deposit liabilities with no defined or contractual maturities
Liabilities resulting from the sale of prepaid stored-value products in the scope of paragraph 405-20-40-3
Note: 1. A contingent obligation arising out of a cancelled lease and a guarantee of a third-party lease obligation are not lease contracts and are subject to the disclosure requirements in Subtopic 825-10.

Question 6.5.50
What fair value disclosures are required?

Excerpt from ASC 825-10

General

> Fair value of financial instruments

50-10 A reporting entity shall disclose either in the body of the financial statements or in the accompanying notes, the fair value of financial instruments and the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3).

For financial instruments recognized at fair value in the statement of financial position, the disclosure requirements of Topic 820 also apply.

Interpretive response: Entities are required to disclose: [825-10-50-10]

- the fair value of financial instruments; and
- the level of the fair value hierarchy in which the fair value measurements are categorized in their entirety (Level 1, 2, or 3)

The disclosures can be made in the body of the financial statements or the accompanying notes. Additionally, entities must provide the disclosures required by Topic 820 for financial instruments recognized at fair value on the balance sheet. See chapter N of KPMG Handbook, Fair value measurement. [825-10-50-10]

Question 6.5.60
How is the fair value information disclosed in the notes to the financial statements presented?

Excerpt from ASC 825-10

General

> Fair value of financial instruments

50-11 Fair value disclosed in the notes shall be presented together with the related carrying amount in a form that clarifies both of the following:

a. Whether the fair value and carrying amount represent assets or liabilities
b. How the carrying amounts relate to what is reported in the statement of financial position.

50-11A See paragraph 470-20-50-1D for additional guidance on disclosures about fair value of convertible debt instruments.

50-12 If the fair value of financial instruments is disclosed in more than a single note, one of the notes shall include a summary table. The summary table shall contain the fair value and related carrying amounts and cross-references to the location(s) of the remaining disclosures required by this Section.

50-13 This Subtopic does not prohibit an entity from disclosing separately the estimated fair value of any of its nonfinancial intangible and tangible assets and nonfinancial liabilities.

Interpretive response: The fair value of the financial instruments disclosed in the notes to the financial statements is presented together with the related carrying amount of the financial asset or financial liability. The disclosures should be clear enough for a financial statement user to understand: [825-10-50-11]

- whether the fair value and carrying amounts represent assets or liabilities; and
- how the carrying amounts relate to what is presented in the balance sheet.

If the fair value information is disclosed in more than one note, a summary table must be included in one of the notes. This summary table contains the fair value and related carrying amounts as well as references to the location(s) of the remaining required disclosures. [825-10-50-12]

Question 6.5.70
Can the fair value disclosures be presented on a net basis?

Excerpt from ASC 825-10

General

> Fair value of financial instruments

50-15 In disclosing the fair value of a financial instrument, an entity shall not net that fair value with the fair value of other financial instruments—even if those financial instruments are of the same class or are otherwise considered to be related (for example, by a risk management strategy)—except to the extent that the offsetting of carrying amounts in the statement of financial position is permitted under either of the following:

a. The general principle in paragraph 210-20-45-1
b. The exceptions for master netting arrangements in paragraph 815-10-45-5 and for amounts related to certain repurchase and reverse repurchase agreements in paragraphs 210-20-45-11 through 45-17.

Interpretive response: It depends. Generally, fair value disclosures of financial instruments may not be presented net. This applies even if these instruments are of the same class or otherwise considered to be related (e.g. by a risk management strategy). However, entities can offset the fair value of financial instruments if permitted under any of the following circumstances. [825-10-50-15]

Financial instrument	Reference to relevant KPMG Handbook
Assets and liabilities for which a right of offset exists [210-20-45-1 – 45-9]	Section 3.4, Financial statement presentation
Derivatives subject to master netting arrangements [815-10-45-5]	Section 14.2.20, Derivatives and hedging
Repurchase and reverse repurchase agreement [210-20-45-11 – 45-17]	Section 8.3.20, Transfers and servicing of financial assets

Question 6.5.80
Can the fair value disclosures required by Subtopic 825-10 be combined with the disclosures required by other Topics?

Excerpt from ASC 825-10

Fair Value Option

> Applicability of This Subsection

50-27 The disclosure requirements in paragraphs 825-10-50-28 through 50-30 do not eliminate disclosure requirements included in other Subtopics, including other disclosure requirements relating to fair value measurement. Entities are encouraged but are not required to present the disclosures required by this Subtopic in combination with related fair value information required to be disclosed by other Subtopics (for example, the General Subsection of this Section and Topic 820).

