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Preface

December 2020

To the clients, friends, and people of Deloitte:

We are pleased to present the 2020 edition of *A Roadmap to Accounting for Current Expected Credit Losses*. Since the issuance of [ASU 2016-13](https://fasb.org/ASU-2016-13) (codified in ASC 326) on June 16, 2016, the FASB has focused on implementation efforts related to the adoption of this ASU. Over the past few years, the FASB has held three transition resource group (TRG) meetings, nine public board meetings,¹ and numerous public roundtables and credit losses workshops to discuss implementation questions raised and challenges identified by stakeholders. In response to the feedback received, the FASB has issued (as of the date of this publication) seven final ASUs to amend certain aspects of ASC 326.

The body of the Roadmap combines the requirements in ASC 326 with Deloitte’s interpretations and examples in a comprehensive, reader-friendly format. We hope that this publication will help readers navigate some of the more challenging aspects of the new credit losses standard. This publication has been developed for readers who have been following every development of the standard, as well as for readers who have not been following all developments and may be working through the standard for the first time. That is, it may function as a quick resource guide for those who have a specific question and are looking for a clear answer, or it may serve as an all-encompassing guide for those who are still building up their knowledge base to lead or work through an implementation.

Although certain calendar-year-end public companies have already adopted the guidance, challenging questions remain. Accordingly, we will continue to develop guidance that we believe will help stakeholders with their implementation challenges.

Subscribers to the [Deloitte Accounting Research Tool (DART)](https://dart.deloitte.com) may access any interim updates to this publication by selecting the Roadmap from the [Roadmap Series](https://dart.deloitte.com/RoadmapSeries) page on DART. If a “Summary of Changes Since Issuance” displays, subscribers can view those changes by clicking the related links or by opening the “active” version of the Roadmap.

We encourage you to use this Roadmap as a guide throughout your application of the new credit losses standard and to contact us with any questions or suggestions for future improvements. However, the Roadmap is not a substitute for consulting with Deloitte professionals on complex accounting questions and transactions.

¹ This Roadmap reflects decisions made by the FASB up through its meeting on March 11, 2020. Stakeholders are encouraged to continue to monitor activity at the FASB, SEC, and other standard setters or regulators for any relevant developments or interpretations that may affect the views expressed in this publication. See Chapter 10 for more information.
We look forward to assisting you on whatever journey you have remaining and hope that you find this Roadmap integral to your success.

Sincerely,

Deloitte & Touche LLP
Contacts

If you have questions about the information in this publication, please contact any of the following Deloitte professionals:

Jonathan Howard
Partner
Deloitte & Touche LLP
+1 203 761 3235
jonahoward@deloitte.com

Ashley Carpenter
Partner
Deloitte & Touche LLP
+1 203 761 3197
ascarpenter@deloitte.com

Brandon Coleman
Partner
Deloitte & Touche LLP
+1 312 486 0259
brcoleman@deloitte.com

Stephen McKinney
Managing Director
Deloitte & Touche LLP
+1 203 761 3579
smckinney@deloitte.com
Chapter 1 — Overview

1.1 Background

The approach used to recognize impairment losses on financial assets has long been identified as a major weakness in current U.S. GAAP, resulting in delayed recognition of such losses and leading to increased scrutiny during the financial crisis. After years of deliberating various models for remedying that weakness (sometimes jointly with the International Accounting Standards Board (IASB®)), the FASB issued its new standard on the measurement of expected credit losses, ASU 2016-13 (codified as ASC 326), in 2016. The timeline below depicts the stages in the Board's development of that guidance, beginning with the Financial Crisis Advisory Group's (FCAG's) recommendation, in 2008, that the FASB and IASB develop a credit loss model that incorporates forward-looking information and eliminates barriers to the timely recognition of losses under incurred loss models.

1.1.1 CECL Model Timeline

- **2008**  
  FCAG recommends that FASB and IASB jointly explore alternatives to the incurred loss model that would use more forward-looking information and would eliminate the delayed recognition of credit losses.

- **2009**  
  IASB issues exposure draft (ED) on amortized cost and impairment related to financial instruments (November).

- **2010**  
  FASB issues proposed ASU on accounting for financial instruments and revisions to the accounting for derivative instruments and hedging activities (May).

- **2011**  
  FASB and IASB jointly issue a supplementary document on accounting for financial instruments and revisions to the accounting for derivative instruments and hedging activities — impairment (January).

- **2012**  
  FASB decides to no longer pursue a converged standard and issues a proposed ASU on credit losses (ASC 825-15) (December).

- **2013**  
  IASB issues ED on expected credit losses (March).

- **2014**  
  IASB issues final guidance by adding to IFRS 9 impairment requirements related to the accounting for an entity’s expected credit losses (July).

- **2016**  
  FASB issues final credit losses standard, ASU 2016-13, codified in ASC 326 (June).

- **2018**  
  FASB issues ASU 2018-19, which contains Codification improvements to ASC 326 (November).

- **2019**  
  FASB issues ASU 2019-04, which contains Codification improvements to ASC 326, ASC 815, and ASC 825 (April).

  - FASB issues ASU 2019-05, which provides targeted transition relief to entities that are adopting ASC 326 (May).

  - FASB issues ASU 2019-10 to change effective dates for new accounting standards (November).

  - FASB issues ASU 2019-11 on additional Codification improvements to ASC 326 (November).

- **2020**  
  FASB issues ASU 2020-02 to make certain amendments to SEC paragraphs in accordance with SAB 119 (February).

  - FASB issues ASU 2020-03 on additional Codification improvements to financial instruments (March).
1.2 Overview

ASU 2016-13 adds to U.S. GAAP an impairment model (known as the current expected credit loss (CECL) model) that is based on expected losses rather than incurred losses. Under the new guidance, an entity recognizes as an allowance its estimate of expected credit losses, which the FASB believes will result in more timely recognition of such losses. ASU 2016-13 is also intended to reduce the complexity of U.S. GAAP by decreasing the number of credit impairment models that entities use to account for debt instruments.

Once effective (see Chapter 9 for a discussion of the effective date), the new guidance will significantly change the accounting for credit impairment. To comply with the ASU’s new requirements, banks and other entities with certain asset portfolios (e.g., loans, leases, debt securities) will need to modify their current processes for establishing an allowance for credit losses and other-than-temporary impairments (OTTIs). Accordingly, they will need to make changes to their operations and systems associated with credit modeling, regulatory compliance, and technology.

1.3 Key Provisions of ASU 2016-13

The table below highlights some of the key provisions of ASU 2016-13 and includes links to sections of this Roadmap that discuss these provisions in more detail.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Key Provisions of ASU 2016-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope (Chapter 2)</td>
<td>The ASU applies to:</td>
</tr>
<tr>
<td></td>
<td>• Most debt instruments (other than those measured at fair value through net income).</td>
</tr>
<tr>
<td></td>
<td>• Trade receivables and contract assets recognized under ASC 606.</td>
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<td></td>
<td>• Certain lease receivables.</td>
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<td></td>
<td>• Reinsurance receivables from insurance transactions.</td>
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<td></td>
<td>• Financial guarantee contracts.</td>
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<td></td>
<td>• Loan commitments.</td>
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<td></td>
<td>Available-for-sale (AFS) debt securities are outside the ASU’s scope (see Chapter 7 for discussion of targeted changes made to the impairment model for AFS debt securities).</td>
</tr>
<tr>
<td>Recognition threshold</td>
<td>None. Impairment is based on expected (rather than probable, incurred) credit losses.</td>
</tr>
<tr>
<td>(Chapter 3)</td>
<td></td>
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<tr>
<td>Measurement (Chapter 4)</td>
<td>Entities have flexibility in measuring expected credit losses as long as the measurement results in an allowance that:</td>
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<tr>
<td></td>
<td>• Reflects a risk of loss, even if remote.</td>
</tr>
<tr>
<td></td>
<td>• Reflects losses that are expected over the contractual life of the asset.</td>
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<tr>
<td></td>
<td>• Takes into account historical loss experience, current conditions, and reasonable and supportable forecasts.</td>
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<tr>
<td></td>
<td>The entity must evaluate financial assets on a collective (i.e., pool) basis if they share similar risk characteristics. If an asset's risk characteristics are not similar to those of any of the entity's other assets, the entity would evaluate the asset individually.</td>
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(Table continued)

<table>
<thead>
<tr>
<th>Topic</th>
<th>Key Provisions of ASU 2016-13</th>
</tr>
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<tbody>
<tr>
<td>Application of the CECL model to off-balance-sheet commitments, trade and lease receivables (Chapter 5)</td>
<td>The CECL model affects the accounting for assets commonly found at nonbanks and includes guidance that an entity should apply when accounting for such assets.</td>
</tr>
<tr>
<td>Purchased credit-deteriorated (PCD) assets (Chapter 6)</td>
<td>The allowance for PCD assets is the estimate of CECL. Interest income recognition is based on the purchase price plus the initial allowance accreting to the contractual cash flows. The non-credit-related discount or premium that results from acquiring a pool of PCD assets is allocated to each individual financial asset.</td>
</tr>
<tr>
<td>AFS debt securities (Chapter 7)</td>
<td>The CECL model does not apply to AFS debt securities. However, the FASB made targeted improvements to existing guidance, including removing the OTTI concept and requiring the use of an allowance limited to the difference between a debt security’s amortized cost and its fair value.</td>
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Shortly before issuing ASU 2016-13, the FASB formed a credit losses TRG.\(^1\) Although the group does not issue guidance, it provides feedback on potential issues related to the implementation of the CECL model. By analyzing and discussing such issues, the TRG helps the Board determine whether it needs to take action, such as providing clarification or issuing additional guidance.

On the basis of feedback received from the TRG and other stakeholders since the issuance of ASU 2016-13, the Board has issued seven final ASUs (as of the date of this publication) in an attempt to (1) clarify the guidance in ASU 2016-13 and (2) provide relief from the costs of implementing the standard. The effective dates of the final ASUs are aligned with that of ASU 2016-13. See Chapter 10 for more information about recent FASB activities.

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\(^1\) The TRG comprises financial statement preparers, auditors, and users; FASB members also attend the group’s meetings. In addition, representatives from the SEC, PCAOB, Federal Reserve, Office of the Comptroller of the Currency (OCC), FDIC, National Credit Union Administration, and Federal Housing Finance Agency are invited to observe the meetings.
Chapter 2 — Scope

2.1 Overview

ASC 326-20

The guidance in this Subtopic applies to the following items:

a. Financial assets measured at amortized cost basis, including the following:
   1. Financing receivables
   2. Held-to-maturity debt securities
   3. Receivables that result from revenue transactions within the scope of Topic 605 on revenue recognition, Topic 606 on revenue from contracts with customers, and Topic 610 on other income
   5. Receivables that relate to repurchase agreements and securities lending agreements within the scope of Topic 860.

b. Net investments in leases recognized by a lessor in accordance with Topic 842 on leases.

c. Off-balance-sheet credit exposures not accounted for as insurance. Off-balance-sheet credit exposure refers to credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815 on derivatives and hedging.

d. Reinsurance recoverables that result from insurance transactions within the scope of Topic 944 on insurance.

One of the FASB’s objectives related to developing a new impairment model was to reduce the complexity of U.S. GAAP by decreasing the number of credit impairment models that entities use to account for debt instruments. Accordingly, the FASB set out to establish a one-size-fits-all model for measuring expected credit losses on financial assets that have contractual cash flows.\(^1\) Ultimately, however, the FASB determined that the CECL model would not apply to AFS debt securities, which will continue to be assessed for impairment under ASC 320. (As discussed in Chapter 7, the FASB moved the impairment model for AFS debt securities from ASC 320 to ASC 326-30 and made limited amendments to this model.)

\(^1\) No impairment model is needed for financial assets measured at fair value (e.g., trading securities or other assets measured at fair value by using the fair value option) because the assets are measured at fair value in every reporting period.
The following diagram depicts the impairment models in current U.S. GAAP that are being replaced by the CECL model:

**Changing Lanes — HTM Debt Securities No Longer Accounted for Under OTTI Guidance**

The CECL model applies to HTM debt securities. As with the measurement objective associated with other financial instruments measured at amortized cost (e.g., loans), the FASB believes that an entity invests in an HTM debt security solely to collect contractual cash flows. As a result, an entity would be required to apply the CECL model to its HTM debt securities in a manner consistent with how it would measure expected credit losses on its other debt instruments (e.g., loan and trade receivables). Therefore, under the guidance in ASU 2016-13, an entity will no longer apply an OTTI model to an HTM debt security when evaluating whether it needs to recognize a credit impairment. This could be a significant change for an entity that currently has an investment portfolio containing both HTM and AFS debt securities because the entity will now be required to measure expected credit losses on each type of security by using different expected credit loss models. See Chapter 4 for more information about the measurement of expected credit losses.

**2.1.1 Unfunded Loan Commitments**

Off-balance-sheet arrangements, such as commitments to extend credit, are subject to credit risk and are therefore within the scope of the CECL model. However, ASC 326-20-30-11 states that an entity is required to measure expected credit losses on commitments in which the entity is exposed to credit risk via a present contractual obligation to extend credit, unless that obligation is unconditionally

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2 Under ASC 325-40, as amended by ASU 2016-13, an entity’s measurement of a credit loss allowance for purchased or retained BIs depends on whether the BIs are classified as held-to-maturity (HTM) debt securities or AFS debt securities. (No impairment model is needed for BIs classified as trading securities because they are measured at fair value, with changes recognized in earnings.) An entity would measure the credit loss allowance on a BI classified as an HTM debt security or an AFS debt security in accordance with ASC 326-20 or ASC 326-30, respectively.
cancellable by the issuer” (emphasis added). As a result, if the entity has the unconditional ability to cancel the unfunded portion of a loan commitment, it would not be permitted to estimate expected credit losses for that portion, even if it has historically never exercised its cancellation right. For more information about the measurement of expected credit losses on loan commitments, see Chapter 5.

Changing Lanes — Reinsurance Receivables Are Within the Scope of the CECL Model

Although ASC 326-20 states that the CECL model applies to reinsurance recoverables measured at amortized cost, the FASB clarifies in ASU 2019-04 that all reinsurance recoverables are within the scope of the model, regardless of the asset’s underlying measurement basis. That is, an entity will need to apply the CECL model to reinsurance recoverables measured on a discounted basis as well as to those measured at amortized cost. See Chapter 10 for more information about recent FASB decisions and activities.

Q&A 2-1  Forward Commitments to Purchase Loans

Question
Is a forward commitment to purchase loans from a third party within the scope of ASC 326-20?

Answer
It depends. We believe that a forward commitment to purchase loans from a third party is within the scope of ASC 326-20 because it exposes the purchaser to the credit risk associated with the underlying loans to be purchased if it is neither (1) unconditionally cancelable by the purchaser nor (2) accounted for as a derivative under ASC 815. That is, once the entity enters into the noncancelable commitment to purchase the loans, it becomes exposed to the credit risk associated with issuing the loans.

2.1.2  Guarantees Between Entities Under Common Control

ASC 326-20-15-3 specifically excludes loans and receivables between entities under common control from the scope of ASC 326-20. However, there is no specific scope exception related to off-balance-sheet credit exposure, including financial guarantees, between entities under common control. A guarantee between common-control entities that exposes the guarantor to the credit risk of a third-party entity is, in substance, the same as direct exposure of the guarantor to the third-party credit risk. Therefore, we believe that guarantee arrangements between common-control entities that are related to third-party credit exposure are within the scope of ASC 326-20. See Chapter 5 for more information about accounting for guarantees within the scope of ASC 326-20.

2.1.3  Guarantees of Lease Payments

In certain lease arrangements, lease payments that are payable to a lessor may be guaranteed by a third party. In a manner consistent with other financial guarantees that are not accounted for as insurance or under ASC 815, the guarantor must determine its credit exposure related to its guarantee of those lease payments. Keep in mind that although operating lease receivables are outside the scope of ASC 326-20, financial guarantees of operating lease payments are within the scope of ASC 326-20 in accordance with ASC 326-20-15-2.
While a financial guarantee can exist in any lease arrangement, a guarantee of lease payments often arises in sublease transactions in which the original lessee (i.e., lessee/intermediate lessor) may guarantee the sublessee's payment to the original lessor. If the nature of a sublease arrangement is such that the lessee/intermediate lessor is relieved of its primary obligation under the head lease, the transaction would be considered a termination of the head lease under ASC 842. As a result, the lessee/intermediate lessor would derecognize the ROU asset and lease liability arising from the head lease. (See Chapter 12 of Deloitte’s A Roadmap to Applying the New Leasing Standard for more information about accounting for sublease arrangements.) If the lessee/intermediate lessor in a sublease arrangement with an unrelated third party remains secondarily liable under the head lease, it is a guarantor in accordance with ASC 405-20-40-2.

In this situation, the lessee/intermediate lessor is exposed to the nonperformance (i.e., credit risk) of the unrelated third party. The lessee/intermediate lessor would measure and recognize the contingent obligation (i.e., the expected credit losses) separately from the noncontingent obligation (i.e., the stand-ready obligation) of the guarantee. See Chapter 5 for more information about accounting for guarantees within the scope of ASC 326-20.

### 2.1.4 Refundable Lease Security Deposits

Certain leasing arrangements may include a security deposit that must be paid to the owner of the leased asset at or before lease commencement. The security deposit is generally provided to support the lessee's intent and commitment to lease the underlying asset (i.e., upon receipt of a security deposit, the lessor typically stops marketing the asset for lease). Security deposits can be either nonrefundable or refundable depending on the terms of the contract. (See Chapter 6 of Deloitte’s A Roadmap to Applying the New Leasing Standard for more information about accounting for nonrefundable and refundable security deposits.) The lessee recognizes a receivable due from the lessor for a refundable security deposit because the lessee is entitled to receive the cash back from the lessor at the end of the lease agreement (provided that it complies with its obligations under the agreement). That is, the refundable security deposit represents a contractual right for the lessee to receive money on fixed or determinable dates and is recognized as an asset in the lessee's statement of financial position. Therefore, we generally believe that refundable lease security deposits meet the definition of a financing receivable in the ASC master glossary and are within the scope of ASC 326-20.

