CUNA MUTUAL GROUP

Changes in Accounting Methods

"Once credit unions understand the impact, they can make more informed decisions."

John Pesh

Changes in Accounting Methods for Equity Securities – Executive Summary

The Financial Accounting Standards Board (FASB) has issued an updated accounting standard related to measurement and recognition of financial assets and liabilities. Accounting Standards Update 2016-01 (ASU 2016-01) impacts credit unions' investment portfolios, including those credit unions investing in non-703 compliant investments to fund for employee benefits, deferred compensation, or charitable donation accounts. Under this update, equity investments will be accounted for as Trading securities, with unrealized gains/losses flowing through the income statement. Previously, the change in value of equity securities was recorded as an adjustment to equity. This paper addresses how to implement a change in accounting method, from Available-for-Sale (AFS) to Trading.

Changes in Accounting Methods – Detailed Analysis

Changes in accounting methods are addressed in Accounting Standards Codification Topic 250 (ASC 250). In this Topic, the FASB specifies that a change in accounting method is to be retrospective to all prior periods, unless impracticable to do so. Retrospective application requires:

- "The cumulative effect of the change to the new accounting principle on periods prior to those presented shall be reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented.
- An offsetting adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity of net assets in the statement of financial position) for that period.
- Financial statements for each individual prior period presented shall be adjusted to reflect the period-specific effects of applying the new accounting principle.

This means that:

1. The effect of the change in accounting method should be reflected in the financial statements as though the investment had always been accounted for under the new method,
2. A change will result in a net change to income and/or expense cumulative from inception of the investment, which is to be reflected in the retained earnings of the entity, as though all prior years had been accounted for under the new method, and
3. All prior year financial statements presented are to be adjusted to reflect the change in method in addition to the current year financial statements.

How this looks:

Disclaimer: the information provided is general guidance only and is not meant to provide definitive accounting advice. Specific questions should be referred to professional accounting advisors.

Assume an investment of $1,000,000 5 years ago, accounted for as AFS. In the current (5th) year, the new standard is adopted, resulting in a change in the accounting method from AFS to Trading. The return pattern of the investment is illustrated in the following chart:

Year	Investment	Fund Total Return	Fund Income Return	Fund Balance	Fund Income/ Expense	Fund Annual Unrealized Gain/Loss	Cumulative Unrealized Gain/Loss
1	1,000,000	6.78%	4.70%	1,067,800	47,000	20,800	20,800
2	0	6.70%	4.30%	1,139,343	45,915	25,627	46,427
3	0	3.56%	4.19%	1,179,903	47,738	-7,178	39,249
4	0	5.39%	4.70%	1,243,500	55,455	8,141	47,391
5 (YTD)	0	2.88%	2.24%	1,279,313	27,854	7,958	55,349

Note: Stated investment returns are hypothetical only, and not intended to represent any specific investment. There is no guarantee that the returns illustrated can actually be achieved.

In order to implement a change from AFS to Trading, adjustments have to be made to how the investment is reflected in the financial statements for:

- The current year to date (year 5),
- The prior years that are presented in their consolidated financial statements (As may be presented in an Annual Report – typically 2–3 prior years, years 3 & 4 in this example), and
- No adjustment made to years 1 & 2 as those are no longer presented in the financial statements.

The requirement in Topic 250 is to make a cumulative effect adjustment as of the first day of the earliest period presented (Year 3, in this example). The unrealized gain as of the end of Year 2 is $46,427.

Adoption of ASU 2016-01 requires a debit to accumulated comprehensive income and a credit to retained earnings of $46,427.

Cumulative Effect Adjustment, Beginning of Year 3

Debit	Other Comprehensive Income (balance sheet)	46,427
Credit	Retained Earnings (balance sheet)	46,427

For subsequent years, the income statement will reflect the change in value in income, rather than in equity as an unrealized gain/loss. The fund balance at fair value is unchanged in any year Any impact on income taxes, if applicable, has not been considered. See table below.

Year	Fund Balance	Fund Income/ Expense as Reported	Fund Income/ Expense as Revised	Fund Annual Unrealized Gain/ Loss as Reported	Fund Annual Unrealized Gain/ Loss as Revised
3	1,179,903	47,738	40,561	-7,178	0
4	1,243,500	55,455	63,597	8,141	0
5(YTD)	1,279,313	27,854	35,813	7,958	0

Conclusion

In response to ASU 2016-01, many credit unions will have to update their reported financial statements to appropriately reflect the new accounting method for investments. This is not a complex change, but does require a cumulative effect adjustment to treat the investments as though they have always been accounted for under the new method. This also requires amending all presented financial statements to appropriately reflect the change.

Credit unions should seek professional advice from tax, accounting and legal advisors as laws and regulations may vary depending on particular circumstances.

Interested in learning more about the Changes in Accounting Methods?

Contact CUNA Mutual Group's Executive Benefits Resource Center at 800.356.2644, ext. 665.8576