Interpretive response: Yes. The FASB encourages entities to combine fair value information disclosed under Subtopic 825-10 with the fair value information disclosed under other Topics, where meaningful. Although not required, the FASB believes having these disclosures in one place would enhance financial statement users' understanding about fair value and the use of fair value in financial reporting. [825-10-50-27, FAS159.BC A31]

6.5.30 Concentrations of credit risk

Question 6.5.90
What disclosures on significant concentrations of credit risk are required?

Excerpt from ASC 825-10

Fair Value Option

> Concentrations of Credit Risk of All Financial Instruments

50-20 Except as indicated in paragraph 825-10-50-22, an entity shall disclose all significant concentrations of credit risk arising from all financial instruments, whether from an individual counterparty or groups of counterparties. Throughout paragraphs 825-10-50-20 and 50-21, the term financial instruments includes derivative instruments accounted for under Topic 815. Group concentrations of credit risk exist if a number of counterparties are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

50-21 Except as indicated in the following paragraph, all of the following shall be disclosed about each significant concentration:

a. Information about the (shared) activity, region, or economic characteristic that identifies the concentration
b. The maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity
c. With respect to collateral, all of the following:
    1. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk
    2. Information about the entity's access to that collateral or other security
    3. The nature and a brief description of the collateral or other security supporting those financial instruments.
d. With respect to master netting arrangements, all of the following:
    1. The entity's policy of entering into master netting arrangements to mitigate the credit risk of financial instruments
    2. Information about the arrangements for which the entity is a party
    3. A brief description of the terms of those arrangements, including the extent to which they would reduce the entity's maximum amount of loss due to credit risk.

Interpretive response: Except for certain exceptions (see Question 6.5.100), an entity discloses all significant concentrations of credit risk arising from financial instruments, whether from an individual counterparty or groups of counterparties. Group concentrations of credit risk exist if a number of counterparties are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. [820-10-50-20]

The following disclosures on significant concentrations of credit risk are required. [820-10-50-21]

General
Information about the shared activity, region or economic characteristic that identifies the concentration.
The maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if (1) parties to the financial instruments that make up the concentration fail completely to perform, and (2) the collateral or other security, if any, for the amount due is of no value to the entity.
Collateral
The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk.

Information about the entity's access to collateral or other security.
The nature and a brief description of the collateral or other security supporting those financial instruments.
Master netting agreements
The entity's policy of entering into master netting arrangements to mitigate the credit risk of financial instruments.
Information about the arrangements.
A brief description of the terms of those arrangements, including the extent to which they would reduce the entity's maximum amount of loss due to credit risk.

Question 6.5.100
Are disclosures regarding significant concentrations of credit risk required for all financial instruments?

Excerpt from ASC 825-10

Fair Value Option

> Concentrations of Credit Risk of All Financial Instruments

50-22 The requirements of the preceding paragraph do not apply to the following financial instruments, whether written or held:

a. The financial instruments described in paragraph 825-10-50-8(a); (c); (e); and (f), except for reinsurance recoverables and prepaid reinsurance premiums
b. Financial instruments of a pension plan, including plan assets, if subject to the accounting and reporting requirements of Topic 715.

Financial instruments of a pension plan, other than the obligations for pension benefits, if subject to the accounting and reporting requirements of Topic 960, are subject to the requirements of paragraphs 825-10-50-20 through 50-21.

Interpretive response: No. The significant concentrations of credit risk disclosures apply to most financial instruments, including derivative instruments accounted for under Topic 815. However, such disclosures are not required for the following: [825-10-50--22]

- employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements (Topics 710, 712, 715, 718, and 960);
- insurance contracts, other than financial guarantees (including financial guarantee insurance contracts in the scope of Topic 944) and investment contracts, as discussed in Subtopic 944-20;

- warranty obligations (see Topic 450 and Product Warranties Subsections of Topic 460);
- unconditional purchase obligations as defined in paragraph 440-10-50-2; and
- financial instruments of a pension plan, including plan assets, if subject to the accounting and reporting requirements of Topic 715.

Even if reinsurance recoverables or prepaid reinsurance premiums are included in the list above, they are not exempt from the significant concentration of credit risk disclosures. [825-10-50-22]

Question 6.5.110

Is cash on deposit with banks in excess of FDIC-insured limits required to be disclosed when it results in a significant concentration of credit risk?

Interpretive response: Yes. We believe it may be appropriate to disclose the existence of uninsured cash balances if the uninsured balances represent a significant concentration of credit risk. If an entity has a bank account balance that exceeds Federal Deposit Insurance Corporation (FDIC) insured amounts it represents a credit risk that the entity would assess to determine whether it is a significant concentration of credit risk.