### 2.1.5 Indemnification Assets

<table>
<thead>
<tr>
<th>ASC 805-20</th>
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<tbody>
<tr>
<td><strong>25-27</strong> The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognize an indemnification asset at the same time that it recognizes the indemnified item, measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognized at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognize the indemnification asset at the acquisition date measured at its acquisition-date fair value.</td>
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</table>
Indemnification assets are often recognized as part of business combinations in accordance with ASC 805. For example, a seller in a business combination may contractually indemnify the acquirer for uncertainties related to specific assets or liabilities, such as those associated with lawsuits and uncertain tax positions. This type of indemnification represents an asset obtained in the business combination. ASC 805 indicates that an entity must record a valuation allowance for uncollectible amounts related to an indemnification asset recognized as part of a business combination but does not specify what guidance the entity should apply to measure or recognize the valuation allowance.

Q&A 2-2  Indemnification Assets Recognized in a Business Combination

Question
Does the CECL model apply to indemnification assets recognized in a business combination?

Answer
It depends. We believe that if the indemnified item is a financial asset measured at amortized cost, the associated indemnification asset is within the scope of ASC 326-20 because ASC 805 requires that indemnification assets be “measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts.”

However, we believe that there are two acceptable approaches for reflecting collectibility in the recognition and measurement of indemnification assets if the indemnified item is not a financial asset measured at amortized cost:

• **Approach 1** — In accordance with ASC 805-20-25-28, recognize and measure the indemnification asset by “using assumptions consistent with those used to measure the indemnified item, subject to management’s assessment of the collectibility of the indemnification asset.” That is, the measurement of the indemnification asset takes collectibility into account; therefore, a separate allowance for uncollectible amounts is unnecessary. This approach is consistent with the guidance in ASC 805-20-25-28 and ASC 805-20-35-4.

• **Approach 2** — Measure an allowance for uncollectible amounts associated with the indemnification asset in accordance with ASC 326-20 by analogy. Although indemnification assets are not explicitly included in (or excluded from) the scope of ASC 326-20, an indemnification asset could be viewed as analogous to a reinsurance receivable, which is within the scope of ASC 326-20.
Whichever of these two approaches an entity chooses should be applied consistently.

**Example**

Entity X has asbestos liabilities related to business activities of a former subsidiary that has been spun off (Spinee Y). The asbestos liabilities are measured in accordance with ASC 450. At the time of the spin-off, Y indemnifies X for a portion of the amounts paid by X in connection with the asbestos liabilities. That is, each year Y will reimburse X for 75 percent of the amounts paid by X.

Entity X applies the guidance in ASC 805-20-25-28 by analogy and recognizes an indemnification asset at the time of the spin-off in an amount equal to 75 percent of the recognized asbestos liability. After the spin-off, X remeasures the indemnification asset by analogy to the guidance in ASC 805-20-35-4. That is, each period, X remeasures the indemnification asset to an amount equal to 75 percent of the then current asbestos liability. The following is a summary of how X would reflect collectibility related to the indemnification asset under each of the two approaches described above:

- **Approach 1** — The indemnification asset recorded by X is measured by using assumptions consistent with those used to measure the indemnified item (i.e., the asbestos liability) under ASC 450, which is subject to management's assessment of the collectibility of the indemnification asset. Therefore, X is not required to record a separate allowance for uncollectible amounts because assumptions related to collectibility are already incorporated into the measurement of the indemnification asset.

- **Approach 2** — Entity X should assess collectibility and measure an allowance for uncollectible amounts related to the indemnification asset in accordance with ASC 326-20. The indemnification asset is analogous to a reinsurance receivable, which is within the scope of ASC 326-20, and X is not explicitly prohibited from applying the guidance in ASC 326-20 to measure the allowance for uncollectible amounts related to the indemnification asset.

We believe that either approach above is acceptable given the facts and circumstances. Entity X should choose an approach and apply it consistently to other indemnification assets.

### 2.1.6 Cash Equivalents

The ASC master glossary defines cash equivalents, in part, as follows:

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

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

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). We believe that cash equivalents that are financial assets recorded at amortized cost (e.g., Treasury bills) are within the scope of ASC 326-20.
2.1.7 Preferred Stock

ASC 326 does not explicitly discuss whether preferred stock is within or outside its scope. The applicability of ASC 326 to preferred stock will depend on whether it meets the definition of a debt security (classified as either HTM or AFS\(^3\)) or an equity security (accounted for under ASC 321). Because the legal form of the preferred stock is not always determinative, the entity should consider whether certain features in the instrument suggest that it is, in substance, a debt security. ASC 320-10-20 defines a debt security, in part, as follows:

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

- Preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor.

Therefore, we believe that a preferred stock instrument that meets the definition of a debt security is within the scope of ASC 326-20 (if it is classified as held to maturity) and ASC 326-30 (if it is classified as available for sale).

Q&A 2-3 Perpetual Preferred Securities

Question
Are perpetual preferred securities that have no maturity date and do not provide for redemption within the scope of ASC 326-20?

Answer
No. Preferred securities that are not redeemable by the issuing entity either mandatorily or at the option of the investor do not meet the definition of a debt security. Equity-classified instruments are subsequently measured at fair value through net income under ASC 321 and are specifically outside the scope of the CECL model in ASC 326-20-15-3.

2.2 Scope Exclusions

<table>
<thead>
<tr>
<th>ASC 326-20-15-3</th>
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<tbody>
<tr>
<td>The guidance in this Subtopic does not apply to the following items:</td>
</tr>
<tr>
<td>a. Financial assets measured at fair value through net income</td>
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<tr>
<td>b. Available-for-sale debt securities</td>
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<tr>
<td>c. Loans made to participants by defined contribution employee benefit plans</td>
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<tr>
<td>d. Policy loan receivables of an insurance entity</td>
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<tr>
<td>e. Promises to give (pledges receivable) of a not-for-profit entity</td>
</tr>
<tr>
<td>f. Loans and receivables between entities under common control.</td>
</tr>
<tr>
<td>g. Receivables arising from operating leases accounted for in accordance with Topic 842.</td>
</tr>
</tbody>
</table>

ASC 326-20-15-3 lists a number of items that are outside the scope of the new credit losses guidance. For such items, impairment is recognized and measured in accordance with other U.S. GAAP. One of these items is an operating lease receivable (see ASC 326-20-15-3(g)), which is accounted for under ASC 842 rather than ASC 326, as discussed below.

\(^3\) Debt securities can also be classified as trading securities under ASC 320. Trading securities are subsequently measured at fair value in the statement of financial position. Unrealized holding gains and losses for trading securities shall be included in earnings in accordance with ASC 320. Financial assets measured at fair value through net income are explicitly scoped out of ASC 326.
Changing Lanes — Billed Operating Lease Receivables

In November 2018, the FASB issued ASU 2018-19 to clarify certain aspects of the CECL model. Specifically, ASU 2018-19 states that operating lease receivables are within the scope of ASC 842 rather than ASC 326. That is, an entity would apply ASC 842 rather than ASC 326-20 to account for changes in the collectibility assessment for operating leases. An entity would recognize such changes as an adjustment to lease income in accordance with ASC 842-30-25-13 rather than recognizing bad-debt expense. We believe that the Board's clarification that operating lease receivables are within the scope of the collectibility guidance in ASC 842 rather than ASC 326 may result in a change in how some lessors account for the collectibility of operating lease receivables upon adopting ASC 842.

Because of that potential change, lessors adopting ASC 842 have raised questions about the appropriate accounting for operating lease receivables recognized by a lessor that are or are expected to become impaired, since such receivables are outside the scope of the new impairment guidance in ASC 326. On the basis of a technical inquiry with the FASB staff, we understand the following:

- ASC 842-30 requires entities to assess the probability of an individual customer's (tenant's) future payment.
- In addition to applying the guidance in ASC 842-30, an entity may elect to use a general or portfolio reserve approach (which is aligned with the legacy application of ASC 450-20).
- If a lessor elects to record a general reserve, the income statement impact may be recorded as a reduction to lease income or as bad-debt expense.
- Given the expected diversity in practice, consistent application and transparent disclosure of the policy elected are critical.

For more information about assessing and accounting for the collectibility of operating lease receivables, see Deloitte's July 1, 2019, Financial Reporting Alert.

Q&A 2-4 Loans Held for Sale

Question
Does the CECL model apply to held-for-sale (HFS) loans?

Answer
No. An entity is required to measure an HFS loan at the lower of amortized cost or fair value in accordance with ASC 948. As discussed in Section 4.10, an entity that transfers a loan from HFS to held for investment (HFI) must reverse any allowance previously measured on the HFS loan, transfer the loan to the new classification category (HFI), and establish a new allowance for expected credit losses by using the measurement guidance in ASC 326.

2.2.1 Loans and Receivables Between Entities Under Common Control

Loans and receivables between entities under common control are specifically excluded from the scope of the CECL model. At the June 2018 TRG meeting, the FASB staff indicated that this scope exception applies to all common-control arrangements at all stand-alone reporting levels (i.e., parent and subsidiaries); however, such application is not specifically addressed in ASC 326.
Chapter 3 — Recognition and Unit of Account

3.1 Recognition

<table>
<thead>
<tr>
<th>ASC 326-20</th>
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<tbody>
<tr>
<td><strong>30-1</strong> The allowance for credit losses is a valuation account that is deducted from, or added to, the amortized cost basis of the financial asset(s) to present the net amount expected to be collected on the financial asset. Expected recoveries of amounts previously written off and expected to be written off shall be included in the valuation account and shall not exceed the aggregate of amounts previously written off and expected to be written off by an entity. At the reporting date, an entity shall record an allowance for credit losses on financial assets within the scope of this Subtopic. An entity shall report in net income (as a credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s).</td>
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</table>

Unlike the incurred loss models in existing U.S. GAAP, the CECL model does not specify a threshold for the recognition of an impairment allowance. Rather, an entity will recognize its estimate of expected credit losses for financial assets as of the end of the reporting period. Credit impairment will be recognized as an allowance — or contra-asset — rather than as a direct write-down of a financial asset's amortized cost basis.

Financial assets within the scope of the CECL model are generally measured at amortized cost. Such assets, including loans and HTM debt securities, are recorded at their amortized cost basis because an entity expects to realize the total value of the financial asset by collecting this basis. Consequently, in paragraph BC48 of [ASU 2016-13](https://asb.gov/), the Board reasons that for assets measured at amortized cost, “an entity should not wait for an event of default or other actual shortfall of cash flows to conclude that a credit impairment exists.” Accordingly, the Board believes that “[r]emoving the probable threshold would result in a more timely measurement of expected credit losses because losses can be expected before they are probable (as that term is used in Topic 450) of occurring (or have occurred).”

**Changing Lanes — Allowance Approach Used for HTM Debt Securities**

Because the CECL model requires the use of an allowance approach for all financial assets measured at amortized cost, an entity will no longer adjust the cost basis of an HTM debt security to reflect an expected credit loss.\(^1\) Paragraph BC75 of the ASU explains the Board’s rationale for this decision:

> [S]takeholders expressed concerns that the requirement to adjust the amortized cost basis of a security when an entity recorded an other-than-temporary impairment distorted yields because those amounts are recognized as interest income in future periods. As a result, the Board decided that expected credit losses should be recorded through an allowance for credit losses for all financial assets that are held for the collection of contractual cash flows and the allowance (as opposed to

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\(^1\) In accordance with ASC 326-20-35-8, an entity would write off the HTM debt security if it is “deemed uncollectible.”
the yield) should be adjusted if credit loss expectations subsequently improve. This decision was supported by both preparers and users. Preparers often cited the complexity of continually adjusting the yield on those securities on a prospective basis.

Although preparers may welcome this change given the concerns expressed about the current accounting for credit losses on HTM debt securities (i.e., prospective yield adjustments after a recognized credit loss), the new requirements may present other challenges for preparers. For example, an entity will now be required to recognize expected credit losses upon initial recognition of an HTM debt security without regard to the security's fair value. That is, the entity will no longer be allowed to avoid recognizing a credit loss simply because the fair value of the HTM debt security equals or exceeds its amortized cost basis. Accordingly, an entity may need to modify its existing credit risk management and financial reporting systems because the entity will now be required to continually update the underlying cash flows expected at the end of the financial reporting period when measuring its expected credit losses, irrespective of the HTM debt security’s fair value.

In addition, because the CECL model does not have a minimum threshold for recognition of impairment losses, entities will need to measure expected credit losses on assets for which there is a low risk of loss (e.g., investment-grade HTM debt securities). However, ASC 326-20-30-10 states that “an entity is not required to measure expected credit losses on a financial asset . . . in which historical credit loss information adjusted for current conditions and reasonable and supportable forecasts results in an expectation that nonpayment of the [financial asset’s] amortized cost basis is zero.” While the FASB may have been thinking of U.S. Treasury securities and certain highly rated debt securities when it decided to allow an entity to recognize zero credit losses on an asset, ASC 326 does not indicate that this is the case. Regardless, challenges will most likely be associated with measuring expected credit losses on financial assets whose risk of loss is low. For more information about the measurement of expected credit losses on U.S. Treasury securities and other highly rated debt instruments, see Section 4.4.7.

### 3.2 Unit of Account

<table>
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<th>ASC 326-20</th>
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<tr>
<td><strong>30-2</strong> An entity shall measure expected credit losses of financial assets on a collective (pool) basis when similar risk characteristic(s) exist (as described in paragraph 326-20-55-5). If an entity determines that a financial asset does not share risk characteristics with its other financial assets, the entity shall evaluate the financial asset for expected credit losses on an individual basis. If a financial asset is evaluated on an individual basis, an entity also should not include it in a collective evaluation. That is, financial assets should not be included in both collective assessments and individual assessments.</td>
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</tbody>
</table>
An entity shall evaluate whether a financial asset in a pool continues to exhibit similar risk characteristics with other financial assets in the pool. For example, there may be changes in credit risk, borrower circumstances, recognition of writeoffs, or cash collections that have been fully applied to principal on the basis of nonaccrual practices that may require a reevaluation to determine if the asset has migrated to have similar risk characteristics with assets in another pool, or if the credit loss measurement of the asset should be performed individually because the asset no longer has similar risk characteristics.

In evaluating financial assets on a collective (pool) basis, an entity should aggregate financial assets on the basis of similar risk characteristics, which may include any one or a combination of the following (the following list is not intended to be all inclusive):

a. Internal or external (third-party) credit score or credit ratings
b. Risk ratings or classification
c. Financial asset type
d. Collateral type
e. Size
f. Effective interest rate
g. Term
h. Geographical location
i. Industry of the borrower
j. Vintage
k. Historical or expected credit loss patterns
l. Reasonable and supportable forecast periods.

An entity must evaluate financial assets within the scope of the model on a collective (i.e., pool) basis if they share similar risk characteristics. If a financial asset's risk characteristics are not similar to those of any of the entity's other financial assets, the entity would evaluate that financial asset individually.

Connecting the Dots — Unit of Account

While ASC 326-20-55-5 identifies risk characteristics that an entity could consider when segmenting its portfolio of financial assets, ASC 326 does not discuss how the entity should choose such characteristics. We believe that an entity should consider risk characteristics that reflect how the entity manages credit risk. If the risk characteristics are chosen in this manner, the risk of loss among the assets in the pool is likely to be similar. Accordingly, in such cases, the historical loss information that management uses to estimate expected credit losses is likely to be more relevant, resulting in a better estimate of such losses in the current reporting period.

In paragraph BC49 of ASU 2016-13, the FASB addresses its rationale for requiring collective evaluation of assets with similar risk characteristics and observes that “financial institutions manage many financial assets on a collective basis, wherein new financial assets are originated, existing financial assets are paid down, and some financial assets may be purchased and some financial assets may be sold. In addition, many users analyze financial asset portfolios of financial institutions on a collective basis.” Furthermore, paragraph BC69 of ASU 2016-13 states, in part:

The Board concluded that financial assets generally are priced assuming an estimated likelihood of credit losses on similar assets, although an entity initially expects to collect all of the contractual cash flows on each individual asset. Similarly, while an entity might not currently expect a loss on an individual asset, it ordinarily would expect some level of losses in a group of assets with similar risk characteristics. Therefore, an estimate of expected credit losses should reflect a collective assessment if similar risk characteristics exist for assets measured at amortized cost.
Q&A 3-1  Removing a Financial Asset From a Pool of Financial Assets

Question
Is an entity required to remove specific financial assets from larger pools when there is evidence of credit deterioration related to those assets?

Answer
Generally, yes. If a deteriorated financial asset meets the definition of a collateral-dependent asset (see Section 4.4.6.1), the financial asset should be removed from the pool because the calculation of losses for this asset will differ from the calculation used for the other assets. Similarly, a financial asset should be removed from a pool of financial assets if it has deteriorated and therefore no longer shares risk characteristics with the rest of the assets in the pool. Even when the estimated credit losses for the pool incorporate a certain level of defaults and the level of individual financial assets within that pool defaults as expected, the financial asset with deteriorated credit quality must be removed from the pool because its risk characteristics are no longer similar to those of the remaining pool assets. If the asset’s risk characteristics become similar to those of other financial assets, the asset should be placed into a pool with those assets.

