Overall Project Objective

The objective of the Accounting for Financial Instruments project is to significantly improve the decision usefulness of financial instrument reporting for users of financial statements. The project will replace the FASB’s and IASB’s respective financial instruments standards with a common standard. The Boards believe that simplification of the accounting requirements for financial instruments should be an outcome of this improvement. Although the project objective is comprehensive, it is also the Boards’ objective that the project should be completed expeditiously.

The Boards believe that this project will:

a. Reconsider the recognition and measurement of financial instruments
b. Address issues related to impairment of financial instruments and hedge accounting
c. Increase convergence in accounting for financial instruments.

To meet the project’s objective, the Boards will perform extensive outreach to obtain feedback from all constituents, including investors, preparers, auditors, regulators, and others on issues relevant to this project.

Background Information and Structure of the Project

At their joint meetings in April and October 2005, the FASB and the IASB discussed the future of reporting for financial instruments. The Boards established three long-term objectives to improve and simplify the reporting for financial instruments:

a. Develop a new standard for the derecognition of financial instruments
b. Require all financial instruments to be measured at fair value with realized and unrealized gains and losses recognized in the period in which they occur
c. Simplify or eliminate the need for special hedge accounting requirements.

In March 2006, the Boards further clarified their intentions to work together to improve and converge financial reporting standards by issuing a Memorandum of Understanding (MoU), A Roadmap for Convergence between IFRSs and US GAAP—2006 – 2008. As part of the MoU, the Boards worked jointly on a research project to reduce the complexity of the accounting for financial instruments. This joint effort resulted in the IASB’s issuance of the March 2008 Discussion Paper, Reducing Complexity in Reporting Financial Instruments, which the FASB also published for comment by its constituents. Focusing on the measurement of financial instruments and hedge accounting, the Discussion Paper identified several possible approaches for improving and simplifying the accounting for financial instruments.
At the joint meeting in October 2008, the FASB and IASB decided to create an advisory group that comprises senior leaders with broad international experience in financial markets. The Financial Crisis Advisory Group (FCAG) was asked to identify any accounting issues that require the Boards’ urgent and immediate attention as well as issues for longer-term consideration. On July 28, 2009, the FCAG issued their Final Report.

The Boards also organized three roundtables in 2008 – one each in London (November 14, 2008), Norwalk (November 25, 2008), and Tokyo (December 3, 2008). The purpose of these roundtables was to (a) allow members of the Boards to hear input from a wide range of stakeholders, including users, preparers, and auditors of financial statements, regulators, and others; and (b) help the Boards identify accounting issues that may require their urgent and immediate attention to improve financial reporting and help enhance investor confidence in financial markets.

Participants in the roundtables made general comments about the importance of (a) working toward convergence between IFRS and U.S. GAAP and (b) allowing sufficient due process before the IASB or the FASB make any changes to current accounting guidance. Participants raised the following issues at the roundtables: (a) impairment, (b) fair value option, (c) fair value measurement, (d) clarification of the interaction of conflicting accounting standards, and (e) clarification for investments in collateralized debt obligations.

In addition to considering the potential for short-term responses to the credit crisis, both Boards emphasized their commitment to developing common solutions aimed at providing greater transparency and reducing complexity in the accounting of financial instruments. As starting points for this longer term objective, the Boards considered the comments received in response to the Discussion Paper on reducing complexity and the Exposure Draft on hedging, the deliberations of the Financial Crisis Advisory Group, input received at the 2008 roundtables, input received from the IASB Financial Instruments Working Group, and numerous informal discussions with constituents. Please refer to the FASB Outreach Summary (as of May 2010) for a summary of feedback received prior to the issuance of the May 2010 proposed Accounting Standards Update.

On May 26, 2010, the FASB issued a comprehensive proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities. This Exposure Draft provided guidance on classification and measurement, impairment and hedging of financial instruments.