For example, a material uninsured cash balance with a single bank may represent a significant concentration of credit risk. In contrast, numerous immaterial uninsured cash balances on deposit with several banks may not represent a significant concentration of credit risk.

Question 6.5.120

Are there certain loan product terms that may result in a significant concentration of credit risk and require additional disclosures?

Excerpt from ASC 825-10

General

> Implementation Guidance

• > Concentrations Involving Loan Product Terms

55-1 The terms of certain loan products may increase a reporting entity's exposure to credit risk and thereby may result in a concentration of credit risk as that term is used in this Subtopic, either as an individual product type or as a group of products with similar features. Possible shared characteristics on which significant concentrations may be determined include, but are not limited to, the following:

a. Borrowers subject to significant payment increases
b. Loans with terms that permit negative amortization
c. Loans with high loan-to-value ratios.

55-2 Judgment is required to determine whether loan products have terms that give rise to a concentration of credit risk. Furthermore, an entity may disclose how underwriting procedures are designed to control the credit risk that may arise from future payment increases.

Background: As discussed in Question 6.5.90, there are specific disclosures for significant concentrations of credit risk.

Interpretive response: Yes. Certain loan products may include terms that may increase an entity's exposure to credit risk and result in a significant concentration of credit risk that must be disclosed. We believe the following characteristics may indicate a potential increase in credit risk. [825-10-55-1 – 55-2]

<table>
<tr><th>Characteristics</th><th>Additional considerations</th></tr>
<tr><td>Borrowers subject to significant payment increases</td><td>Lending products may have features for reduced payment requirements early in the loan's term or below market interest for an initial period. For these loans, evidence that the borrower may not be able to make payments throughout the term of the loan may not become apparent until the contractual provisions of the loans cause an increase in the required payment.</td></tr>
<tr><td>Interest-only loans</td><td rowspan="3">Loan products may have initial payment requirements that are less than or equal to the contractual interest amount. These products include option ARMs, negative amortizing, deferred interest or interest-only loans. Negative amortization and the deferral of interest increase the loan amount, which can result in an increased loan-to-value ratio and a reduction in the borrower's equity. These features can result in possible increases in a borrower's loan repayment when the contractually required repayments increase due to interest rate movements, step-up from the initial</td></tr>
<tr><td>Loans with terms that permit deferrals or payments smaller than interest accruals (negative amortization)</td></tr>
<tr><td>Option adjustable-rate mortgages or similar products that may expose the borrower to future increases in repayments in excess of increases that result solely from increases in the market interest rate (e.g. negative amortization results in the loan</td></tr>
</table>

Characteristics	Additional considerations
reaching a maximum principal accrual limit)	interest rate, or the required amortization of the principal amount. The severity of the increase is influenced by these and other factors. These payment increases could affect a borrower's ability to repay the loan and lead to increased defaults and losses.
Loans with high loan-to-value ratios	Loans may have high loan-to-value ratios due to decreasing collateral values and/or multiple loans collateralized with the same collateral. High loan-to-value ratios could expose an entity to increased credit risk.

The list above is not all inclusive. Determining whether loans contain characteristics that may give rise to a concentration of credit risk requires judgment. Entities should consider disclosing how their underwriting procedures are designed to mitigate credit risk that may arise from future payment increases. [825-10-55-2]

6.5.40 Market risk

Question 6.5.130
Is disclosure of quantitative information about market risk of financial instruments required?

Excerpt from ASC 825-10

General

> Market Risk of All Financial Instruments

50-23 An entity is encouraged, but not required, to disclose quantitative information about the market risks of financial instruments that is consistent with the way it manages or adjusts those risks. Appropriate ways of reporting that quantitative information will differ for different entities and will likely evolve over time as management approaches and measurement techniques evolve. Possibilities include disclosing any of the following:

a. More details about current positions and perhaps activity during the period
b. The hypothetical effects on comprehensive income (or net assets), or annual income, of several possible changes in market prices
c. A gap analysis of interest rate repricing or maturity dates
d. The duration of the financial instruments
e. The entity's value at risk from derivatives and from other positions at the end of the reporting period and the average value at risk during the year.

This list is not exhaustive, and an entity is encouraged to develop other ways of reporting quantitative information.

Interpretive response: No. Under US GAAP, entities are encouraged but not required to disclose quantitative information about the market risk of financial instruments. The appropriate ways of reporting this information will differ between entities and continues to evolve over time. See FASB excerpt above for items entities may consider disclosing.

