

# The Technical Guide

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## FASB No. 159: THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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### General

Once in a while there's a change in Generally Accepted Accounting Principles (GAAP) that can really get people talking. This is the case with the recently released Financial Accounting Standards Board (FASB) Statements 159 (FAS 159), "*The Fair Value Option for Financial Assets and Financial Liabilities*" and Statement 157 (FAS 157) "*Fair Value Measurements*." The objective of FAS 159 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. FAS 157 prescribes a new hierarchy for measuring fair value.

Under FAS 159, entities are permitted to measure certain financial instruments and other assets and liabilities at their fair value on an *instrument-by-instrument* basis. Once the fair value option (FVO) election is made, it is irrevocable and those instruments must be subsequently accounted for at their fair value. In addition, FAS 157 must be adopted at the same time as FAS 159.

If the early adoption of FAS 159 is elected, the fair values of the instruments are recorded as a cumulative-effect adjustment to the opening balance of undivided earnings.

### Additional Eligible Items

Other eligible items related to the instruments shall also be included with the instruments and removed from the statement of financial position and included in the cumulative-effect adjustment. Those eligible items include, but are not limited to:

- a. Unamortized deferred costs, fees, premiums, and discounts
- b. Valuation allowances (for example, allowances for loan losses)
- c. Accrued interest, which would be reported as part of the fair value of the eligible item

Eligible financial instruments include securities currently classified as available-for-sale (AFS) or held-to-maturity (HTM), loans, and financial liabilities. If the fair value option is elected for any AFS or HTM securities, the cumulative unrealized gains and losses at the effective date shall be included in the cumulative-effect adjustment. If an entity elects the FVO for an HTM or AFS security in conjunction with the adoption of this Statement, that security shall be reported as a trading security under Statement 115. In addition, electing the fair value option for an existing HTM security will not call into question the intent of an entity to hold other debt securities to maturity in the future.

## **Significant Issues**

FAS 159 clearly articulates the principles and objectives of the standard. Principles-based standards should be applied in a good faith manner consistent with those objectives and principles. Although FAS 159 allows for early adoption of the FVO for HTM and AFS investment securities, early adoption of those securities in the unrecognized loss positions (underwater securities), should be examined by Management to ensure that FAS 159 was applied in a manner that is consistent with the principles and objectives outlined in the standard.

### *Intent and Ability to Hold Securities*

Additionally, if a credit union was to adopt FAS 159, and subsequently sell those securities shortly thereafter, the issue of “intent” to hold to maturity may be called into question, and could require the recognition of an other than temporary impairment (OTTI).

One key factor in determining whether a security is other than temporarily impaired is whether the credit union has the intent and ability to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value. When a credit union has decided to sell an impaired security and does not expect the fair value of the security to fully recover prior to the sale date, the security should be deemed other than temporarily impaired and recorded at its fair value through an adjustment to earnings.

The ability to support the assertion of “intent” will be different for each credit union. Those credit unions with a December year end will be in a better position to support their December 31, 2006, intent assertion because FAS 159 was issued on February 17, 2007, after they had closed their books. Credit unions with March 31st, June 30th, and September 30th year ends will have more difficulty supporting their intent assertion if they employ a similar strategy at their first election date in 2007.

## **Election Dates**

An entity may adopt this Statement and elect the FVO for existing eligible items as of the beginning of a fiscal year that begins on or before November 15, 2007, subject to the following conditions:

- a. The choice to adopt early shall be made after issuance of this Statement but within 120 days of the beginning of the fiscal year of adoption.
- b. The entity also adopts all of the requirements of Statement 157 at this Statement’s early adoption date (the first day of the fiscal year of adoption) or earlier.
- c. At the time the entity chooses to adopt this Statement early, the entity has not yet issued financial statements, including required notes to those financial statements, for any interim period of the fiscal year that includes the early adoption date.
- d. The choices to apply or not apply the fair value option to eligible items existing at the early adoption date are retroactive to the early adoption date.
- e. For eligible items with an election date occurring after the early adoption date but before the date of the entity’s choice to apply early, the election for those items is retroactive to their election date.
- f. All other requirements that would normally apply as of the required effective date also apply as of the early adoption date.

## **Disclosure**

Adopting FAS 159 will require new disclosures for financial statements. For credit unions electing the FVO for items existing at the effective date, the following disclosures are required in its financial statements for the fiscal year that includes the effective date:

- A. A schedule that presents the following by line item in the statement of financial position:
  - (1) The cumulative-effect adjustment to undivided earnings for items on that line.
  - (2) The fair value at the effective date of eligible items for which the FVO is elected and the carrying amount of those same items immediately before electing the fair value option.
- B. The net effect on the entity's deferred tax assets and liabilities (if any) of electing the FVO.
- C. Management's reasons for electing the FVO for each existing eligible item or group of similar eligible items.
- D. If the FVO is elected for some but not all eligible items within a group of similar eligible items:
  - (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.
- E. The amount of valuation allowances that were removed from the statement of financial position because they related to items for which the fair value option was elected.

## **Effective Date**

FAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FAS 157. Entities are not permitted to apply this Statement retrospectively to fiscal years preceding the effective date unless the entity chooses early adoption. The choice to adopt early should be made after issuance of this Statement but within 120 days of the beginning of the fiscal year of adoption, provided the entity has not yet issued financial statements, including required notes to those financial statements, for any interim period of the fiscal year of adoption.

Statement No. 159 may be found in its entirety on the Financial Accounting Standards Board web site ([www.fasb.org](http://www.fasb.org)).

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