During redeliberations of the May 2010 Exposure Draft, the FASB decided that it would complete its deliberations on the project in three phases, similar to the IASB’s approach to the project. Please refer to the classification and measurement, impairment, and hedge accounting project pages for specific details on each of those topics. Below is additional background information specifically related to each of those topics.

Click here to access the IASB’s financial instruments project page for more information about the IASB’s project plan and deliberations.
Accounting for Financial Instruments
Overall Project Objective and Background Information

Classification and Measurement

In January 2012, the FASB and the IASB decided to jointly redeliberate select aspects of classification and measurement of financial instruments. The Boards tentatively decided to discuss the following key differences:

1. The contractual cash flow characteristics of a financial instrument
2. The need and basis for bifurcation of financial instruments
3. The basis for and scope of a possible third classification category (debt instruments measured at fair value through other comprehensive income)
4. Any interrelated issues from the above (for example, disclosures or the model for financial liabilities given the financial asset decisions).

The FASB and IASB issued their respective Exposure Drafts in 2013. In light of feedback received, the FASB ultimately decided not to proceed with the contractual cash flow characteristics test and business model test that was jointly developed with the IASB.

Impairment

The IASB and FASB developed and issued separate impairment models in 2009 and 2010, respectively. The IASB model was an expected cash flow approach which resulted in an effective interest rate which integrated credit loss expectations. The FASB model eliminated the “probable threshold” for impairment recognition in current U.S. GAAP. The FASB model was based on the recognition of full lifetime expected losses upon acquisition or origination of the financial asset.

The FASB participated with the IASB in an Expert Advisory Panel (EAP) that advised the Boards on the operational issues surrounding the IASB’s Expected Cash Flow approach and the FASB’s approach for determining credit impairments. The document below provides a summary of the discussions of the EAP on the pertinent aspects of the proposed FASB credit impairment model to inform the FASB and its constituents. This paper does not contain the detailed minutes of the EAP or its final recommendations to the Boards.

**Summary of EAP Discussions (as of July 2010)**

The FASB and IASB began joint redeliberations on credit impairment and interest income recognition in November 2010. On January 31, 2011, the FASB and the IASB proposed a common solution for impairment accounting by issuing a Supplementary Document.

In response to the feedback received on the Supplementary Document, the Boards began to pursue an approach that would reflect the deterioration in the credit quality of financial assets. This approach would involve three categories of assets (i.e., a “three-bucket” approach). Similar to the
approach set forth in the Supplementary Document, recognition and measurement of credit impairment losses would be based on expected losses.

After spending a considerable amount of time and effort developing the three-bucket approach, the FASB decided not to pursue an Exposure Draft on the three-bucket approach given the feedback the FASB had received on the approach. The FASB modified its decisions in response to concerns raised by constituents and issued proposed Accounting Standards Update, *Financial Instruments—Credit Losses (proposed Update)* in December 2012.

**Hedging**

At its January 31, 2007 meeting, the FASB directed the staff to research (a) issues causing difficulties in the application of hedge accounting and (b) potential approaches to accounting for hedging activities. Based on that research, the staff identified seven issues that cause significant difficulties in hedge accounting:

1. Strict documentation requirements
2. Lack of clarity regarding when dedesignation and redesignation is necessary
3. Which hedged items or hedged transactions could be included in a group
4. How effectiveness should be assessed and what should be included in effectiveness testing
5. How cash flows and different aspects of the discount rate should be incorporated into the measurement of a hedged item to determine the change in value attributable to an individual hedged risk
6. How ineffectiveness should be measured in a cash flow hedge and what features should be included in a perfect hypothetical derivative.
7. What the consequences should be for failing to meet the criteria for hedge accounting

On June 6, 2008, the FASB issued an Exposure Draft, *Accounting for Hedging Activities*, to address the issues identified.

A majority of respondents to both the Discussion Paper on reducing complexity and the Exposure Draft on hedging urged the Boards to work together on a joint project to improve, simplify, and converge the guidance for accounting for hedging activities.