The above list is not meant to be exhaustive and entities are encouraged to develop other ways to report quantitative information on market risks. [825-10-50-23]

6.5.50 Fair value option

Question 6.5.140
What are the objectives of the fair value option disclosures?

Excerpt from ASC 825-10

Fair Value Option

> Applicability of This Subsection

50-23A This guidance discusses the applicability of the disclosure requirements in this Subsection to all entities that have elected the fair value option.

50-24 The principal objectives of the disclosures required by paragraphs 825-10-50-28 through 50-32 are to facilitate both of the following comparisons:

a. Comparisons between entities that choose different measurement attributes for similar assets and liabilities
b. Comparisons between assets and liabilities in the financial statements of an entity that selects different measurement attributes for similar assets and liabilities.

50-25 Those disclosure requirements are expected to result in the following:

a. Information to enable users of its financial statements to understand management's reasons for electing or partially electing the fair value option
b. Information to enable users to understand how changes in fair values affect earnings for the period
c. The same information about certain items (such as equity investments and nonperforming loans) that would have been disclosed if the fair value option had not been elected
d. Information to enable users to understand the differences between fair values and contractual cash flows for certain items.

To meet those objectives, the disclosures described in paragraphs 825-10-50-28 through 50-32 are required for items measured at fair value under the option in this Subtopic and the option in paragraph 815-15-25-4. Those disclosures are not required for securities classified as trading securities under Topic 320, life settlement contracts measured at fair value pursuant to Subtopic 325-30, or servicing rights measured at fair value pursuant to Subtopic 860-50. Those Subtopics include disclosure requirements not affected by this Subtopic.

Interpretive response: The principal objectives of the fair value option disclosures are to facilitate comparison of financial statements for different entities and for similar assets and liabilities of an entity. [825-10-50-24]

Different entities	Enhance comparability between entities that have similar assets and liabilities but have elected different measurement alternatives. For example, two different entities hold debt securities but one has elected the fair value option and the other has recorded the instrument at amortized cost. These disclosures will permit comparability between these entities.
Similar assets and liabilities of an entity	Enhance comparability between similar assets and liabilities of an entity for which different measurement alternatives have been applied. For example, an entity holds loans but has elected the fair value option for some and not others, see Question 6.3.20. These disclosures will permit comparability between these instruments in the entity's financial statements.

The disclosures are expected to result in information for financial statement users to: [825-10-50-25]

- understand an entity's reason for electing or partially electing the fair value option;
- understand how changes in fair value affect earnings for the period;
- understand the differences between fair values and contractual cash flows for certain items; and
- obtain the same information about certain instruments (e.g. equity investments and nonperforming loans) that would have been disclosed if the fair value option had not been elected.

Question 6.5.150

Are the fair value option disclosures required for all instruments measured at fair value?

Interpretive response: No. The fair value option disclosures are required for financial instruments measured at fair value under Subtopic 825-10 and paragraph 815-15-25-4. Paragraph 815-15-25-4 permits an entity to elect the fair value option for hybrid financial instruments that contain an embedded derivative that Subtopic 815-15 would require to be bifurcated if the instrument was not otherwise measured at fair value. [825-10-50-25]

However, these disclosures are not required for debt securities classified as trading (Topic 320), life settlement contracts measured at fair value (Subtopic 325-30) or servicing rights measured at fair value (Subtopic 860-50). We believe such disclosures are also not required for equity securities measured at fair value under Topic 321. [825-10-50-25]

Question 6.5.160

What fair value option disclosures are required for each balance sheet presented?

Excerpt from ASC 825-10

Fair Value Option

> Required Disclosures as of Each Date for Which an Interim or Annual Statement of Financial Position Is Presented

50-28 As of each date for which a statement of financial position is presented, entities shall disclose all of the following:

a. Management's reasons for electing a fair value option for each eligible item or group of similar eligible items
b. If the fair value option is elected for some but not all eligible items within a group of similar eligible items, both of the following:
    1. A description of those similar items and the reasons for partial election
    2. Information to enable users to understand how the group of similar items relates to individual line items on the statement of financial position.
c. For each line item in the statement of financial position that includes an item or items for which the fair value option has been elected, both of the following:
    1. Information to enable users to understand how each line item in the statement of financial position relates to major classes of assets and liabilities presented in accordance with the fair value disclosure requirements of Topic 820. (Paragraph 825-10-50-11 also requires an

entity to relate carrying amounts that are disclosed in accordance with that paragraph to what is reported in the statement of financial position.)