Changing Lanes — Unit of Account for HTM Debt Securities
ASC 326 requires an entity to collectively measure expected credit losses on financial assets that share similar risk characteristics, including HTM debt securities. This requirement represents a significant change from existing U.S. GAAP, under which an entity must evaluate the credit impairment of debt securities individually. As a result, an entity may need to change its existing impairment assessments and systems related to measuring HTM debt securities for expected credit losses. See Section 7.2.7 for a comparison between the credit loss model for HTM debt securities and that for AFS debt securities.
Chapter 4 — Measurement of Expected Credit Losses

4.1 Introduction
For assets measured at amortized cost, the CECL model eliminates the existing recognition thresholds in U.S. GAAP. Under the new guidance, the estimate of expected credit losses will be (1) recognized immediately upon either origination or acquisition and (2) adjusted in each subsequent reporting period. Since the primary guidance in ASU 2016-13 is measurement-related, measurement is the most significant aspect of the CECL model. This chapter addresses the following topics:

- Contractual life (Section 4.2 below).
- The information an entity needs when estimating credit losses (Section 4.3).
- Measurement methods (Section 4.4).
- Write-offs and recoveries (Section 4.5).
- Credit enhancement features (Section 4.6).
- Troubled debt restructurings (TDRs) (Section 4.7).
- Considerations related to postacquisition accounting for acquired loans (Section 4.8).
- Subsequent events (Section 4.9).
- Transfers to other measurement categories (Section 4.10).

4.2 Contractual Life

ASC 326-20

30-6 An entity shall estimate expected credit losses over the contractual term of the financial asset(s) when using the methods in accordance with paragraph 326-20-30-5. An entity shall consider prepayments as a separate input in the method or prepayments may be embedded in the credit loss information in accordance with paragraph 326-20-30-5. An entity shall consider estimated prepayments in the future principal and interest cash flows when utilizing a method in accordance with paragraph 326-20-30-4. An entity shall not extend the contractual term for expected extensions, renewals, and modifications unless either of the following applies:

a. The entity has a reasonable expectation at the reporting date that it will execute a troubled debt restructuring with the borrower.

b. The extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.
ASC 326-20-30-1 describes the impairment allowance as a “valuation account that is deducted from, or added to, the amortized cost basis of the financial asset(s) to present the net amount expected to be collected on the financial asset.” An entity can use various measurement approaches to determine the impairment allowance. Some approaches project future principal and interest cash flows (i.e., a discounted cash flow (DCF) method), while others project only future principal losses. Regardless of the measurement method used, an entity’s estimate of expected credit losses should reflect the losses that occur over the contractual life of the financial asset.

An entity is required to consider expected prepayments either as a separate input in the method used to estimate expected credit losses or as an amount embedded in the credit loss experience that it uses to estimate such losses. The entity is not allowed to consider expected extensions of the contractual life unless (1) extensions are a contractual right of the borrower or (2) the entity has a reasonable expectation as of the reporting date that it will execute a TDR with the borrower.

**Connecting the Dots — Contractual Life**

Although paragraph BC40 of ASU 2016-13 states that the FASB believes that credit losses occur at a rapid rate early in a financial asset’s life and then taper off to a lower rate before maturity, the CECL model requires an entity to consider expected credit losses over the contractual life of an asset rather than a shorter period. The primary rationale for this requirement is that an allowance for credit losses that does not include some expected losses (e.g., those that are expected to occur after a prescribed forecast period) would fail to reflect the net amount expected to be collected on the financial asset. In addition, such an allowance could make expected credit losses noncomparable from instrument to instrument, period to period, and entity to entity. Moreover, the Board believes that an approach in which an entity is required to measure expected credit losses over the financial asset’s contractual life has the added benefit of removing the need to articulate the length of time over which entities should have to estimate credit losses.

**4.2.1 Prepayments**

Although an entity is required to estimate expected credit losses over the contractual life of an asset, it must consider how prepayment expectations will reduce the term of a financial asset, which is likely to lead to a reduction in the entity’s exposure to credit losses. Therefore, prepayments could have a significant effect on the estimate of expected credit losses, and that impact will vary on the basis of whether the entity is estimating such losses by using a DCF method or another measurement method. When an entity uses a DCF method to project expected future cash flows, expected prepayments will affect the amount and timing of cash flows expected to be collected. When a loss estimation method other than a DCF method is used, prepayments will be either reflected in the entity’s historical loss information or considered as a separate input to the estimate of expected credit losses.

**Changing Lanes — Determining Whether a Refinancing Is a Prepayment in the Measurement of Expected Credit Losses**

Although ASC 326-20 requires entities to consider the effect of estimated prepayments on the measurement of expected credit losses, expected prepayments have not been a significant input into allowance calculations under the incurred loss model in current U.S. GAAP. Accordingly, practice has not been established regarding what constitutes a “prepayment” for the measurement of expected credit losses. The lack of a generally accepted definition of prepayment has led to different views on how an entity should consider certain transactions or events in estimating prepayments under ASC 326.
Such an evaluation is particularly difficult for lenders that are determining whether to consider refinancings of an existing loan to be prepayments when measuring expected credit losses. Loans are commonly refinanced with lenders before maturity (through a contractual modification or the creation of a new loan), and the proceeds are used to repay the existing loan. The current guidance in ASC 310-20-35-9 through 35-12 contains a framework for entities to use in assessing whether refinancings are new loans so that they can determine recognition of fees and other costs. However, ASC 326 does not provide similar guidance.

At an August 2018 meeting, the FASB indicated that an entity should not be prohibited from defining prepayments in the manner that best reflects management’s expectation of credit losses; however, the Board decided not to amend ASC 326 to reflect this discussion. Because the new guidance does not define a specific framework for considering prepayments, we believe that, as with other elements of the CECL model, an entity should use judgment in determining whether a loan refinancing or restructuring transaction should be considered a prepayment in the measurement of expected credit losses. Accordingly, the guidance on loan refinancing and restructuring in ASC 310-20-35-9 through 35-12 may provide one, but not the only, approach to the consideration of prepayments.

Q&A 4-1 Consideration of Prepayments in the Estimation of Expected Credit Losses Under a Method Other Than a DCF Method

Question
How do estimated prepayments affect the estimate of expected credit losses when a method other than a DCF method is used to calculate such losses?

Answer
Under ASC 326, an entity that is using an approach other than a DCF method to estimate expected credit losses is not required to explicitly take into account discounting and the timing of payments and defaults. However, such timing could affect the exposure to loss and the entity may need to consider this when applying other methods. For example, if an entity acquired loans at a premium and is estimating credit losses on the unpaid principal balance and the premium separately, as permitted by ASC 326-20-30-5, an increase in estimated prepayments would decrease the credit exposure related to the premium. Prepayments result in an acceleration of the amortization of premiums on a pool of loans, so there would be fewer unamortized premiums remaining at the time of credit losses for the related pool of loans if estimated prepayments increased.

It is not appropriate to estimate expected credit losses by applying a loss rate over the weighted-average estimated life of a pool of prepayable financial assets (or, under another method, to calculate expected credit losses only through the weighted-average estimated life of the entire pool). Rather, the estimate of expected credit losses must take into account all credit losses over the entire life of a pool of financial assets (i.e., an entity should also recognize credit losses related to certain assets within the pool when these losses occur after the weighted-average life of the pool). However, note that the FASB staff issued a Q&A that discusses how an entity can use the weighted-average remaining maturity (WARM) method when estimating expected credit losses. Under the WARM method, the entity estimates such losses over the remaining contractual maturity. This method inherently differs from a method in which a loss

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1 The TRG originally discussed this issue at its June 2018 meeting. At that meeting, the TRG agreed with the FASB staff’s recommendation that an entity should not be prohibited from defining prepayments in a manner that best reflects management’s expectation of credit losses.
rate is applied over the weighted-average estimated life of a pool of assets. See Section 4.4.5 for more information about the WARM method.

4.2.2 Expected Extensions, Renewals, and Modifications

ASC 326-20-30-6 requires an entity that is measuring expected credit losses to consider prepayments that result in a shortening of the financial asset’s contractual life. However, this paragraph also states that an entity is not permitted to extend the contractual term unless it “has a reasonable expectation at the reporting date that it will execute a troubled debt restructuring” or the contract contains extension or renewal options that are not “unconditionally cancellable by the entity.”

It may seem conceptually inconsistent to require an entity to consider the effect of prepayments while allowing it to ignore the effects of renewals, extensions, and modifications on an asset’s expected life. However, the FASB believes that the estimate of cash flows not expected to be collected should be limited to the current legal terms of the contractual arrangement between the borrower and the lender. Specifically, the estimate of expected credit losses is intended to quantify expected losses on credit that the lender has extended as of the balance sheet date (i.e., in the form of either a recognized financial asset or the present legal obligation to extend credit). Credit losses that could result from the future renewal, modification, extension, or expansion of a credit facility that is not addressed in the current contractual terms therefore would not be considered in the estimation of expected credit losses because the lender has not yet exposed itself to such losses (i.e., at a future date, the lender can choose to avoid that credit exposure by not renewing, modifying, extending, or expanding the credit facility). Accordingly, an entity should consider expected credit losses that could result from future extensions or renewal options only if those options were in the original or modified contract as of the reporting date and cannot be unconditionally canceled by the entity (see Q&A 4-2 for more information).

However, an economic concession granted by a lender in a TDR reflects the lender’s effort to maximize its recovery on existing credit rather than to extend new credit. Since many TDRs involve deferring payments (e.g., by extending the maturity date), a lender could reasonably expect to grant an economic concession to an existing borrower as part of its efforts to maximize the recovery of existing credit that was extended as of the balance sheet date. As long as the lender reasonably expects to execute a TDR on an individual financial asset with the borrower, the lender may use its estimate of expected cash flows (which may include payments made for years beyond the current contractual term) in estimating expected credit losses as of the balance sheet date. Such an estimate provides the most representationally faithful depiction of the expected credit losses that the lender has extended as of the balance sheet date. If lenders were prohibited from using such an approach, they might be required to artificially assume that a borrower would refinance externally (which could prove impossible and result in an unrealistic depiction of the actual economic credit loss expected by the lender). Keep in mind, however, that although an entity may conclude that a TDR is not reasonably expected, it is not allowed to ignore deterioration in credit quality that has occurred in the current reporting period. For more information about the accounting for TDRs under the CECL model, see Section 4.7.
Q&A 4-2  How an Entity Should Consider Extensions or Renewals When Determining the Contractual Life

ASC 326-20-30-6 requires entities to “estimate expected credit losses over the contractual term of the financial asset(s).” Although the guidance does not define contractual term, it specifies certain elements that entities should consider in determining this term. For instance, the guidance indicates that, in certain circumstances, it is consistent with the overall objective of ASC 326 for entities to consider extensions in determining the contractual term.

**Question**

In what circumstances would an entity be permitted to consider extensions in determining the contractual term over which to estimate expected credit losses?

**Answer**

ASU 2019-04 amends ASC 326-20-30-6 to clarify that an entity should consider extension and renewal options that “are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.” (However, options accounted for as derivatives in accordance with ASC 815 are outside the scope of these amendments.) Arrangements affected by the amendments would include those in which (1) the ability to exercise renewal options is outside the lender’s control and (2) the lender would have a present obligation to extend credit.

Arrangements in which an entity should include extension options in the contractual term when determining expected credit losses include, but are not limited to, those that contain a contractual extension option that gives the borrower either the unilateral or conditional ability to extend the arrangement’s term. If the borrower’s ability is conditional, it may or may not be within the borrower’s control to satisfy the condition (e.g., the borrower may be subject to financial covenants).

An entity should also consider how “prepayments” would affect the estimate of credit losses for loans with an extension option that is not unconditionally cancelable by the entity. In other words, if such loans are not extended, they would be considered prepaid before the end of the contractual term.

Notwithstanding the above, ASU 2020-03 on Codification improvements (issued in March 2020) amends the guidance in ASC 326 to require a lessor to use the lease term (as defined in ASC 842) as the contractual term when measuring expected credit losses on a net investment in a lease. See Chapter 10 for more information about the ASU.
4.2.2.1 Demand Loans

As its name implies, a demand loan is a loan for which the full and immediate payment of principal and accrued interest is required upon the lender's demand. In certain situations, the demand for payment is unconditional (i.e., the lender can make the demand at any time, with or without cause). Such a loan does not have a contractual maturity and therefore remains outstanding until it is called by the lender or paid off by the borrower. The loan is implicitly renewed every day until it is called or paid.

Q&A 4-3 Determining the Life of a Demand Loan

Question
What is the life of a loan that is immediately and unconditionally payable upon demand by the lender?

Answer
ASC 326 requires an entity to estimate expected credit losses over the life of the financial asset. Specifically, ASC 326-20-30-6 states:

An entity shall estimate expected credit losses over the contractual term of the financial asset(s) when using the methods in accordance with paragraph 326-20-30-5. An entity shall consider prepayments as a separate input in the method or prepayments may be embedded in the credit loss information in accordance with paragraph 326-20-30-5. An entity shall consider estimated prepayments in the future principal and interest cash flows when utilizing a method in accordance with paragraph 326-20-30-4. An entity shall not extend the contractual term for expected extensions, renewals, and modifications unless either of the following applies:

a. The entity has a reasonable expectation at the reporting date that it will execute a troubled debt restructuring with the borrower.

b. The extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.

In the absence of a reasonable expectation of a TDR, the contractual terms of the asset, rather than the business practices of the lender, govern the asset's life (e.g., an entity would ignore the fact that the lender has historically renewed the demand loan). As a result, the contractual life of a loan that is unconditionally payable upon demand by the lender is the period for which the borrower must repay the loan once it is demanded by the lender. In this case, because the demand loan is unconditionally and immediately payable by the borrower, the contractual term of the loan would be one day.

Q&A 4-4 Estimating Credit Losses on a Demand Loan

Question
Since the life of the demand loan discussed in Q&A 4-3 above is one day, does the lender have to individually assess the borrower's ability to repay on that date?
**Answer**

Not necessarily. ASC 326-20-30-2 requires an entity to pool assets that share similar risk characteristics when calculating expected credit losses. Therefore, the lender is required to pool assets (including demand loans) that share similar risk characteristics when assessing the borrower’s ability to repay. If the risk characteristics of the demand loan are not similar to those of other financial assets, the entity would individually assess the borrower’s ability to repay the loan.

**Q&A 4-5 Considerations in the Assessment of a Borrower’s Ability to Repay a Demand Loan**

**Question**

What should the lender consider when assessing the borrower’s ability to repay upon demand?

**Answer**

Upon the demand for payment of the loan, the borrower can:

- Pay the lender with available funds.
- Pay the lender by refinancing the loan with another bank.
- Modify the loan through a TDR.
- Default.

Therefore, as of the balance sheet date, the lender would need to determine which outcome would occur. For example, if the lender refinances the demand loan on the basis of the borrower’s current credit profile, the lender may also assume that the borrower could refinance with another bank within a reasonable amount of time and therefore pay the loan off in full.

In addition, the expected payment does not have to be on the date of the demand if the refinance is reasonably expected to take place in the event that payment is demanded. The FASB staff discussed this issue at the November 2018 TRG meeting. Specifically, paragraph 47 of TRG Memo 15 states:

> The staff believes that considering future economic and other conditions beyond the contractual term of the financial assets does not, in and of itself, result in an extension of the contractual term. The staff believes that entities should consider available information that is relevant for assessing the collectibility of cash flows during the contractual term, which may include information from periods beyond the contractual term. Future economic and other conditions may inform an entity’s analysis of determining the inputs in developing expected credit losses over the contractual term of the financial asset.

As a result, the lender should consider conditions beyond the contractual term of the demand loan if the conditions would affect the expected credit losses on the loan.
4.2.3 Considerations Related to the Life of Credit Card Receivables

ASC 326 requires entities to determine the allowance for loan losses on financial assets on the basis of management’s current estimate of expected credit losses on financial assets that exist as of the measurement date. Regardless of the method that entities use to estimate such losses, they must carefully consider all amounts expected to be collected (or not collected) over the life of the financial asset. Given the revolving nature of credit card lending arrangements, stakeholders have questioned how credit card issuers should determine the life of a credit card account balance so that they can estimate expected credit losses.

Under the CECL model, an allowance must not include expected losses on unconditionally cancelable loan commitments. Because credit card lines are generally unconditionally cancelable, expected losses on future draws should not be accrued before such amounts are drawn. Accordingly, some believe that an entity should apply a customer’s expected payments only to the funded portion of outstanding commitments as of the measurement date when modeling the repayment period of the measurement-date receivable. That is, an entity would estimate the life of a credit card receivable without considering the impact of future draws that are unconditionally cancelable and how that would affect payment history or whether a portion of future payments would be related to future draws and not the current outstanding balance of the credit card line.

On the basis of these questions (and the recommendations made at the June 2017 TRG meeting), the FASB has agreed that it would be acceptable for an entity use one of the following two methods to estimate future payments on credit card receivables:

- Include all payments expected to be collected from the borrower.
- Include only a portion of payments expected to be collected from the borrower.

However, the Board has acknowledged that an entity may also use other methods to estimate future payments. The method an entity selects should be applied consistently to similar facts and circumstances. Further, the entity’s determination of the appropriate method to use in estimating the amount of expected future payments is separate from the determination of how to allocate the future payments to credit card balances.

4.3 Information Set

<table>
<thead>
<tr>
<th>ASC 326-20</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>30-7</strong> When developing an estimate of expected credit losses on financial asset(s), an entity shall consider available information relevant to assessing the collectibility of cash flows. This information may include internal information, external information, or a combination of both relating to past events, current conditions, and reasonable and supportable forecasts. An entity shall consider relevant qualitative and quantitative factors that relate to the environment in which the entity operates and are specific to the borrower(s). When financial assets are evaluated on a collective or individual basis, an entity is not required to search all possible information that is not reasonably available without undue cost and effort. Furthermore, an entity is not required to develop a hypothetical pool of financial assets. An entity may find that using its internal information is sufficient in determining collectibility.</td>
</tr>
</tbody>
</table>
Historical credit loss experience of financial assets with similar risk characteristics generally provides a basis for an entity's assessment of expected credit losses. Historical loss information can be internal or external historical loss information (or a combination of both). An entity shall consider adjustments to historical loss information for differences in current asset specific risk characteristics, such as differences in underwriting standards, portfolio mix, or asset term within a pool at the reporting date or when an entity's historical loss information is not reflective of the contractual term of the financial asset or group of financial assets.