2. The aggregate carrying amount of items included in each line item in the statement of financial position that are not eligible for the fair value option, if any.

d. The difference between the aggregate fair value and the aggregate unpaid principal balance of each of the following:
   1. Loans and long-term receivables (other than securities subject to Topic 320) that have contractual principal amounts and for which the fair value option has been elected
   2. Long-term debt instruments that have contractual principal amounts and for which the fair value option has been elected.

e. For loans held as assets for which the fair value option has been elected, all of the following:
   1. The aggregate fair value of loans that are 90 days or more past due
   2. If the entity's policy is to recognize interest income separately from other changes in fair value, the aggregate fair value of loans in nonaccrual status
   3. The difference between the aggregate fair value and the aggregate unpaid principal balance for loans that are 90 days or more past due, in nonaccrual status, or both.

Interpretive response: As of each date for which an interim or annual balance sheet is presented, an entity discloses all of the following about items for which the fair value option was elected. [825-10-50-28(a) – 28(e)]

All instruments	The reason for electing the fair value option for each eligible item or group of similar eligible items.
	If the fair value option is elected for some but not all eligible items in a group of similar eligible items: • a description of those similar items and the reasons for partial election; and • information to enable users to understand how the group of similar items relates to individual line items on the balance sheet.
	For each line item in the balance sheet that includes an item or items for which the fair value option has been elected: • information to enable users to understand how each line item in the balance sheet relates to major classes of assets and liabilities presented in accordance with the fair value disclosure requirements of Topic 820; and • the aggregate carrying amount of items included in each line item in the balance sheet that are not eligible for the fair value option, if any.

Loans, long-term receivables and long-term debt instruments	For items with contractual principal amounts, the difference between the aggregate fair value and the aggregate unpaid principal balance. This does not apply to securities in the scope of Topic 320. See Question 2.4.20 for guidance on determining whether an instrument is a security.
Additional disclosures for loans	The following information on loans held as assets for which the fair value option has been elected: • The aggregate fair value of loans that are 90 days or more past due; • The aggregate fair value of loans in nonaccrual status if an entity recognizes interest income separately from other changes in fair value; and • The difference between the aggregate fair value and the aggregate unpaid principal balance for loans that are 90 days or more past due, in nonaccrual status, or both.

Question 6.5.170

What disclosures are required for investments under the fair value option that would otherwise be accounted for under the equity method?

Excerpt from ASC 825-10

Fair Value Option

> Required Disclosures as of Each Date for Which an Interim or Annual Statement of Financial Position Is Presented

50-28 As of each date for which a statement of financial position is presented, entities shall disclose all of the following: …

a. For investments that would have been accounted for under the equity method if the entity had not chosen to apply the fair value option, the information required by paragraph 323-10-50-3 (excluding the disclosures in paragraph 323-10-50-3(a)(3); (b); and (d)).

50-29 The disclosure in paragraph 825-10-50-28(f) applies to investments in common stock, investments in in-substance common stock, and other investments (for example, partnerships and certain limited liability corporations) that both:

a. Would otherwise be required to be accounted for under the equity method under other generally accepted accounting principles (GAAP)
b. Would be required to satisfy the disclosure requirements of paragraph 323-10-50-3.

When applying paragraph 825-10-50-28(f), an entity shall apply the guidance from paragraphs 323-10-50-2 and 323-10-50-3(a) and (c).

Interpretive response: Entities are required to provide certain disclosures required by Subtopic 323-10 if they both: [825-10-50-28(f), 50-29]

- elected the fair value option for investments in common stock, in-substance common stock and other investments that would otherwise be accounted for under the equity method; and
- would have been required to satisfy the disclosure requirements of paragraph 323-10-50-3.

Below is a summary of the disclosures required by Subtopic 323-10. For additional information see KPMG Handbook, Equity method of accounting.

323-10-50-3(a)(1), 50-3(a)(2)
• Name of the investee and percentage of ownership of common stock. • The accounting policies of the investor with respect to investments in common stock
323-10-50-3(c)
• If the investor's equity method investments are material in aggregate, it may need to provide summarized balance sheet and income statement information for those investments. The investor may provide that information for each investment individually or in groups.

An entity may present these disclosures in the notes to the financial statements, or in separate statements or schedules. An entity should consider the significance of an investment to its balance sheet and income statement when evaluating the extent of disclosures of the investee's financial position and results of operations. If the entity has more than one investment in common stock, disclosures on a combined basis may be appropriate. [323-10-50-2, 50-3(a)]

Question 6.5.180
What disclosures are required for each income statement presented?

Excerpt from ASC 825-10

Fair Value Option

> Required Disclosures for Each Period for Which an Interim or Annual Income Statement Is Presented

50-30 For each period for which an income statement is presented, entities shall disclose all of the following about items for which the fair value option has been elected:

a. For each line item in the statement of financial position, the amounts of gains and losses from fair value changes included in earnings during the period and in which line in the income statement those gains and losses are reported. This Subtopic does not preclude an entity from meeting this requirement by disclosing amounts of gains and losses that include amounts of gains and losses for other items measured at fair value, such as items required to be measured at fair value.
b. A description of how interest and dividends are measured and where they are reported in the income statement. This Subtopic does not address the methods used for recognizing and measuring the amount of dividend income, interest income, and interest expense for items for which the fair value option has been elected.
c. For loans and other receivables held as assets, both of the following:
    1. The estimated amount of gains or losses included in earnings during the period attributable to changes in instrument-specific credit risk
    2. How the gains or losses attributable to changes in instrument-specific credit risk were determined.
d. For liabilities, all of the following about the effects of the instrument-specific credit risk and changes in it:
    1. The amount of change, during the period and cumulatively, of the fair value of the liability that is attributable to changes in the instrument-specific credit risk …
    3. How the gains and losses attributable to changes in instrument-specific credit risk were determined.
    4. If a liability is settled during the period, the amount, if any, recognized in other comprehensive income that was recognized in net income at settlement.

Interpretive response: For each period for which an income statement is presented, an entity is required to disclose the following about items for which the fair value option is elected. [825-10-50-30]

All instruments	For each line item in the balance sheet, the amounts of gains and losses from fair value changes included in earnings during the period and in which line in the income statement those gains and losses are reported. An entity may disclose the amounts of gains and losses for items measured at fair value under the fair value option combined with gains and losses for other items measured at fair value. [FAS 159. BC A30]
	A description of how interest and dividends are measured and where they are reported in the income statement.
Loans and other receivables	The estimated amount of gains or losses included in earnings during the period attributable to changes in instrument-specific credit risk.

	How the gains or losses attributable to changes in instrument-specific credit risk were determined.
Liabilities	The amount of change, during the period and cumulatively, in the fair value of the liability that is attributable to changes in the instrument-specific credit risk. See Question 6.3.210 for additional guidance related to the measurement of the change in fair value attributable to instrument-specific credit risk.
	How the gains and losses attributable to changes in instrument-specific credit risk were determined.
	If a liability is settled during the period, the amount, if any, in OCI related to changes in fair value attributable to instrument-specific credit risk that was recognized in earnings at settlement.

Question 6.5.190

Is an entity required to disclose how it estimates fair value?

Excerpt from ASC 825-10

Fair Value Option

> Other Required Disclosures

50-31 In annual periods only, an entity shall disclose the methods and significant assumptions used to estimate the fair value of items for which the fair value option has been elected. For required disclosures about the method(s) and significant assumptions used to estimate the fair value of financial instruments, see paragraph 820-10-50-2(bbb) except that an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorized within Level 3 of the fair value hierarchy required by that paragraph.

Interpretive response: Yes. In annual periods only, an entity discloses the methods and significant assumptions used to estimate the fair value of items for which the fair value option has been elected and that are categorized in Level 2 or 3 of the fair value hierarchy. However, an entity is not required to include the quantitative disclosures about significant unobservable inputs used in the fair value measurement of items categorized in Level 3. [820-10-50-2(bbb), 825-10-50-31]

For additional guidance on the disclosures required by Topic 820 see Chapter N of KPMG Handbook, Fair value measurement.

Question 6.5.200
Are additional disclosures required when an entity initially elects the fair value option?

Excerpt from ASC 825-10

Fair Value Option

> Other Required Disclosures

50-32 If an entity elects the fair value option at the time one of the events in paragraph 825-10-25-4(d) through (e) occurs, the entity shall disclose both of the following in financial statements for the period of the election:

a. Qualitative information about the nature of the event
b. Quantitative information by line item in the statement of financial position indicating which line items in the income statement include the effect on earnings of initially electing the fair value option for an item.

Background: As discussed in Question 6.3.30 an entity may elect the fair value option when certain election events occur. If the election event is the result of one of the following, additional disclosures are required: [825-10-50-32]

- an investment in another entity becomes subject to the equity method; or
- an event occurs that requires an instrument to be initially measured at fair value but does not require fair value measurement in subsequent periods, excluding certain impairments.