An entity shall not rely solely on past events to estimate expected credit losses. When an entity uses historical loss information, it shall consider the need to adjust historical information to reflect the extent to which management expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed for the period over which historical information was evaluated. The adjustments to historical loss information may be qualitative in nature and should reflect changes related to relevant data (such as changes in unemployment rates, property values, commodity values, delinquency, or other factors that are associated with credit losses on the financial asset or in the group of financial assets). Some entities may be able to develop reasonable and supportable forecasts over the contractual term of the financial asset or group of financial assets. However, an entity is not required to develop forecasts over the contractual term of the financial asset or group of financial assets. Rather, for periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses, an entity shall revert to historical loss information determined in accordance with paragraph 326-20-30-8 that is reflective of the contractual term of the financial asset or group of financial assets. An entity shall not adjust historical loss information for existing economic conditions or expectations of future economic conditions for periods that are beyond the reasonable and supportable period. An entity may revert to historical loss information at the input level or based on the entire estimate. An entity may revert to historical loss information immediately, on a straight-line basis, or using another rational and systematic basis.

An entity must consider all available relevant information when estimating expected credit losses, including details about past events, current conditions, and reasonable and supportable forecasts. That is, while an entity can use historical charge-off rates as a starting point for determining expected credit losses, it must evaluate how conditions that existed during the historical charge-off period may differ from its current expectations and revise its estimate of expected credit losses accordingly. However, the entity is not required to forecast conditions over the entire contractual life of the asset. Rather, for the period beyond that for which the entity can make reasonable and supportable forecasts, the entity should revert to historical credit loss experience.
4.3.1 Historical Credit Loss Experience

ASC 326-20-30-8 states that “[h]istorical credit loss experience of financial assets with similar risk characteristics generally provides a basis for an entity’s assessment of expected credit losses.” Historical credit loss experience can be used as a starting point for estimating expected credit losses and for reversion for periods beyond which management can make reasonable and supportable forecasts of such losses. In calculating historical credit loss information, an entity may consider different factors depending on its policies, asset types, and pooling of assets according to their risk characteristics.

ASC 326-20-30-8 and 30-9 require entities to adjust historical loss information to reflect differences associated with (1) asset-specific risk characteristics and (2) current conditions and reasonable and supportable forecasts of future economic conditions relevant to the financial assets. ASC 326-20-30-9 states that “[f]or periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses, an entity shall revert to historical loss information . . . reflective of the contractual term of the financial asset or group of financial assets.” Further, ASC 326-20-55-6(c) indicates that when estimating expected credit losses, an entity must use significant judgment to decide on “[t]he approach to determine the appropriate historical period for estimating expected credit loss statistics.”

4.3.1.1 Determining Historical Credit Loss Data

The guidance in ASC 326 on the factors that an entity should consider in determining the appropriate historical periods to use to calculate historical credit loss information is limited to the following:

- ASC 326-20-30-8 and 30-9 indicate that the historical loss information should reflect “the contractual term of the financial asset or group of financial assets.”
- ASC 326-20-55-3 states, in part:

An entity may use historical periods that represent management’s expectations for future credit losses. An entity also may elect to use other historical loss periods, adjusted for current conditions, and other reasonable and supportable forecasts. When determining historical loss information in estimating expected credit losses, the information about historical credit loss data, after adjustments for current conditions and reasonable and supportable forecasts, should be applied to pools that are defined in a manner that is consistent with the pools for which the historical credit loss experience was observed.
To determine the appropriate historical credit loss data to use in calculating historical loss information, management must apply professional judgment and consider the nature of the financial assets and their risk characteristics. In making this determination, an entity must evaluate the number of, and which, periods to include in historical credit loss information.

4.3.1.1.1 The Number of Periods to Include in Historical Credit Loss Information

As noted above, ASC 326 only discusses the number of periods of historical credit loss information in the context of whether such information reflects “the contractual term of the financial asset or group of financial assets.” Given that guidance, entities may think that the number of periods of historical loss information must at least equal the contractual term of the financial assets for which an allowance for credit losses is being estimated (e.g., 10 years of historical loss information for financial assets with a 10-year contractual maturity). While such a conclusion may be appropriate, it does not represent a requirement. Rather, ASC 326 specifies only that the historical loss information must reflect historical defaults of similar financial assets during the entire contractual term of those assets. For example, if an entity is estimating expected credit losses for a group of financial assets with a contractual maturity of 10 years, it may determine that five years of historical loss information appropriately reflects the entire contractual term of the financial assets being evaluated because the composition of the financial assets within the five-year historical loss information appropriately includes a mix of financial assets that have been outstanding (seasoned) for periods commensurate with the remaining contractual maturities of the financial assets being evaluated.

Since ASC 326 (1) does not specifically require that the number of periods of historical loss information at least equal the contractual term of the financial assets being evaluated and (2) does not prohibit an evaluation in which the number of periods of historical loss information exceeds the contractual term of those assets, an entity should consider the factors discussed in the subsections below in determining the number of periods to use in historical loss information.

4.3.1.1.1.1 Whether the Number of Periods Used Appropriately Represents the Seasoning of the Financial Assets Being Evaluated

Since the evaluation of credit losses is rarely linear, it is important for historical loss information to appropriately reflect the specific default patterns expected on the basis of the type of financial asset. For example, for a group of financial assets with a 10-year contractual maturity, the historical credit loss information should appropriately represent the expectations regarding defaults that will occur in each year of the assets’ contractual life on the basis of their seasoning as of the balance sheet date.

4.3.1.1.1.2 Whether the Number of Periods Used Appropriately Represents the Asset-Specific Risk Characteristics of the Financial Assets Being Evaluated

ASC 326-20-30-8 requires an entity to adjust “historical loss information for differences in current asset specific risk characteristics, such as differences in underwriting standards, portfolio mix, or asset term within a pool.” However, the differences cited in this paragraph are not inclusive (i.e., there may be other relevant differences in asset-specific risk characteristics to consider, such as changes in prepayment behaviors resulting from changes in the nature of the financial assets or the environmental conditions that affect prepayments).

If an entity is relying on internal historical loss information and there have been recent significant changes in asset-specific risk characteristics, the entity may find it more appropriate to use a more recent, shorter period of historical loss information (as opposed to using a longer period, in which case the adjustment of such loss information may be more complex).
4.3.1.1.1.3 Whether the Number of Periods Used Appropriately Represents How the Historical Loss Information Is Being Used in the Calculation of Expected Credit Losses

ASC 326-20-30-9 requires an entity to revert to historical loss information, adjusted solely to reflect differences in asset-specific risk characteristic, in calculating expected credit losses for periods beyond which management can make reasonable and supportable forecasts of expected credit losses. Thus, the remaining contractual life of a group of financial assets for which an entity is solely reverting to historical loss information will be shorter than the full contractual maturity of such assets. Accordingly, entities should consider the need, for reversion purposes, to use historical loss information that reflects the seasoning of the financial assets, since the determination of credit losses is not linear. This seasoning aspect for reversion periods is likely to differ from the seasoning of the financial assets on the balance sheet date.

Further, paragraph BC50 of ASU 2016-13 notes that “[s]ome entities may be able to forecast over the entire estimated life of an asset, while other entities may forecast over a shorter period.” For entities that are able to forecast expected losses over the entire estimated life of a group of financial assets, the seasoning considerations above will be reflected in the forecasted expected losses rather than in historical loss information used for reversion.

4.3.1.1.1.4 Whether the Number of Periods Used Appropriately Reflects a Full Economic Cycle

It is generally appropriate for the historical credit loss information to include a full economic cycle (i.e., peaks and troughs) even if the life of a particular financial asset is shorter than an economic cycle. The length of the period that encompasses an economic cycle will depend on the facts and circumstances.

The determination of whether historical credit loss information should reflect a full economic cycle will also ultimately depend on the particular facts and circumstances, including the extent to which an entity is able to adjust historical loss information on the basis of (1) reasonable and supportable assumptions of future economic conditions and (2) the remaining period (if any) for which expected credit losses will be determined by reverting to historical loss information. For example, if the remaining period for reversion to historical loss information is short and the timing of such reversion is in the near term, an entity could reasonably conclude that historical credit loss information that reflects the current economic conditions is more relevant than historical credit loss information over an entire economic cycle. In all cases, the historical loss information used to make adjustments based on reasonable and supportable assumptions of future economic conditions should represent where an entity is within an economic cycle.

4.3.1.1.1.5 The Number of Periods of Relevant Historical Loss Information That Are Available to the Entity

Some entities may have more historical loss data than others and therefore may include longer periods in the calculation of historical credit losses. Note that, as discussed below, entities that use longer periods should not be biased in selecting such data (i.e., by including periods with more peaks than troughs or vice versa).

For example, one entity may only have historical loss information that starts 10 years ago and therefore may calculate historical loss information on this basis. Another entity may, however, have historical loss information that begins 40 years ago and therefore may use a longer period. Under ASC 326, two entities may reasonably use different periods. These differences may be attributable to the size and sophistication of the entity, how long the entity has existed, and the availability of relevant external data when sufficient internal data are unavailable.
4.3.1.1.2 Which Historical Periods to Include in Historical Loss Information

In addition to determining the number of historical periods to use in calculating historical loss information, management should consider which of these periods to include. While it often may be reasonable for an entity to start with the most recent period and work backwards consecutively, such an approach is not necessarily required or always appropriate. In determining which historical periods to use, an entity should consider the factors discussed below.

4.3.1.1.2.1 Whether the Approach Is Objective and Reflects Expected Future Credit Losses

An entity should be objective, not biased, in estimating the allowance for credit losses. Therefore, it would not be appropriate for an entity to select historical periods that reflect either an overly aggressive or an overly conservative level of credit losses (i.e., “cherry-picking” historical information to achieve a desired accounting result). A biased selection of historical information (e.g., using long-term historical loss information that includes more peaks than troughs or vice versa) would not be consistent with the credit loss measurement objective of ASC 326.

4.3.1.1.2.2 Whether the Approach Is Consistent With Asset-Specific Risk Characteristics

In a manner consistent with the discussion above, an entity that is selecting among periods of historical credit loss information should consider how such information is aligned with the current asset-specific risk characteristics of the financial assets being evaluated. For example, if an entity has made changes to its underwriting to be more consistent with an underwriting approach used in prior periods, it may be more appropriate for the entity, if all else is held constant, to use older historical loss information (as opposed to using more recent historical loss information and applying more complex judgments about how to adjust such information).

Note that management should use significant judgment in determining the allowance for credit losses and should include thorough documentation to support that judgment. While an entity is not prohibited from changing the composition of historical credit loss data used in this determination, any changes the entity makes in constructing historical loss information should be justified by the facts and circumstances and would reflect a change in accounting estimate. See Q&A 4-13 for more information.

Q&A 4-6 Effect of Accrued Interest on Historical Loss Information

An entity may have a nonaccrual policy under which it stops accruing interest if it believes the collection of interest is in doubt. This is generally the case when a borrower is in default for a specified period (e.g., 90 days past due). Many entities also reverse the previously accrued interest if the borrower remains in default for an extended period (e.g., 180 days). In those cases, historical loss information would not reflect any or all interest amounts that were not collected, because the entity had already decided to stop accruing interest on the asset and also may have reversed any interest that accrued before determining the ultimate amount of any loss on the asset.

Question

Should historical loss information be adjusted (increased) to reflect the amount of accrued interest that would have been charged off if the entity had not applied a nonaccrual accounting policy? 

Note that this question is not relevant when expected credit losses are calculated by using DCFs.
Answer

It depends. ASC 326-20-55-6(b) states that one of the judgments an entity uses in estimating credit losses is the following:

The approach to measuring the historical loss amount for loss-rate statistics, including whether the amount is simply based on the amortized cost amount written off and whether there should be adjustments to historical credit losses (if any) to reflect the entity’s policies for recognizing accrued interest. [Emphasis added]

In addition, as discussed in Section 4.4.4.1, ASC 326-20-30-5A states that “[a]n entity may make an accounting policy election . . . not to measure an allowance for credit losses for accrued interest receivables if the entity writes off the uncollectible accrued interest receivable balance in a timely manner.”

Accordingly, we believe that an entity should adjust historical loss information if its loss data are not consistent with its accounting policy election related to whether an allowance is measured for losses on accrued interest. For example, if the entity does not elect to measure an allowance for credit losses on accrued interest receivables as permitted by ASC 326-2-30-5A, it should adjust the historical loss information to reflect the amount of accrued interest that would have been charged off if the entity had not applied a nonaccrual accounting policy.

4.3.2 Adjustments to Historical Loss Data for Differences in Asset-Specific Risk Characteristics

While historical loss data serve as a starting point for estimating expected credit losses, ASC 326 requires an entity to evaluate whether such data are relevant to the financial assets for which the estimate is being made. Specifically, ASC 326-20-30-8 states that “[a]n entity shall consider adjustments to historical loss information for differences in current asset specific risk characteristics, such as differences in underwriting standards, portfolio mix, or asset term within a pool at the reporting date or when an entity’s historical loss information is not reflective of the contractual term of the financial asset or group of financial assets.” For example, it would not be appropriate for an entity to use historical loss data related to subprime mortgages when estimating expected credit losses on prime mortgages in the current financial reporting period.
4.3.3 Current Conditions and Reasonable and Supportable Forecasts

As discussed in Section 4.3.1, an entity’s historical credit loss experience with financial assets whose risk characteristics are similar generally serves as a basis for the entity’s assessment of expected credit losses. As discussed in Section 4.3.2, sometimes an entity needs to adjust historical data for differences in asset-specific risk characteristics. However, ASC 326-20-30-9 states that an entity “shall not rely solely on past events to estimate expected credit losses.” Rather, an entity that uses historical loss information should consider adjusting information to appropriately reflect management’s current expectation of future credit losses. Specifically, ASC 326-20-30-9 states that an entity “shall consider the need to adjust historical information to reflect the extent to which management expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed for the period over which historical information was evaluated.”

Note that the adjustments for current conditions and reasonable and supportable forecasts differ from (and are incremental to) the adjustments discussed in Section 4.3.2 that are related to differences between historical data and asset-specific risk characteristics. For example, an entity may upwardly adjust historical loss rates to reflect that it now lends money to retail customers with lower credit scores and is trying to estimate losses on a pool of loans to those customers. This would be an adjustment for differences in asset-specific risk characteristics. However, the entity may also adjust the historical loss rates again to reflect the difference between the current economic conditions and the conditions related to the period represented by the historical information. For example, if current unemployment rates are lower than the rates during the period reflected in the historical data, the loss rates may be adjusted down to reflect current conditions. An entity may also be required to make further adjustments to reflect reasonable and supportable forecasts.

While some entities may be able to develop reasonable and supportable forecasts over the contractual term of a financial asset (or group of financial assets), ASC 326 does not require an entity to develop such forecasts. Furthermore, under ASC 326-20-30-7, the entity’s search for all possible information that may be relevant to management’s expectations regarding future credit losses does not need to involve “undue cost or effort.” ASC 326-20-30-7 and ASC 326-20-30-9 state, in part:

30-7 When developing an estimate of expected credit losses on financial asset(s), an entity shall consider available information relevant to assessing the collectibility of cash flows . . . . An entity shall consider relevant qualitative and quantitative factors that relate to the environment in which the entity operates and are specific to the borrower(s). When financial assets are evaluated on a collective or individual basis, an entity is not required to search all possible information that is not reasonably available without undue cost and effort. . . .
30-9 For periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses, an entity shall revert to historical loss information determined in accordance with paragraph 326-20-30-8 that is reflective of the contractual term of the financial asset or group of financial assets. An entity shall not adjust historical loss information for existing economic conditions or expectations of future economic conditions for periods that are beyond the reasonable and supportable period. An entity may revert to historical loss information at the input level or based on the entire estimate. An entity may revert to historical loss information immediately, on a straight-line basis, or using another rational and systematic basis.

It would be rare for an entity to conclude that there is no reasonable and supportable information about current conditions and expectations for future economic conditions and therefore for the entity to solely use historical loss information to measure expected credit losses. Paragraph BC51 of ASU 2016-13 states that the FASB “expects that an entity should not ignore relevant data when considering historical experience or when considering qualitative adjustments for current conditions and reasonable and supportable forecasts.” The Board also acknowledges that “the adjustment for current conditions and reasonable and supportable forecasts will be the most subjective aspect of the estimate.” Paragraph BC53 of ASU 2016-13 further explains that the purpose of the language in ASC 326-20-30-9 on reversion to historical loss information is to “provide additional guidance on how to measure expected credit losses as an entity moves into periods of increasing uncertainty and decreasing precision.” This guidance is not intended to allow an entity to merely default to historical loss information when estimating expected credit losses.

The determination of how far into the future an entity can reasonably adjust historical loss information to reflect projected future economic conditions relevant to the recoverability of a particular type of financial asset will depend on the particular facts and circumstances, including the types of macroeconomic data that are predictive of future credit losses, and may be limited to the periods for which future macroeconomic data may be obtained from external sources. ASC 326-20-30-9 specifically prohibits adjustment to historical loss information “for existing economic conditions or expectations of future economic conditions for periods that are beyond the reasonable and supportable period.” However, an entity is not precluded from projecting future economic conditions for periods beyond which there is published external information if such projections are reasonably supportable given the particular facts and circumstances.

**Q&A 4-7 Use of Macroeconomic Data to Make Reasonable and Supportable Forecasts**

*Question*

What type of macroeconomic data should an entity use when estimating expected credit losses?

*Answer*

The objective of incorporating macroeconomic data into the modeling of the allowance for credit losses is to use relevant information about how current and projected economic conditions will affect the level of future credit losses on financial assets (i.e., how current and future economic conditions will affect historical loss experience). An entity would be expected to use such macroeconomic data in estimating expected credit losses.