Interpretive response: It depends on what type of election event occurred. An entity discloses both of the following when the election event is the result of one of the circumstances discussed in the background above: [825-10-50-32]

- qualitative information about the nature of the event; and
- quantitative information by line item in the balance sheet indicating which line items in the income statement include the effect on earnings of initially electing the fair value option.

6.5.60 FASB Examples

The examples in this section reproduced from Subtopic 825-10 illustrate selected disclosure requirements for which the fair value option was elected.

Excerpt from ASC 825-10

Fair Value Option

> Illustrations

• > Example 1: Fair Value Measurements and Changes in Fair Values Included in Current-Period Earnings

55-6 The following Cases illustrate selected disclosure requirements for items reported at fair value under this Subtopic:

a. The Fair Value Option Subsection of 825–10–50 disclosures with voluntary integration of the General Subsection of 825–10–50 disclosures (Case A)
b. The Fair Value Option Subsection of 825–10–50 disclosures without voluntary integration of the General Subsection of 825–10–50 disclosures (Case B).

55-7 Cases A and B represent suggested forms for presenting disclosure information. While the suggested forms of presentation illustrate selected required disclosures, the suggested forms of presentation are not mandated by this Subtopic. Aggregation of related fair value disclosures is encouraged but not required.

55-8 The statement of financial position for Entity XYZ as of December 31, 20X1, is provided to assist in understanding the illustrative fair value disclosures in Cases A and B.

Company XYZ
Statement of Financial Position
($ in 000s)

Description		**At December 31, 20X1**
Assets		
Cash and due from banks		$ 38
Deposits with banks		22
Fed funds sold and securities purchased under resale agreements		134
Securities borrowed		75
Trading debt securities		115
Debt securities available-for-sale (net of allowance for credit losses of $3)		75
Debt securities held-to-maturity	$ 34	
Allowance for credit losses on held-to-maturity debt securities	(2)	
Debt securities held-to-maturity, net of allowance for credit losses		32
Loans and lease receivables ($150 at fair value)	$ 560	
Allowance for loan and lease losses	(10)	
Loans, net of allowance for loan and lease losses		550

Derivatives	60
Equity investments	125
Premises and equipment	10
Other assets	20
Total assets	$ 1,256
Liabilities	
Non-interest-bearing deposits	$ 143
Interest-bearing deposits	412
Fed funds purchased and securities sold under resale agreements	130
Accounts payable	110
Short-term borrowings	128
Long-term debt ($60 at fair value)	200
Total liabilities	$ 1,123
Shareholders' equity	
Common stock (authorized 5,000,000 shares; issued 3,550,000 shares)	$ 4
Additional paid-in capital	88
Retained earnings	42
Accumulated other comprehensive income (loss)	(1)
Total shareholders' equity	133
Total liabilities and shareholders' equity	$ 1,256

• • > Case A: Disclosure with Voluntary Integration

55-9 The objective is to provide information about all of the following:

a. Assets and liabilities measured at fair value on a recurring basis (as required by Subtopic 820-10)
b. Changes in fair values of assets and liabilities for which the fair value option has been elected in a manner that relates to the statement of financial position (as required by this Subtopic)
c. Fair value estimates and corresponding carrying amounts for major categories of assets and liabilities that include items measured at fair value on a recurring basis (in accordance with the General Subsection of 825–10–50).

55-10 The following table represents the fair value tabular disclosure required by paragraph 820-10-50-2(b), supplemented to do both of the following:

a. Provide information about where in the income statement changes in fair values of assets and liabilities reported at fair value are included in earnings
b. Voluntarily integrate selected disclosures required annually by the General Subsection of 825-10-50.

Disclosures required by paragraphs 825-10-50-28(c) and 825-10-50-30(a) are illustrated in the narrative disclosure that follows the table.

($ in 000s)

Description	Total Carrying Amount in Statement of Financial Position 12/31/X1 [(a)]	Fair Value Estimate 12/31/X1 [(b)]	Assets or Liabilities Measured at Fair Value 12/31/X1	Fair Value Measurements at December 31, 20X1, Using			Changes in Fair Values for the 12-Month Period Ended December 31, 20X1, for Items Measured at Fair Value Pursuant to Election of the Fair Value Option					
				Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Trading Gains and Losses	Other Gains and Losses	Interest Income on Loans	Interest Expense on Long-Term Debt	Total Changes in Fair Values Included in Current-Period Earnings	Total Changes in Fair Values Included in Other Comprehensive Income
Trading debt securities	$ 115	$ 115	$ 115	$ 105	$ 10		$ 10 [(c)]				$ 10	
Available-for-sale debt securities, net	75	75	75	75								
Loans, net	400	412	150	--	100	$ 50		$ (3)	$ 10		7	
Derivatives	60	60	60	25	15	20	5 [(c)]				5	
Equity investments	125	125	125 *	50	25	50		(18)			(18)	
Long-term debt	(200)	(206)	(60)		(40)	(20)		13		$ (4)	5	$ 4

(*) Includes investments that would otherwise be accounted for under the equity method of accounting.