ASC 326 does not require an entity to incorporate into its credit loss estimate a certain number of macroeconomic variables, and it does not establish a required period into the future for which macroeconomic variables are considered reasonable and supportable information for the entity to use in making credit loss estimates (i.e., as compared with defaulting to historical loss information). However, we believe that, in estimating credit losses, an entity should use macroeconomic data that correlate to historical losses (and are periodically revalidated) and should not ignore macroeconomic data that are relevant to the expectation of future cash flows.
An entity may use more than one external source of macroeconomic data, although it is not required to do so. If an entity evaluates more than one external source of macroeconomic data, it is not required to apply probability weighting to the information. Rather, it could consider multiple sources to validate the primary source of information used. In addition, an entity could use its internal views on key economic indicators rather than using external sources. However, the entity should consider whether it is appropriate that its internal views are contrary to published information.

Q&A 4-8  Reasonable and Supportable Forecast Periods

Question
Is an entity required to use the same reasonable and supportable forecast period for different financial assets or for different inputs to its models when estimating expected credit losses?

Answer
No. ASC 326 does not require an entity’s forecast period to be the same for all asset types or for all inputs into the models it uses for estimating credit losses. On the contrary, ASC 326-20-30-7 states that “[w]hen developing an estimate of expected credit losses on financial asset(s), an entity shall consider available information relevant to assessing the collectibility of cash flows [as well as] relevant qualitative and quantitative factors that relate to the environment in which the entity operates and are specific to the borrower(s).” The effects of changes in macroeconomic data could differ depending on which of the entity’s assets are involved, causing an entity to use different reasonable and supportable forecast periods when estimating expected credit losses. For example, an entity may consider macroeconomic data related to residential mortgages differently depending on the location of borrowers or the underlying collateral securing the loans. As a result, the entity may need to use different reasonable and supportable forecast periods to reflect the differences in the macroeconomic data relevant to the particular asset.

Further, in July 2019, the FASB staff addressed this issue in the following Q&A:

<table>
<thead>
<tr>
<th>FASB Staff Q&amp;A</th>
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<tbody>
<tr>
<td><strong>Topic 326, No. 2: Developing an Estimate of Expected Credit Losses on Financial Assets</strong></td>
</tr>
<tr>
<td><strong>Questions and Answers — General Questions About the CECL Standard</strong></td>
</tr>
<tr>
<td><strong>Question 8</strong></td>
</tr>
<tr>
<td>May the length of reasonable and supportable forecast periods vary between different portfolios, products, pools, and inputs?</td>
</tr>
<tr>
<td><strong>Response</strong></td>
</tr>
<tr>
<td>Yes. The duration or length of the reasonable and supportable forecast period is a judgment that may vary based on the entity’s ability to estimate economic conditions and expected losses. The reasonable and supportable forecast may vary between portfolios, products, pools, and inputs. However, specific inputs (such as unemployment rates) should be applied on a consistent basis between portfolios, products, and pools, to the extent that the same inputs are relevant across products and pools. It also is acceptable to have a single reasonable and supportable period for all of an entity’s products. An entity is to disclose information that will enable users to understand management’s method for developing its expected credit losses, the information used in developing its expected credit losses, and the circumstances that caused changes to the expected credit losses among other disclosures about the allowance for credit losses.</td>
</tr>
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</table>
Q&A 4-9  Multiple Economic Scenarios

**Question**
Must an entity consider multiple forward-looking economic scenarios when determining its reasonable and supportable forecast?

**Answer**
No. ASC 326 does not require an entity to develop (or preclude it from developing) multiple economic scenarios, as addressed in the following FASB staff Q&A issued in July 2019:

<table>
<thead>
<tr>
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</tr>
<tr>
<td><strong>Question 12</strong></td>
</tr>
<tr>
<td>When developing a reasonable and supportable forecast to estimate expected credit losses, is probability weighting of multiple economic scenarios required?</td>
</tr>
<tr>
<td><strong>Response</strong></td>
</tr>
<tr>
<td>No. Topic 326 does not require an entity to probability weight multiple economic scenarios when developing an estimate of expected credit losses. One entity may choose to probability weight multiple economic scenarios when developing its estimate of expected credit losses, while another entity may rely on a single economic scenario to develop reasonable and supportable forecasts.</td>
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Q&A 4-10  Consistent Assumptions Used by an Entity

**Question**
Should the economic forecasts used to estimate expected credit losses be the same as those used for other forecasting purposes within the organization (e.g., budgeting, goodwill impairment testing)?

**Answer**
It depends. ASU 2016-13 notes that various methods for forecasting expected credit losses are acceptable and does not outline a specific approach to use. While the information used to forecast expected credit losses may be consistent with the information used for other forecasting purposes, it does not need to be the same.

Q&A 4-11  Validating the Forecasting Process

**Question**
Is an entity required to evaluate the accuracy of its reasonable and supportable forecasts (i.e., subsequently review its ability to accurately predict the future)?
Answer

No. Although the forecasts must be reasonable and supportable, ASC 326 does not require an entity to substantiate its ability to accurately predict economic conditions. In other words, when estimating its expected credit losses, an entity is not required to evaluate in the current reporting period whether it had “successfully” predicted economic conditions in prior periods. Paragraph BC50 of ASU 2016-13 states that “[e]stimates of credit losses may not precisely predict actual future events and, therefore, subsequent events may not be indicative of the reasonableness of those estimates.” While paragraph BC50 is addressing the overall estimate of expected credit losses more broadly, we believe that it applies equally to reasonable and supportable forecasts about the future. That is, inherent in any forecast of economic conditions is a level of uncertainty and lack of precision. As a result, we do not believe that an entity must evaluate whether existing economic conditions were accurately predicted in its previous forecasts in earlier reporting periods. However, paragraph 3.5.21(d) of the AICPA Audit and Accounting Guide on credit losses states that “significantly missing near-term forecasts may be an indicator of a deficient forecasting process.”

4.3.4 Reversion to Historical Loss Information

As mentioned previously, some entities may be able to develop reasonable and supportable forecasts over the contractual term of a financial asset. Those that cannot do so will need to revert to historical loss experience for the periods beyond which they can develop reasonable and supportable forecasts. The Board believes that it would be inappropriate to assign zero as the estimate of credit losses during the period beyond which an entity could develop a reasonable and supportable forecast. In paragraph BC53 of ASU 2016-13, the FASB indicates that “an approach that does not record some expected losses (for example, those that are expected to occur after some prescribed forecast period) would fail to reflect the amount that an entity expects to collect, which is the Board’s measurement objective for financial assets. . . . Therefore, the Board decided to provide additional guidance on how to measure expected credit losses as an entity moves into periods of increasing uncertainty and decreasing precision.”
In a manner consistent with its objective not to prescribe or prohibit specific approaches or assumptions that management uses to develop its expectations about the future, the FASB has given entities flexibility related to choosing how to revert to historical loss experience. ASC 326-20-30-9 states that “[a]n entity may revert to historical loss information at the input level or based on the entire estimate [and] may revert to [such] information immediately, on a straight-line basis, or using another rational and systematic basis.” While such use of reversion is not an accounting policy election, the entity is required to disclose the reversion method (e.g., the level at which it reverts and the period over which it chooses to revert) as a significant judgment used by management when determining the cash flows it expects to collect.

Further, how an entity reverts to historical loss experience could be affected by whether it has a single reasonable and supportable forecast period covering all financial assets and inputs used in estimating losses or whether it uses multiple forecast periods for different financial assets and inputs (see Q&A 4-8 for more information about determining the reasonable and supportable forecast period). In other words, an entity may believe that reversion on a straight-line basis is appropriate for certain assets or inputs but may decide to use a different rational and systematic reversion method for other assets and inputs if it believes that such a method would result in a better representation of its expected credit losses in such circumstances.

It is important to highlight two points regarding an entity’s ability to revert to historical loss information as discussed in ASC 326-20-30-9. First, the historical loss information used for reversion must be adjusted (to the extent necessary given the particular facts and circumstances) for differences in asset-specific risk characteristics (see Section 4.3.2). Second, such reversion is appropriate (and required) only for periods beyond which management can reasonably adjust historical loss information “for current conditions and reasonable and supportable forecasts,” as discussed in ASC 326-20-30-10. That is, an entity may not default solely to historical loss information to estimate expected credit losses.

**Q&A 4-12  Reverting to Historical Loss Experience Over a Period Shorter Than the Contractual Life of an Asset**

**Question**
Can an entity revert to its historical loss experience over a period shorter than the asset’s contractual life?

**Answer**
Yes. While ASC 326-20-30-9 allows an entity to revert to historical loss experience on “a straight-line basis, or using another rational and systematic basis,” it does not require that the reversion occur over the remaining contractual life of the financial asset. As a result, an entity can choose to revert to historical loss experience over a period shorter than the asset’s remaining contractual life if it believes that such reversion would result in a better estimate of its expected credit losses.
4.4 Measurement Methods and Techniques

**ASC 326-20**

**30-3** The allowance for credit losses may be determined using various methods. For example, an entity may use discounted cash flow methods, loss-rate methods, roll-rate methods, probability-of-default methods, or methods that utilize an aging schedule. An entity is not required to utilize a discounted cash flow method to estimate expected credit losses. Similarly, an entity is not required to reconcile the estimation technique it uses with a discounted cash flow method.

**30-4** If an entity estimates expected credit losses using methods that project future principal and interest cash flows (that is, a discounted cash flow method), the entity shall discount expected cash flows at the financial asset's effective interest rate. When a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the amortized cost basis and the present value of the expected cash flows. If the financial asset's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that financial asset's effective interest rate (used to discount expected cash flows as described in this paragraph) shall be calculated based on the factor as it changes over the life of the financial asset. An entity is not required to project changes in the factor for purposes of estimating expected future cash flows. If the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-20-30-4A. Subtopic 310-20 on receivables — nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.

**30-4A** As an accounting policy election for each class of financing receivable or major security type, an entity may adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments. However, if the asset is restructured in a troubled debt restructuring, the effective interest rate used to discount expected cash flows shall not be adjusted because of subsequent changes in expected timing of cash flows.

**30-5** If an entity estimates expected credit losses using a method other than a discounted cash flow method described in paragraph 326-20-30-4, the allowance for credit losses shall reflect the entity's expected credit losses of the amortized cost basis of the financial asset(s) as of the reporting date. For example, if an entity uses a loss-rate method, the numerator would include the expected credit losses of the amortized cost basis (that is, amounts that are not expected to be collected in cash or other consideration, or recognized in income). In addition, when an entity expects to accrete a discount into interest income, the discount should not offset the entity's expectation of credit losses. An entity may develop its estimate of expected credit losses by measuring components of the amortized cost basis on a combined basis or by separately measuring the following components of the amortized cost basis, including all of the following:

- **a.** Amortized cost basis, excluding applicable accrued interest, premiums, discounts (including net deferred fees and costs), foreign exchange, and fair value hedge accounting adjustments (that is, the face amount or unpaid principal balance)
- **b.** Premiums or discounts, including net deferred fees and costs, foreign exchange, and fair value hedge accounting adjustments
- **c.** Applicable accrued interest. See paragraph 326-20-30-5A for guidance on excluding accrued interest from the calculation of the allowance for credit losses.

**30-5A** An entity may make an accounting policy election, at the class of financing receivable or the major security-type level, not to measure an allowance for credit losses for accrued interest receivables if the entity writes off the uncollectible accrued interest receivable balance in a timely manner. This accounting policy election should be considered separately from the accounting policy election in paragraph 326-20-35-8A. An entity may not analogize this guidance to components of amortized cost basis other than accrued interest.
The objectives of ASU 2016-13 are to eliminate the incurred loss approach and the probability threshold for recognition of credit losses. In accordance with ASC 326-20-30-3 (see above), various methods can be used to meet these objectives. In paragraph BC50 of ASU 2016-13, the FASB indicates that its reasoning behind allowing entities to use various methods in estimating credit losses is that “entities manage credit risk differently and should have flexibility to best report their expectations.” The Board also acknowledges that “different methods may result in a range of acceptable outcomes” and do not inherently cause a particular estimate to be unreasonable.

Accordingly, an entity can select from a number of measurement approaches to determine the allowance for expected credit losses. Some approaches project future principal and interest cash flows (i.e., a DCF method), while others project only future principal losses. If an entity chooses to estimate credit losses by using a method other than a DCF method, it has the option of estimating such losses on the asset’s amortized cost basis in the aggregate or by separately measuring the components of the amortized cost basis (e.g., premiums and discounts), as described in ASC 326-20-30-5.

While an entity is not required to change its current method(s) of estimating credit losses upon adopting ASU 2016-13, it should consider, for each type of financial asset, whether it is more appropriate to use a different method to meet the ASU’s objectives. For example, the entity may determine that certain methods are not suitable for measuring expected credit losses on prepayable financial assets (see Q&A 4-15 for discussion of how estimated prepayments may affect the estimate of expected credit losses if a method other than a DCF approach is used). In addition, as required by ASC 326-20-30-10 and discussed in paragraph BC63 of ASU 2016-13, regardless of the method used, an entity’s estimate of expected credit losses should take into account “the expected risk of loss, even if that risk is remote.”

To faithfully estimate the collectibility of financial assets within the scope of ASC 326-20, an entity should use judgment in developing estimation techniques and apply those techniques consistently over time. ASC 326-20-55-7 emphasizes that an entity should use methods that are “practical and relevant” given the specific facts and circumstances and that “[t]he method(s) used to estimate expected credit losses may vary on the basis of the type of financial asset, the entity’s ability to predict the timing of cash flows, and the information available to the entity.”

Regardless of whether an entity changes its current method(s) of estimating credit losses upon adoption of ASU 2016-13, the method(s) used must be disclosed by portfolio segment and major security type in accordance with ASC 326-20-50-11.

Q&A 4-13 Changes in Estimation Techniques or Assumptions

Question

Does a change in the estimation technique or assumptions used to calculate expected credit losses after an entity’s initial adoption of ASU 2016-13 reflect a change in accounting principle or a change in accounting estimate?
Answer

ASC 250 distinguishes between a change in accounting principle and a change in accounting estimate. The guidance also discusses a change in accounting estimate effected by a change in accounting principle. The table below discusses (1) when it is appropriate to effect a change in accounting principle or a change in accounting estimate and (2) how such changes should be accounted for in an entity’s financial statements.

<table>
<thead>
<tr>
<th>Type of Change</th>
<th>When a Change Is Appropriate</th>
<th>Accounting for the Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in accounting principle</td>
<td>May be made upon the initial adoption of a newly issued Codification update. If it occurs under any other circumstances, it must be justified on the basis that the alternative accounting principle is preferable (see ASC 250-10-45-2). SEC registrants are required to file a preferability letter to effect a change in accounting principle.</td>
<td>Reported “through retrospective application of the new accounting principle to all prior periods, unless it is impracticable to do so” (see ASC 250-10-45-5).</td>
</tr>
<tr>
<td>Change in accounting estimate</td>
<td>Generally results from “the continuing process of obtaining additional information and revising estimates” related to the present status and expected future benefits and obligations associated with assets and liabilities (see ASC 250-10-45-18 and the definition of a change in accounting estimate). The objective of measuring an asset or liability in other Codification topics will affect the assessment of when a change in accounting estimate is justified given the particular facts and circumstances.</td>
<td>Should not be accounted for by restating or retrospectively adjusting amounts reported in prior-period financial statements. Rather, such a change should “be accounted for in the period of change if the change affects that period only or in the period of change and future periods if the change affects both” (see ASC 250-10-45-17).</td>
</tr>
<tr>
<td>Change in accounting estimate effected by a change in accounting principle</td>
<td>May only be made “if the new accounting principle is justifiable on the basis that it is preferable” (see ASC 250-10-45-19). An SEC registrant is not required to file a preferability letter to make a change in accounting estimate effected by a change in accounting principle (see paragraph 4230.2(c)(4) of the SEC Financial Reporting Manual).</td>
<td>Treated as a change in accounting estimate (see ASC 250-10-45-18).</td>
</tr>
</tbody>
</table>

3 ASC 250-10-20 defines a “change in accounting principle” as follows:
A change from one generally accepted accounting principle to another generally accepted accounting principle when there are two or more generally accepted accounting principles that apply or when the accounting principle formerly used is no longer generally accepted.
A change in the method of applying an accounting principle also is considered a change in accounting principle.

4 ASC 250-10-20 defines a “change in accounting estimate” as follows:
A change that has the effect of adjusting the carrying amount of an existing asset or liability or altering the subsequent accounting for existing or future assets or liabilities. A change in accounting estimate is a necessary consequence of the assessment, in conjunction with the periodic presentation of financial statements, of the present status and expected future benefits and obligations associated with assets and liabilities. Changes in accounting estimates result from new information. Examples of items for which estimates are necessary are uncollectible receivables, inventory obsolescence, service lives and salvage values of depreciable assets, and warranty obligations.

5 ASC 250-10-20 defines a “change in accounting estimate effected by a change in accounting principle” as follows:
A change in accounting estimate that is inseparable from the effect of a related change in accounting principle. An example of a change in estimate effected by a change in principle is a change in the method of depreciation, amortization, or depletion for long-lived, nonfinancial assets.

ASC 250-10-45-18 highlights that an entity must often use judgment to differentiate between a change in accounting principle and a change in accounting estimate and discusses certain changes that reflect a change in accounting estimate effected by a change in accounting principle.
The determination of the allowance for credit losses on financial assets reflects an accounting estimate. Making such an estimate involves the determination of both the estimation technique (e.g., DCFs, loss-rate method) and the assumptions inherent in that technique. ASC 326-20-55-6 notes that “estimating expected credit losses is highly judgmental” and includes the following nonexhaustive list of judgments that may be involved in such estimation:

- a. The definition of default for default-based statistics
- b. The approach to measuring the historical loss amount for loss-rate statistics, including whether the amount is simply based on the amortized cost amount written off and whether there should be adjustments to historical credit losses (if any) to reflect the entity's policies for recognizing accrued interest
- c. The approach to determine the appropriate historical period for estimating expected credit loss statistics
- d. The approach to adjusting historical credit loss information to reflect current conditions and reasonable and supportable forecasts that are different from conditions existing in the historical period
- e. The methods of utilizing historical experience
- f. The method of adjusting loss statistics for recoveries
- g. How expected prepayments affect the estimate of expected credit losses
- h. How the entity plans to revert to historical credit loss information for periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses
- i. The assessment of whether a financial asset exhibits risk characteristics similar to other financial assets.

As part of its processes for estimating expected credit losses, an entity will need to continually obtain and evaluate new information to determine how it affects the presentation of the net amounts expected to be collected on financial assets. Such processes could include changing the estimation technique for specific types of financial assets, changing the assumptions inherent in the application of a particular estimation technique, or both.

### 4.4.1 Changes in Estimation Techniques

ASC 326-20-35-1 and ASC 326-20-55-7 address considerations related to determining the estimation technique used to calculate expected credit losses and state:

**35-1** At each reporting date, an entity shall record an allowance for credit losses on financial assets (including purchased financial assets with credit deterioration) within the scope of this Subtopic. An entity shall compare its current estimate of expected credit losses with the estimate of expected credit losses previously recorded. An entity shall report in net income (as a credit loss expense or a reversal of credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s). The method applied to initially measure expected credit losses for the assets included in paragraph 326-20-30-14 generally would be applied consistently over time and shall faithfully estimate expected credit losses for financial asset(s). [Emphasis added]

**55-7** Because of the subjective nature of the estimate, this Subtopic does not require specific approaches when developing the estimate of expected credit losses. Rather, an entity should use judgment to develop estimation techniques that are applied consistently over time and should faithfully estimate the collectibility of the financial assets by applying the principles in this Subtopic. An entity should utilize estimation techniques that are practical and relevant to the circumstance. The method(s) used to estimate expected credit losses may vary on the basis of the type of financial asset, the entity's ability to predict the timing of cash flows, and the information available to the entity. [Emphasis added]
An entity may consider changing its estimation technique for a particular type of financial asset for various reasons. For example, in practice, it may be common for a financial asset’s risk characteristics to no longer be similar to those of the original pool of financial assets. In such situations, an entity may need to measure expected credit losses on the asset by using a method different from that used for the original pool. Accordingly, it may be appropriate for the entity to change the estimation technique for the financial asset and, depending on the facts and circumstances, the new estimation technique may be applied to the financial asset individually or to a different pool of financial assets whose risk characteristics are now similar to those of that asset. For instance, an entity may determine that the allowance for credit losses on a credit-deteriorated financial asset (including, but not limited to, a modified financial asset) should be estimated by using a DCF approach or by applying the practical expedient related to collateral-dependent financial assets, but the entity may also determine that the allowance for credit losses on the original pool of financial assets should continue to be estimated by using a loss-rate approach.

If there is no change in risk characteristics, an entity would generally be expected to apply its estimation technique consistently over time. However, when a change in an estimation technique is justified given the particular facts and circumstances, an entity should treat the change as a change in accounting estimate rather than as a change in accounting estimate effected by a change in accounting principle. Although the definition of a change in accounting principle in ASC 250 indicates that “[a] change in the method of applying an accounting principle also is considered a change in accounting principle” (emphasis added), the definition of a change in accounting estimate cites uncollectible receivables as an item for which estimates are necessary. In prior registrant comment letters and informal conversations, the SEC staff has expressed its view that changes in the method of estimating the allowance for credit losses represent changes in accounting estimates. We do not expect a change in this view upon adoption of ASU 2016-13.

**Q&A 4-14 Applying Different Measurement Methods to Similar Pools of Assets**

An entity can select from a number of measurement approaches to estimate expected credit losses. Some approaches project future principal and interest cash flows (i.e., a DCF method), while others project only future principal losses.

**Question**

Must an entity apply the same measurement approach when measuring expected credit losses related to similar pools of assets?

**Answer**

Not necessarily. While it is clear that an entity could use different approaches to measure expected credit losses related to individual financial assets that do not share similar risk characteristics, it is less clear whether that same conclusion applies to similar pools of financial assets. As discussed in Chapter 3, an entity must evaluate financial assets on a collective (i.e., pool) basis if they share similar risk characteristics. Once the entity determines a pool of financial assets, it can apply any of the measurement methods discussed in ASC 326-20 to that pool. As a result, an entity could potentially apply a different measurement approach to different pools of similar financial assets.
Chapter 4 — Measurement of Expected Credit Losses

Example

A commercial real estate lender has historically provided financing in the northeastern and southeastern United States and has determined its pools of assets for measuring expected credit losses on the basis of internal risk rating (1–5). The internal risk rating takes into account borrower-specific factors such as size, geographical location, historical payment defaults, and loan term (note that the lender does not believe that the borrower-specific factors cause the loans not to share similar risk characteristics). Given the amount of historical information gathered on these commercial pools, the lender uses a DCF method to estimate expected credit losses related to the pools.

In the current year, the lender begins to finance commercial loans in the southwestern United States. As the lender has historically done, it assigns an internal risk rating to the loans issued in the southwestern United States and determines that those loans should be pooled together. However, the lender does not have sufficient information to apply a DCF method to these loans (as noted above, the lender did have such information for the loans issued in the northeastern and southeastern United States). Therefore, on the basis of the guidance in ASC 326-20-55-7, which emphasizes that an entity should use methods that are “practical and relevant” given the specific facts and circumstances and that “[t]he method(s) used to estimate expected credit losses may vary on the basis of . . . the entity's ability to predict the timing of cash flows, and the information available to the entity,” the lender chooses to apply a loss-rate method to the pool of commercial real estate loans issued in the southwestern United States and continues to apply a DCF method to the pools of commercial real estate loans issued in the northeastern and southeastern United States.

4.4.2 Changes in Assumptions

Changes to the assumptions an entity uses in applying a particular estimation technique are appropriate when the entity is making those changes because it has obtained and evaluated new information that affects its process for faithfully estimating the collectibility of financial assets in accordance with ASC 326. Any such changes, which should be justifiable given the particular facts and circumstances, should be reflected as a change in accounting estimate. Such changes would include the nonexhaustive list of judgments listed in ASC 326-20-55-6.

While changes in the estimation techniques and assumptions used to measure expected credit losses are considered changes in accounting estimates, changes in certain items, which are described in ASC 326 as “significant accounting policies,” could indirectly affect the estimation of credit losses and would need to be reflected as changes in accounting principles. ASC 326-20-50-17 states that an entity’s significant accounting policies would include the following:

a. Nonaccrual policies, including the policies for discontinuing accrual of interest, recording payments received on nonaccrual assets (including the cost recovery method, cash basis method, or some combination of those methods), and resuming accrual of interest, if applicable.

b. The policy for determining past-due or delinquency status.

c. The policy for recognizing writeoffs within the allowance for credit losses.

In addition, an entity’s change in its interest income recognition practices may reflect a change in accounting principle or a change in accounting estimate effected by a change in accounting principle. Interest income recognition guidance is largely addressed in other Codification topics. However, ASC 326 does address an entity’s treatment of the change in the allowance for credit losses that results from the passage of time when a DCF approach is used to estimate expected credit losses. ASC 326-20-45-3 allows an entity to either (1) report the entire change in present value as credit loss expense or (2) report the change in present value attributable to the passage of time as interest income. The alternative chosen would reflect an accounting policy; thus, any change in the alternative used would be considered a change in accounting principle.
See ASC 250-10-50 for information about the disclosures that must accompany a change in accounting principle or a change in accounting estimate.

### 4.4.3 Considerations Related to Estimating Credit Losses by Using a DCF Method

#### 4.4.3.1 Effect of Prepayments on an Entity Using a DCF Method

An entity that uses a DCF method to estimate expected credit losses must “discount expected cash flows at the financial asset’s effective interest rate [(EIR)]” (emphasis added) in accordance with ASC 326-20-30-4. This paragraph further states that “[w]hen a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the amortized cost basis and the present value of the expected cash flows.” ASC 326-20-20 defines the EIR, in part, as “[t]he rate of return implicit in the financial asset, that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the financial asset.”

Consequently, ASC 326 is unclear on whether an entity that applies a DCF method to discount the expected cash flows should use the same EIR it applied to recognize interest income in accordance with ASC 310-20. With few exceptions, it is assumed under ASC 310-20 that for interest income recognition purposes, the loan will remain outstanding until its contractual maturity (and that, therefore, expected prepayments are not considered). However, the CECL model requires an entity to consider prepayments when applying the DCF method. As a result, the loan term used for recognizing interest income is inconsistent with that used for estimating expected credit losses.

Further, this inconsistency could result in certain anomalies. For example, when an entity uses a DCF method to estimate expected credit losses for a loan that includes a premium to par, any expected prepayments would accelerate the recognition of premiums that are related solely to the use of a discount rate under which, for CECL model purposes, prepayments are assumed to a set of cash flows for which prepayments are not assumed for interest income recognition purposes. The acceleration of the premium recognition results in an increase to the credit allowance because the amortized cost basis on day 1 would be greater than the present value of the expected cash flows. The opposite is true for a loan that includes a discount to par under which the use of a DCF method that includes expected prepayments would accelerate the recognition of the discount. This acceleration would, in turn, artificially lower the allowance because the amortized cost basis on day 1 would be less than the present value of the expected cash flows.

This issue, among others discussed at the June 2017 TRG meeting, led the FASB to issue ASU 2019-04, under which an entity can make an accounting policy election (at the “class of financing receivable” level) to use a prepayment-adjusted EIR when applying a DCF method under the CECL model, even though the EIR used for interest income recognition is not adjusted for prepayments. The ASU also states that an entity that has elected an accounting policy of adjusting the EIR for prepayments should update the adjusted EIR periodically to match any changes in expected prepayments. Moreover, the ASU clarifies that an entity should not adjust the EIR used to discount expected cash flows for subsequent changes in expected prepayments if the financial asset is restructured in a TDR.

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6 The EIR is different for PCD assets. ASC 326 states that when determining the EIR “[f]or purchased financial assets with credit deterioration, however, to decouple interest income from credit loss recognition, the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to the acquirer’s assessment of credit losses at the date of acquisition.”
4.4.3.2 Variable-Rate Instruments

ASU 2016-13 originally stated that if a financial asset’s contractual interest rate varies on the basis of an independent factor, such as an index or rate, “[p]rojections of changes in the factor shall not be made for purposes of determining the effective interest rate or estimating expected future cash flows” (emphasis added). After the ASU was issued, however, stakeholders questioned whether it was inconsistent for the guidance to prohibit entities from projecting changes in the factor that leads to changes in the financial asset’s contractual interest rate while requiring them to consider projections when estimating expected cash flows.

As a result, in ASU 2019-04, the FASB clarifies that an entity is permitted to consider projections of changes in the factor as long as such projections are the same as those used to estimate expected future cash flows. For example, the reasonable and supportable forecast period over which an entity chooses to project the contractual variable interest rate should be consistent for both estimating future cash flows and determining the EIR.

Specifically, ASC 326-20-30-4 states, in part:

If the financial asset’s contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that financial asset’s effective interest rate (used to discount expected cash flows as described in this paragraph) shall be calculated based on the factor as it changes over the life of the financial asset. An entity is not required to project changes in the factor for purposes of estimating expected future cash flows. If the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall use the same projections in determining the effective interest rate used to discount those cash flows. In addition, if the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-20-30-4A. Subtopic 310-20 on receivables — nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.

Connecting the Dots — Measuring Expected Credit Losses When an EIR on a Fixed-Rate Loan Is Lower Than a Current Market Rate

ASU 2019-04 clarified that an entity is permitted to consider projections of changes in factors that lead to changes in a variable-rate instrument’s contractual interest rate when determining the asset’s EIR. However, when an entity is determining the EIR on a fixed-rate loan, even in situations in which interest rates have increased since the origination of the loan, the entity would not consider the current market rate when discounting the expected future cash flows of the loan. Keep in mind that discounting the future cash flows at a rate lower than the current market rate will result in a lower amount of expected credit losses. An entity should change its estimate of expected credit losses solely on the basis of changes in credit quality (i.e., a change in future cash flows that is attributable to credit). The FASB did not intend the measurement of expected credit losses to reflect changes in interest rates in general or changes specific to a borrower.

However, if the creditor uses a practical expedient in measuring expected credit losses (e.g., fair value of collateral on a collateral-dependent loan), the measurement may reflect changes in interest rates because fair value incorporates current market conditions as of the measurement date.
4.4.4 Estimating Credit Losses by Using Methods Other Than a DCF Method

If an entity chooses to estimate credit losses by using a method other than a DCF method, it has the option of estimating credit losses on the asset’s amortized cost basis in the aggregate or by separately measuring the components of the amortized cost basis (e.g., premiums and discounts), as described in ASC 326-20-30-5. Depending on which of these alternatives the entity chooses, it may be required to adjust its historical loss information. For example, if an entity’s historical loss rate reflects losses of only principal amounts, it may need to adjust that information if it chooses to estimate credit losses on the entire amortized cost basis of an asset to which premiums, discounts, or other basis adjustments apply.

Q&A 4-15 Effect of Timing on Expected Credit Losses

**Question**
How does the timing of defaults and prepayments affect the calculation of expected credit losses?

**Answer**
The timing of defaults and prepayments (e.g., repayment of the financial asset, either partially or entirely, before its stated maturity according to its contractual terms) affects an entity’s calculation of expected credit losses differently depending on the method used:

- **DCF method** — When a DCF method is applied to a pool of financial assets, the time value of money is explicitly incorporated (i.e., both the amount and timing of cash flows matter). For example, the timing of prepayments affects the timing of the recognition of discounts and premiums and the number of interest coupons to be received. These factors could increase or offset credit losses when a DCF method is applied to a pool of assets by using an overall EIR.

- **Measuring expected credit losses on the separate components of amortized cost (e.g., premiums, discounts) or on the asset’s combined amortized cost basis** — Regardless of whether an entity estimates expected credit losses on the separate components of amortized cost or the combined amortized cost basis of the asset, an entity is permitted but not required to consider the timing of when credit losses will occur. However, if an entity chooses to consider timing when estimating expected credit losses, the timing will affect the amount of amortized premiums, discounts, deferred fees and costs, etc. In addition, the entity would also need to estimate the acceleration of the amortization of the amounts resulting from prepayments.

Q&A 4-16 Nonaccrual Loans

**Question**
ASC 310-20-35-17 states that the amortization of net deferred fees and costs should be discontinued when an entity is not accruing interest on a loan “because of concerns about the realization of loan principal or interest.” Does the guidance in ASC 310-20-35-17 apply even if an entity has net deferred costs or a premium associated with the loan?

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7 Discussed at the August 29, 2018, FASB meeting.
Answer
Yes. While ASC 310-20 does not explicitly refer to premiums and discounts, if a loan is on nonaccrual status, presumably no interest should be recorded, including the amortization of premiums and discounts. Note, however, that when an entity estimates expected credit losses on a nonaccrual loan, it must consider the entire amortized cost basis of the loan, including unamortized net deferred costs and unamortized premiums (irrespective of whether the entity chooses to measure expected credit losses on the asset’s amortized cost basis in the aggregate or by separately measuring the components of the amortized cost basis, as permitted by ASC 326-20-30-5).

Q&A 4-17 Discounting Inputs When a Method Other Than a DCF Method Is Used

Question
Is an entity allowed to discount only certain inputs in estimating credit losses if it uses a method other than a DCF method (e.g., a probability-of-default or a loss-given-default credit loss method)?

Answer
No, partial discounting is prohibited. If an entity wants to discount the inputs used to measure the allowance for credit losses, it should discount all the inputs used in the measurement. Note that this question was addressed at the November 2018 TRG meeting, and it was determined that ASU 2016-13’s guidance on discounting is clear. As a result, the FASB is not expected to amend the guidance in ASC 326 to reflect the TRG discussion.

In addition, it would not be acceptable for an entity to discount future losses when using a loss-rate method (i.e., amortized cost × expected loss rate). Discounting is allowed only under a DCF approach in which an entity uses the EIR at inception.

Q&A 4-18 Consideration of Capitalized Interest When a Method Other Than a DCF Method Is Used

Question
When an entity uses a method other than a DCF method to estimate credit losses, should its allowance for such losses take into account future capitalized interest?

Answer
No. The entity should not consider expected future capitalized interest in calculating an allowance for credit losses because such interest is not included in the asset’s amortized cost basis on which the entity is estimating expected credit losses.

For a financial asset issued at a discount, the amount due upon default — provided that there are no terms or conditions that only require the repayment of “accreted value” at any point in the asset’s term — would be the par amount and accrued interest to date (which is greater than the asset’s amortized cost basis). For a financial asset issued at par with expected future capitalized interest, the amount due upon default is also the par amount and accrued interest to date, which would equal the amortized cost basis at the time of default (as long as there are no other adjustments to the amortized cost basis). Therefore, an entity would not consider
any unearned interest, regardless of the expectation that it will be capitalized in future periods before a default occurs, in the calculation of an allowance for credit losses because the legal amount owed upon default would not include that future expected accrued interest.

To illustrate this point, at its June 2018 meeting, the TRG discussed an example in which an entity issues a student loan for $60,000. The student is not required to make any payments on the loan until after four years (i.e., the loan will be in deferment for four years). However, interest accrues during the deferment period in such a way that at the end of year 4, the student will owe the lender $100,000, comprising a principal amount of $60,000 and interest of $40,000. In this scenario, although the student will owe the lender $100,000 after the deferment period ends, the lender will calculate its expected credit losses during the deferment period by using an amortized cost amount that does not include future capitalized interest (i.e., the principal amount of $60,000).