Loans are included in loans and lease receivables in the statement of financial position. As of December 31, 20X1, approximately $160,000 of lease receivables are included in loans and lease receivables in the statement of financial position and are not eligible for the fair value option.

(a) This column discloses carrying amount information required annually by this Subtopic only for major categories of assets and liabilities that include items measured at fair value.

(b) This column discloses fair value estimates required annually by this Subtopic only for major categories of assets and liabilities that include items measured at fair value. This Subtopic requires an entity to disclose fair value estimates and related carrying amounts for all financial instruments within the scope of this Subtopic. Paragraph 825-10-50-12 requires that if an entity discloses the fair value of financial instruments in more than a single note, one of the notes include a summary table (note presented in this Example).

(c) This Subtopic does not require disclosure of the amounts in the Trading Gains and Losses column nor does it preclude disclosure of these amounts. These amounts are shown for completeness.

55-11 An entity might provide either of the following additional disclosures required by paragraph 825-10-50-28(a) through (b) after the following table:

a. Management's reasons for electing a fair value option for each eligible item or group of similar eligible items
b. If the fair value option is elected for some but not all eligible items within a group of similar eligible items, both of the following:
   1. A description of those similar items and the reasons for partial election
   2. Information to enable users to understand how the group of similar items relates to individual line items on the statement of financial position.

• • > Case B: Disclosure without Voluntary Integration

55-12 The following table illustrates an alternative presentation that does not integrate disclosures required annually by this Subtopic or the additional gain and loss amounts voluntarily displayed in the table in Case A. The following table represents the fair value hierarchy table set forth in Topic 820, supplemented to provide information about where in the income statement changes in fair values of assets and liabilities for which the fair value option has been elected are included in earnings. Disclosures required by paragraphs 825-10-50-28(c) and 825-10-50-30(a) are illustrated in the narrative disclosure that follows the table.

($ in 000s)

		Fair Value Measurements at December 31, 20X1, Using			Changes in Fair Values for the 12-Month Period Ended December 31, 20X1, for Items Measured at Fair Value Pursuant to Election of the Fair Value Option				
Description	**Fair Value Measurements 12/31/X1**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Other Gains and Losses**	**Interest Income on Loans**	**Interest Expense on Long-Term Debt**	**Total Changes in Fair Values Included in Current-Period Earnings**	**Total Changes in Fair Values Included in Other Comprehensive Income**
Trading debt securities	$ 115	$ 105	$ 10						
Available-for-sale debt securities	75	75							
Loans	150	--	100	$ 50	$ 3	$ 10		$ 7	
Derivatives	60	25	15	20					
Equity investments *	125	50	25	50	(18)			(18)	
Long-term debt	(60)		(40)	(20)	13		$ (4)	5	$ 4

(*) Represents investments that would otherwise be accounted for under the equity method of accounting.

Loans are included in loans and lease receivables in the statement of financial position. As of December 31, 20X1, approximately $160,000 of lease receivables are included in loans and lease receivables in the statement of financial position and are not eligible for the fair value option.

55-13 An entity might provide either of the following additional disclosures required by paragraph 825-10-50-28(a) through (b) after the table:

a. Management's reasons for electing a fair value option for each eligible item or group of similar eligible items
b. If the fair value option is elected for some but not all eligible items within a group of similar eligible items, both of the following:
   1. A description of those similar items and the reasons for partial election
   2. Information to enable users to understand how the group of similar items relates to individual line items on the statement of financial position.

Index of changes

This index lists the significant additions and changes made in this edition to assist you in locating recently added or updated content. New Questions and Examples added in this edition are identified throughout the Handbook with ** and items that have been significantly updated or revised are identified with #.

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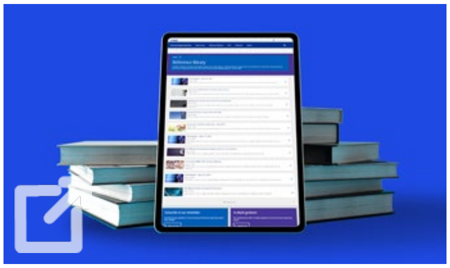

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