### 4.4.4.1 Accrued Interest

ASU 2016-13 defines “amortized cost basis” as “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” (emphasis added). The ASU’s inclusion of accrued interest in the definition of amortized cost basis has three significant implications for financial statements with respect to the measurement, presentation, and disclosure of the amortized cost basis and the allowance for credit losses of financial assets:

- To measure an allowance for credit losses on the amortized cost basis of a financial asset, entities will be required to include an allowance for the applicable accrued interest of that asset.
- Entities will have to present the accrued interest amount in the amortized cost basis of the financial assets in the same line item on the balance sheet.
- Entities will be required to include accrued interest in their disclosures about the amortized cost basis by class of financing receivable and vintage in accordance with ASC 326-20-50-5 and 50-6, respectively.

Further, because accrued interest is included in the definition, the reversal of such interest will need to be written off in the same manner as the principal or other components of the amortized cost basis (see Section 4.5 for a discussion of write-offs). ASC 326-20-35-8 states that “[w]riteoffs of financial assets, which may be full or partial writeoffs, shall be deducted from the allowance” (emphasis added). In other words, all components of the amortized cost basis, including the accrued interest, must be written off through the allowance for credit losses.

After the issuance of ASU 2016-13, stakeholders raised concerns that the inclusion of accrued interest in the definition of amortized cost basis could be operationally burdensome because many loan systems are not able to track accrued interest on an individual loan level. Stakeholders have also expressed concerns about the conflict between existing nonaccrual policies, which generally follow regulatory instructions requiring the reversal of accrued interest as a debit to the interest income line item (at least in part), and the write-off guidance in ASC 326-20-35-8. Many stakeholders, primarily financial institutions, indicated that existing nonaccrual policies present a more accurate reflection of the earning potential of a loan and interest income than does the write-off guidance in ASC 326-20-35-8. Those stakeholders further maintained that any change from the existing nonaccrual policies would reduce the consistency and comparability of current-period financial statements, regulatory reports, and important interest-income-based metrics (e.g., net interest margin) with those of prior periods.
ASU 2019-04 addresses these concerns (which were originally discussed at the June 2018 TRG meeting). Specifically, ASU 2019-04 states that an entity would be allowed to:

a. Measure the allowance for credit losses on accrued interest receivable balances separately from other components of the amortized cost basis of associated financial assets.

b. Make an accounting policy election not to measure an allowance for credit losses on accrued interest receivable amounts if an entity writes off the uncollectible accrued interest receivable balance in a timely manner and makes certain disclosures.

c. Make an accounting policy election to write off accrued interest amounts by [either] reversing interest income or recognizing credit loss expense, or a combination of both. The entity also is required to make certain disclosures.

d. Make an accounting policy election to present accrued interest receivable balances and the related allowance for credit losses for those accrued interest receivable balances separately from the associated financial assets on the balance sheet. If the accrued interest receivable balances and the related allowance for credit losses are not presented as a separate line item on the balance sheet, an entity should disclose the amount of accrued interest receivable balances and the related allowance for credit losses and where the balance is presented.

e. Elect a practical expedient to disclose separately the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements.

Q&A 4-19  Inclusion of Taxes, Insurance, and Other Costs

Question
Should a lender’s expectations of future losses on payments of tax, insurance premiums, and other “costs” (i.e., payments made by the lender that may not be recovered from borrowers) be included in the estimate of expected credit losses before the lender advances the funds?

Answer
No. Estimates of losses on unrecoverable lender payments of taxes and insurance and other costs should not be included in the lender’s day 1 estimate of expected credit losses. Those amounts should only be included in its estimate of expected credit losses when the funds are advanced. Some would argue that because the lender is not obligated to make those payments on the borrower’s behalf, not establishing an allowance for these amounts before such advances is consistent with the treatment of unfunded loan commitments discussed in Section 2.1. Others would argue that even if the lender was effectively compelled to make the advances to protect its collateral, not including estimates of future advances in the expected credit losses is consistent with the treatment of future capitalized interest discussed in Q&A 4-18 since those amounts do not represent the amount owed by the borrower on the balance sheet date.

4.4.5  Weighted-Average Remaining Maturity Method
In January 2019, the FASB staff issued a Q&A document that addresses whether and, if so, how the WARM method could be used to estimate expected credit losses. The document states that the “WARM method uses an average annual charge-off rate [that] contains loss content over several vintages and is used as a foundation for estimating the credit loss content for the remaining balances of financial assets in a pool at the balance sheet date. The average annual charge-off rate is applied to the contractual term, further adjusted for estimated prepayments to determine the unadjusted historical charge-off rate for the remaining balance of the financial assets.” The staff indicated that it is acceptable to use the WARM method to estimate an allowance for credit losses, particularly for less complex financial asset pools, and that an entity needs to consider whether qualitative adjustments should be made.
To illustrate how an entity might apply the WARM method, the FASB staff included a number of examples in the Q&A, one of which is reproduced below.

**FASB Staff Q&A**

**Topic 326, No. 1: Whether the Weighted-Average Remaining Maturity Method Is an Acceptable Method to Estimate Expected Credit Losses**

**Question 3 . . .**

**Fact Pattern**

- Estimate the allowance for credit losses as of 12/31/2020
- Pool of financial assets of similar risk characteristics
  - Amortized cost basis of ~$13.98 million
  - 5-year financial assets (contractual term adjusted by prepayments)
- Management expects the following in 2021 and 2022:
  - Rise in unemployment rates
- Management cannot reasonably forecast beyond 2022
- Assume 0.25% qualitative adjustment to represent both current conditions and reasonable and supportable forecasts

The example illustrates estimating an allowance for credit losses on a pool of financial assets as of December 31, 2020. The pool has an outstanding balance of approximately $13.98 million as of December 31, 2020 and has financial assets with a contractual life of 5 years. The $13.98 million amortized cost is for a pool of financial assets with similar credit risk characteristics.

Management expects a rise in unemployment rates for 2021 and 2022 and cannot reasonably forecast beyond 2022. The example assumes a 0.25% qualitative adjustment for current conditions and reasonable and supportable forecasts discussed further below. It is important to note that this input will be a significant assumption when estimating expected credit losses under Update 2016-13 because it represents amounts for the current conditions and reasonable and supportable forecast. Moreover, because the example is for illustrative purposes, the staff has not assumed a specific type of financial asset pool given the breadth of products that exist in the market place and the specific facts and circumstances that may exist for a particular entity. Rather, the calculations are meant to depict the mechanics of the model in various ways. Therefore, as noted in the example calculations, an entity will need to determine if adjustments need to be made to historical loss data in accordance with paragraph 326-20-30-8 in addition to the reasonable and supportable forecasts.

**Step 1: Calculate Annual Charge-Off Rate**

<table>
<thead>
<tr>
<th>Year</th>
<th>Amortized Cost</th>
<th>Average Balance</th>
<th>Actual Annual Net Charge-Offs</th>
<th>Annual Charge-Off Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>$5,126</td>
<td></td>
<td>21</td>
<td>0.30%</td>
</tr>
<tr>
<td>2016</td>
<td>8,969</td>
<td>7,048</td>
<td>21</td>
<td>0.30%</td>
</tr>
<tr>
<td>2017</td>
<td>11,220</td>
<td>10,094</td>
<td>51</td>
<td>0.51%</td>
</tr>
<tr>
<td>2018</td>
<td>12,312</td>
<td>11,766</td>
<td>42</td>
<td>0.36%</td>
</tr>
<tr>
<td>2019</td>
<td>12,936</td>
<td>12,624</td>
<td>32</td>
<td>0.25%</td>
</tr>
<tr>
<td>2020</td>
<td>13,980</td>
<td>13,458</td>
<td>49</td>
<td>0.37%</td>
</tr>
</tbody>
</table>

*Balances are in thousands except charge-off rate data

Average annual charge-off rate 0.36%
In Table 1 above:

1. Red bolded number of 0.36% is an average of 5 years of annual charge-off rates.
2. The historical time period used to determine the average annual charge-off rate is a significant judgment that will need to be properly supported and documented in accordance with paragraph 326-20-30-8. For this example, assume the entity compared historical information for similar financial assets with the current and forecasted direction of the economic environment, and believes that its most recent 5-year period is a reasonable period on which to base its expected credit-loss-rate calculation after considering the underwriting standards and contractual terms for loans that existed over the historical period in comparison with the current pool. Additionally, assume the entity considered whether any adjustments to historical loss information in accordance with paragraph 326-20-30-8 were needed before considering adjustments for current conditions and reasonable and supportable forecasts but determined that none were necessary. It should be noted that this is a simplified example using a generic pool. An entity that estimates the allowance for credit losses using the WARM method (or any method) should determine if its historical loss information needs to be adjusted for changes in underwriting standards, portfolio mix, or asset term within the pool at the reporting date.

**Step 2: Estimate the Allowance for Credit Losses**

**Table 2: Estimated Amortized Cost Basis**

<table>
<thead>
<tr>
<th>Year End</th>
<th>Est. Paydown</th>
<th>Projected Amort Cost</th>
<th>Avg Annual Charge-Off Rate</th>
<th>Allowance for Credit Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020 Actual Amortized Cost</td>
<td>$13,980</td>
<td>0.36%</td>
<td>$50</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>$3,700</td>
<td>10,280</td>
<td>0.36%</td>
<td>37</td>
</tr>
<tr>
<td>2022</td>
<td>3,900</td>
<td>6,380</td>
<td>0.36%</td>
<td>23</td>
</tr>
<tr>
<td>2023</td>
<td>3,000</td>
<td>3,380</td>
<td>0.36%</td>
<td>12</td>
</tr>
<tr>
<td>2024</td>
<td>2,160</td>
<td>1,220</td>
<td>0.36%</td>
<td>4</td>
</tr>
<tr>
<td>2025</td>
<td>1,220</td>
<td>—</td>
<td>0.36%</td>
<td>—</td>
</tr>
</tbody>
</table>

Est. unadjusted charge-off amount for remaining balance 126

**Paydown & amortized cost balances in thousands**

Unadjusted historical charge-off rate for remaining balance 0.90%

Qualitative Adjustment 0.25%

Total allowance for credit losses rate as of 2020 1.15%

Total allowance of credit losses as of 2020 ($13,980 × 1.15%) 161

In Table 2 above:

1. First column titled “Year End” displays subsequent years, until 2025, which represents the time anticipated for the pool to be paid off.
2. Second column titled “Est. Paydown” represents expected payments in the future periods until the pool is expected to fully pay off. Management will need to estimate the future paydowns, which includes the scheduled payments + prepayments.
FASB Staff Q&A (continued)

3. Third column titled “Projected Amort Cost”:
   b. Subtract projected paydowns from the “Est. Paydown” column to estimate future projected amortized cost for each of the remaining years of the pool’s life (for example, $13,980M minus $3,700M equals $10,280M).

4. Fifth column titled “Allowance for Credit Losses”:
   a. Take each of the future years’ projected amortized cost and multiply by the average annual charge-off rate, thereby estimating each of the remaining years’ losses and aggregating to estimate the cumulative losses (for example, in the first year, $13.98MM of amortized cost is multiplied by the average annual charge-off rate of 0.36% for a first year’s credit loss estimate of $50K dollars).
   b. For the second year, which is 2022, the $10.28MM representing the ending balance as of 2021 and the beginning balance as of 2022 is multiplied by the average annual charge-off rate of 0.36% to estimate the second year’s credit losses of $37K dollars. This process is repeated for each remaining year.
   c. Sum the last column to estimate the total expected credit losses of $126K dollars.

Note: Do not include the expected credit losses in this column. Paydowns should include scheduled payments and non-credit related prepayments.

Note: Estimated prepayments are also a significant judgment that will need to be properly supported and documented.

5. Finally, add 0.25% of qualitative adjustments as an assumption established as part of the fact pattern of the example to estimate the allowance for credit losses rate of 1.15%. The 1.15% is multiplied by $13.98MM to estimate the total allowance for credit losses of $161K dollars.

Note: This is not the full allowance for credit losses because the entity has not yet accounted for current conditions and reasonable and supportable forecasts.

d. Convert $126K of expected losses into a loss rate of 0.90% by dividing $126K by the amortized cost of $13.98MM.

Note: 0.25% is a significant assumption made by management that will need to be adequately documented and supported. For this example, in accordance with paragraph 326-20-55-4, the entity considered significant factors that could affect the expected collectability of the amortized cost basis of the pool and determined that the primary factor is the unemployment rate. As part of this analysis, assume that the entity observed that the unemployment rate has increased as of the current reporting period date. Based on current conditions and reasonable and supportable forecasts, the entity expects that unemployment rates are expected to increase further over the next one to two years. To adjust the historical loss rate to reflect the effects of those differences in current conditions and forecasted changes, the entity estimates a 25-basis-point increase in credit losses incremental to the 0.9 percent historical lifetime loss rate related to the expected deterioration in unemployment rates. Management estimates that the incremental 25-basis-point increase based on its knowledge of historical loss information during past years in which there were similar trends in unemployment rates. Management is unable to support its estimate of expectations for unemployment rates beyond the reasonable and supportable forecast period. Under this loss-rate method, the incremental credit losses for the current conditions and reasonable and supportable forecast (the 25 basis points) is added to the 0.9 percent rate that serves as the basis for the expected credit loss rate. No further reversion adjustments are needed because the entity has applied a 1.15% loss rate where it has immediately reverted into historical losses that reflect the contractual term in accordance with paragraphs 326-20-30-8 through 30-9. This approach reflects an immediate reversion technique for the loss-rate method. It is important to note that the 25-basis-point increase reflects the entity’s estimate of the incremental losses in years 2021 and 2022 from unemployment and assumes no incremental losses for the remaining years. Further, the reversion technique selected by the entity is a significant assumption that will need to be supported by management and is not a policy election or practical expedient.
Connecting the Dots — Applicability of the WARM Method

The FASB staff indicated that it is acceptable to use the WARM method to estimate expected credit losses. Under that method, entities use qualitative adjustments to alleviate the operational challenges they may face when applying other loss methods. For example, in its response to Question 2 of the Q&A document, the staff suggests that such qualitative adjustments may be used to overcome “situations involving minimal loss history, losses that are sporadic with no predictive patterns, low numbers of loans in each pool, data that is only available for a short historical period, a composition that varies significantly from historical pools of financial assets, or changes in the economic environment.”

However, the FASB staff also cautions preparers that although the WARM method can be used effectively in some situations, certain “challenges will be more significant, and an entity may find that the WARM method is inappropriate for its situation.” Because the WARM method relies heavily on qualitative adjustments for which significant judgment is required, we believe that entities may discover that the costs of applying it outweigh its benefits. As a result, we do not expect many entities to apply the WARM method in practice.

4.4.6 Practical Expedients Related to Measuring Expected Credit Losses

ASC 326 permits entities to use practical expedients to measure expected credit losses for the following two types of financial assets:

- **Collateral-dependent financial assets** — In a manner consistent with its practice under existing U.S. GAAP, an entity is permitted to measure its estimate of expected credit losses for collateral-dependent financial assets as the difference between the financial asset’s amortized cost and the collateral’s fair value (adjusted for selling costs, when applicable).

- **Financial assets for which the borrower must continually adjust the amount of securing collateral (e.g., certain repurchase agreements and securities-lending arrangements)** — An entity is permitted to measure its estimate of expected credit losses on these financial assets as the difference between the amortized cost basis of the asset and the collateral’s fair value.

4.4.6.1 Collateral-Dependent Financial Assets

ASU 2016-13 does not change the U.S. GAAP guidance on determining when a financial asset is a collateral-dependent financial asset. As is consistent with previous U.S. GAAP, a financial asset is considered collateral-dependent if “repayment is expected to be provided substantially through the operation or sale of the collateral.” Furthermore, under ASC 326-20-35-4, and in a manner consistent with previous U.S. GAAP, an entity is required to measure the allowance for credit losses on the basis of the fair value of the collateral when it determines that foreclosure is probable.

However, ASU 2016-13 does change an entity’s ability to measure the allowance for credit losses on a collateral-dependent financial asset when foreclosure is not probable. Under previous U.S. GAAP, an entity could elect, as a practical expedient, to measure the allowance for credit losses on a collateral-dependent financial asset that is impaired on the basis of the collateral’s fair value in any circumstance. By contrast, ASC 326-20-35-5 indicates that if foreclosure is not probable, an entity can elect to use such a practical expedient for collateral-dependent financial assets only “when the borrower is experiencing financial difficulty based on the entity’s assessment as of the reporting date.” The phrase “when the borrower is experiencing financial difficulty” is consistent with the guidance in ASC 310-40 that an entity considers to determine whether a modification of a financial asset reflects a TDR. Therefore, the guidance in ASC 310-40 that is used to determine whether a debtor is experiencing financial difficulties is relevant to the determination of an entity’s ability to use the practical expedient for a
collateral-dependent financial asset. ASC 310-40-15-20 indicates that the following indicators should be considered in the determination of when a debtor may be experiencing financial difficulties (this list is not all-inclusive):

- a. The debtor is currently in payment default on any of its debt. In addition, a creditor shall evaluate whether it is probable that the debtor would be in payment default on any of its debt in the foreseeable future without the modification. That is, a creditor may conclude that a debtor is experiencing financial difficulties, even though the debtor is not currently in payment default.
- b. The debtor has declared or is in the process of declaring bankruptcy.
- c. There is substantial doubt as to whether the debtor will continue to be a going concern.
- d. The debtor has securities that have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange.
- e. On the basis of estimates and projections that only encompass the debtor's current capabilities, the creditor forecasts that the debtor's entity-specific cash flows will be insufficient to service any of its debt (both interest and principal) in accordance with the contractual terms of the existing agreement for the foreseeable future.
- f. Without the current modification, the debtor cannot obtain funds from sources other than the existing creditors at an effective interest rate equal to the current market interest rate for similar debt for a nontroubled debtor.

In determining when the practical expedient for collateral-dependent financial assets can be applied, an entity should also consider the FASB's rationale for changing previous U.S. GAAP to limit the application of this expedient. Since the CECL model is built on the foundation that expected credit losses are estimated over the contractual life of a financial asset, the FASB was concerned that allowing an unrestricted practical expedient for collateral-dependent financial assets could enable entities to defer the recognition of credit losses that are expected to occur over the asset's contractual life as a result of declines in the collateral's fair value. Consequently, under the new guidance, the practical expedient can only be elected if the borrower is experiencing financial difficulties, since only at this point does the collateral's fair value signify a reasonable expectation of the recoverability of the financial asset. This guidance is consistent with paragraph BC64 of ASU 2016-13, which refers to the acceptability of measuring expected credit losses on the basis of the fair value of the collateral “because fair value reflects the amount expected to be collected.” Before the point at which a debtor is experiencing financial difficulties, the collateral's fair value would not necessarily reflect the net amount of the financial asset expected to be collected because of an entity's prolonged exposure to declines in that fair value.

Entities may wish to implement accounting practices under which they perform an objective determination of when a borrower is experiencing financial difficulties (e.g., when a loan is a certain number of days past due or becomes subject to the entity's nonaccrual policy). The reasonableness of such practices would depend on the specific facts and circumstances, including the financial asset type, and any such objective evidence would need to be supplemented by qualitative considerations since an entity must use judgment and consider its particular facts and circumstances in determining when a borrower is experiencing financial difficulties.

Since ASC 326 does not require entities to use the practical expedient for collateral-dependent financial assets before foreclosure is probable, the principal risk in the application of objective evidence lies in prematurely measuring expected credit losses on the basis of the collateral's fair value. Rather, to apply this practical expedient when foreclosure is not probable, an entity must appropriately assess all relevant facts and circumstances to determine whether the borrower is experiencing financial difficulties. The entity may consider both quantitative and qualitative indicators in performing this assessment. While the mere fact that a borrower is past due on its payments would generally indicate that it is experiencing financial difficulties, this may not always be the case. For example, a borrower may be past due on a loan because of a payment delay was temporarily caused by a natural disaster or
other similar event that did not have a significant bearing on the borrower’s wherewithal to make the contractually required payments on the loan receivable.

Keep in mind that the entity is only allowed to use the practical expedient (when foreclosure is not probable) if the borrower is experiencing financial difficulty. As a result, the entity would be permitted to continue to use the practical expedient only if it concludes that the borrower continues to experience financial difficulty. In other words, the conditions related to using the practical expedient when foreclosure is not probable must be met in every reporting period. To the extent that the entity determines that the borrower is no longer experiencing financial difficulty (or that repayment will no longer be substantially provided through the collateral’s sale or operation), the entity would need to measure expected credit losses by using another appropriate measurement method discussed in ASC 326-20-30-3.

Q&A 4-20 Determining Whether Repayment Is Expected to Be Provided Solely by Collateral

Question
How does an entity determine whether repayment of a loan is expected to be provided solely by the underlying collateral?

Answer
An entity must use judgment in determining whether repayment of a loan is expected to be provided solely by the underlying collateral. On October 24, 2013, the federal financial institution regulatory agencies jointly issued “Interagency Supervisory Guidance Addressing Certain Issues Related to Troubled Debt Restructurings” (the “Interagency Guidance”), which provides the following additional interpretation of the definition of a collateral-dependent loan:

An impaired loan is collateral dependent if “repayment is expected to be provided solely by the underlying collateral,” which includes repayment from the proceeds from the sale of the collateral, cash flow from the continued operation of the collateral, or both. Whether the underlying collateral is expected to be the sole source of repayment for an impaired loan is a matter requiring judgment as to the availability, reliability, and capacity of sources other than the collateral to repay the debt. Generally, repayment of an impaired loan would be expected to be provided solely by the sale or continued operation of the underlying collateral if cash flows to repay the loan from all other available sources (including guarantors) are expected to be no more than nominal. For example, the existence of a guarantor is one factor to consider when determining whether an impaired loan, including a TDR loan, is collateral dependent. To assess the extent to which a guarantor provides repayment support, the ability and willingness of the guarantor to make more-than-nominal payments on the loan should be evaluated.

The repayment of some impaired loans collateralized by real estate may depend on cash flow generated by the operation of a business or from sources outside the scope of the lender’s security interest in the collateral, such as cash flows from borrower resources other than the collateral. These loans are generally not considered collateral dependent due to the more-than-nominal payments expected to come from these other repayment sources. For such loans, even if a portion of the cash flow for repayment is expected to come from the sale or operation of the collateral (but not solely from the sale or operation of the collateral), the loan would not be considered collateral dependent.

For example, an impaired loan collateralized by an apartment building, shopping mall, or other income-producing property where the anticipated cash flows for loan repayment are expected to be derived solely from the property’s rental income, and there are no other available and reliable repayment sources, would be considered collateral dependent because repayment is expected to be provided only from the continued operation of the collateral. However, an impaired loan secured

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8 The Interagency Guidance was jointly issued by the Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, and the OCC.
by the owner-occupied real estate of a business (such as a manufacturer or retail store) where the anticipated cash flows to repay the loan are expected to be derived from the borrower’s ongoing business operations and activities would not be considered collateral dependent because the loan is not expected to be repaid solely from cash flows from the sale or operation of the collateral. Nevertheless, if the borrower’s condition worsens so that any payments from the operation of the business are expected to be nominal and repayment instead is expected to depend solely on the sale or operation of the underlying collateral, the loan would then be considered collateral dependent. [Footnotes omitted]

Under this guidance, a loan would be collateral-dependent if it is a nonrecourse loan and the creditor expects to foreclose on it, because in such circumstances, the creditor may only look to the collateral for satisfaction of the loan. Conversely, if the creditor is unsure whether it will foreclose on the collateral, the loan would not be considered collateral-dependent unless it is expected to be repaid solely through the continued operation of the collateral.9

However, if the loan is collateralized by real estate and the creditor has recourse to the general credit of the borrower or to a guarantor, the assessment is less clear. The creditor would need to (1) consider whether the borrower’s financial ability to satisfy the obligation would include repayment sources other than the collateral and (2) formulate an expectation regarding the borrower’s future actions. If a debtor has no means of repaying the loan other than through operation of the collateral, the creditor should conclude that the loan is collateral-dependent. However, if more-than-nominal payments are expected to come from other repayment sources, the loan would generally not be considered collateral-dependent. A similar assessment should be performed when a source of repayment may come from a guarantor. The ability and willingness of a guarantor to make more-than-nominal payments on a loan would result in a conclusion that the loan is not collateral-dependent.

Q&A 4-21 Considering Collateral Values in the Measurement of Expected Credit Losses

For collateral-dependent financial assets, ASC 326-20-35-4 requires an entity to measure expected credit losses on the basis of the collateral's fair value if the entity determines that foreclosure is probable.

Question

If a financial asset does not qualify for the practical expedient for collateral-dependent financial assets, is the collateral value irrelevant to the estimate of expected credit losses on the financial asset?

Answer

No. ASC 326-20-30-10 states, in part:

Except for the circumstances described in paragraphs 326-20-35-4 through 35-6, an entity shall not expect nonpayment of the amortized cost basis to be zero solely on the basis of the current value of collateral securing the financial asset(s) but, instead, also shall consider the nature of the collateral, potential future changes in collateral values, and historical loss information for financial assets secured with similar collateral.

9 As indicated in the examples in the Interagency Guidance, an entity must use judgment and consider the specific facts and circumstances, including the nature and functionality of the underlying collateral, in determining whether a loan is expected to be repaid solely through continued operation of the collateral. In OCC Supervisory Memorandum No. 2009-7, the OCC indicated that “[r]esidential real estate loan modifications without evidence of a sustained repayment capacity or cash flows from the borrower rely on the underlying collateral as the sole source of repayment and, as such, would likely be deemed collateral-dependent upon modification.”
Accordingly, if the practical expedient for collateral-dependent financial assets in ASC 326-20-35-5 is not applied, an entity should consider, among other factors that may affect expected credit losses on the financial asset (or group of similar financial assets), how the collateral's fair value may affect the estimation of such losses over the contractual life of the financial asset (or group of financial assets). If the practical expedient is not applied, an entity cannot measure the allowance for credit losses solely on the basis of the reporting-date fair value of the collateral or avoid recognizing an allowance for credit losses solely because the reporting-date fair value of the collateral equals or exceeds the amortized cost basis of the financial asset (or group of financial assets).

Nevertheless, the collateral security on a financial asset would be expected to affect an entity's estimation of expected credit losses. In this regard, as discussed in ASC 326-20-30-10, an entity should consider the nature of the collateral (including the nature of the security and the seniority thereon), potential future changes in the collateral's fair value, and historical losses (adjusted for current conditions and reasonable and supportable forecasts) for financial assets secured with similar collateral. ASC 326-20-55-15 further indicates that debt-to-value ratios and collateral affect the credit quality indicators that are pertinent to financial assets. Accordingly, the collateral securing a financial asset is likely to have an impact on both the probability of default and the loss-given default on the financial asset.

If the practical expedient for collateral-dependent financial assets is not applied, there could potentially be no allowance for credit losses on financial assets, although such situations are not typical. Paragraph BC63 of ASU 2016-13 states:

The Board decided that an entity should consider the expected risk of loss, even if that risk is remote, and that an entity need not measure an expected credit loss when historical information adjusted for current conditions and reasonable and supportable forecasts results in an expectation that the risk of nonpayment of the amortized cost basis is zero. The Board decided not to explicitly state which financial assets are appropriate to have a zero allowance for expected credit losses. The Board understands that an expectation of zero loss is entirely based on the nature and characteristics of a financial asset, which may change over time. As a result, the Board concluded that a “bright-line” approach would be inappropriate for all facts and circumstances and decided not to provide explicit guidance on what specific assets are appropriate for zero expected credit losses. The Board decided that an entity should determine at the reporting date an estimate of credit loss that best reflects its expectations (or its best estimate of expected credit loss).

For example, it may be appropriate not to recognize an allowance for credit losses on certain secured financial assets in which the loan-to-value ratio is so low that it reduces the expected credit losses to zero. To make such a determination, an entity would need to appropriately consider the relevant facts and circumstances, including, but not limited to, the following:

- The remaining contractual term of the financial asset (and, if relevant, the entity's ability to call the financial asset upon a decline in the collateral's fair value).
- The nature of the collateral.
- The nature and terms of the security (including any subordination provided by other interests in the collateral).
- Past experience with similar collateralized financial assets.
- Current conditions and reasonable and supportable forecasts that may affect the prior historical loss information (e.g., potential reasonable and supportable declines in the

\[\text{Equation}\]

Other factors that can affect an entity's estimation of expected credit losses may include estimated prepayments on the financial asset (or group of financial assets) and expected repayments that may be received from sources other than the collateral (e.g., general recourse to the borrower or an embedded credit enhancement provided by a third-party guarantor).
fair value of the collateral that have not occurred in the past). An entity is not required to consider extremely remote scenarios but should consider those that are reasonably possible.

However, if an entity is aware of a historical default on a particular asset or an asset with similar risk characteristics, regardless of whether the asset was held by the entity or another entity, it would be difficult for the entity to conclude that it is not required to recognize an allowance for credit losses for that asset or asset class. In addition, an entity should consider that paragraph BC71 of ASU 2016-13 states, in part, that “it would be inappropriate to measure credit losses for financial assets on an individual basis to arrive at a zero expected credit loss when a pool of financial assets with similar risk characteristics exists that would indicate otherwise.”

**Q&A 4-22 Consideration of Costs to Sell When Foreclosure Is Probable**

*Question*

In estimating expected credit losses, should an entity that believes foreclosure is probable consider the costs to sell the collateral securing the financial asset?

*Answer*

Yes. ASU 2019-04 amended ASC 326-20-35-4 to clarify that an entity is required to adjust the fair value of the collateral by the estimated costs to sell if it intends to sell rather than operate the collateral when it determines that foreclosure on a financial asset is probable.

### 4.4.6.2 Collateral Maintenance Provisions

<table>
<thead>
<tr>
<th>ASC 326-20</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>35-6</strong> For certain financial assets, the borrower may be contractually required to continually adjust the amount of the collateral securing the financial asset(s) as a result of fair value changes in the collateral. In those situations, if an entity reasonably expects the borrower to continue to replenish the collateral to meet the requirements of the contract, an entity may use, as a practical expedient, a method that compares the amortized cost basis with the fair value of collateral at the reporting date to measure the estimate of expected credit losses. An entity may determine that the expectation of nonpayment of the amortized cost basis is zero if the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset and the entity reasonably expects the borrower to continue to replenish the collateral as necessary to meet the requirements of the contract. If the fair value of the collateral at the reporting date is less than the amortized cost basis of the financial asset and the entity reasonably expects the borrower to continue to replenish the collateral as necessary to meet the requirements of the contract, the entity shall estimate expected credit losses for the unsecured amount of the amortized cost basis. The allowance for credit losses on the financial asset is limited to the difference between the fair value of the collateral at the reporting date and the amortized cost basis of the financial asset.</td>
</tr>
</tbody>
</table>

In arrangements in which the borrower must continually adjust the collateral securing the asset to reflect changes in the collateral’s fair value (e.g., reverse repurchase arrangements), the entity is permitted to measure its estimate of expected credit losses on these financial assets only on the basis of the unsecured portion of the amortized cost as of the balance sheet date (i.e., the difference between the amortized cost basis of the asset and the collateral’s fair value). In such arrangements, the entity must reasonably expect that the borrower will continue to replenish the collateral as necessary. Under the practical expedient for the collateral maintenance provision, the entity may assume that there will be zero losses on the portion of the asset's amortized basis that is equal to the fair value of the collateral as of the balance sheet date. If the fair value of the collateral is equal to or greater than the amortized
cost of the asset, the expected losses would be zero. If the fair value of the collateral is less than the amortized cost of the asset, the expected losses are limited to the difference between the fair value of the collateral and the amortized cost basis of the asset. Example 7 in ASC 326-20 illustrates application of this practical expedient.

**ASC 326-20**


**55-45** This Example illustrates one way an entity may implement the guidance in paragraph 326-20-35-6 for estimating expected credit losses on financial assets with collateral maintenance provisions.

**55-46** Bank H enters into a reverse repurchase agreement with Entity I that is in need of short-term financing. Under the terms of the agreement, Entity I sells securities to Bank H with the expectation that it will repurchase those securities for a certain price on an agreed-upon date. In addition, the agreement contains a provision that requires Entity I to provide security collateral that is valued daily, and the amount of the collateral is adjusted up or down to reflect changes in the fair value of the underlying securities transferred. This collateral maintenance provision is designed to ensure that at any point during the arrangement, the fair value of the collateral continually equals or is greater than the amortized cost basis of the reverse repurchase agreement.

**55-47** At the end of the first reporting period after entering into the agreement with Entity I, Bank H evaluates the reverse repurchase agreement's collateral maintenance provision to determine whether it can use the practical expedient in accordance with paragraph 326-20-35-6 for estimating expected credit losses. Bank H determines that although there is a risk that Entity I may default, Bank H's expectation of nonpayment of the amortized cost basis on the reverse repurchase agreement is zero because Entity I continually adjusts the amount of collateral such that the fair value of the collateral is always equal to or greater than the amortized cost basis of the reverse repurchase agreement. In addition, Bank H continually monitors that Entity I adheres to the collateral maintenance provision. As a result, Bank H uses the practical expedient in paragraph 326-20-35-6 and does not record expected credit losses at the end of the first reporting period because the fair value of the security collateral is greater than the amortized cost basis of the reverse repurchase agreement. Bank H performs a reassessment of the fair value of collateral in relation to the amortized cost basis each reporting period.

**Q&A 4-23 Frequency of Collateral Replenishment**

ASC 326-20-35-6 states that “[a]n entity may determine that the expectation of nonpayment of the amortized cost basis is zero if the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset and the entity reasonably expects the borrower to continue to replenish the collateral."

**Question**

To use the practical expedient, must a borrower replenish collateral on a daily basis to meet the condition that it continually replenish the collateral?

**Answer**

It depends. The guidance is not clear on how frequently an entity must post additional collateral. While “continually” may mean that the replenishment must occur on a daily basis, certain arrangements require that collateral be replenished only if a specific minimum threshold is reached (i.e., if the change in the fair value of the collateral is greater than a specified amount). In such arrangements, the requirements to use the practical expedient would never be met, which we believe was not the FASB’s intent. Therefore, we think that an entity should use
judgment when evaluating the terms of the arrangement with respect to posting additional collateral. In performing this evaluation, the entity should consider whether there are certain situations in which the posting of additional collateral is either required or prohibited when a specified threshold is reached.

In addition, we believe that the entity should also consider the collateral’s nature as well as how frequently it evaluates the collateral’s adequacy. The adequacy of the collateral’s value should be evaluated continually, even daily. If the evaluation is performed less frequently than daily, we believe that it would be more difficult for the entity to support its use of the practical expedient. Furthermore, the entity should consider the nature of the collateral because the more liquid and observable the collateral’s value is, the easier it is to support the collateral’s adequacy in the arrangement. The less liquid and observable the value of the collateral is (e.g., Level 3 for fair value disclosure purposes), the harder it will be for the entity to demonstrate that it has evaluated the adequacy of the collateral in attempting to qualify to use the practical expedient.

4.4.7 U.S. Treasury Securities and Other Highly Rated Debt Instruments

ASC 326-20

Example 8: Estimating Expected Credit Losses When Potential Default Is Greater Than Zero, but Expected Nonpayment Is Zero

55-48 This Example illustrates one way, but not the only way, an entity may estimate expected credit losses when the expectation of nonpayment is zero. This example is not intended to be only applicable to U.S. Treasury securities.

55-49 Entity J invests in U.S. Treasury securities with the intent to hold them to collect contractual cash flows to maturity. As a result, Entity J classifies its U.S. Treasury securities as held to maturity and measures the securities on an amortized cost basis.

55-50 Although U.S. Treasury securities often receive the highest credit rating by rating agencies at the end of the reporting period, Entity J’s management still believes that there is a possibility of default, even if that risk is remote. However, Entity J considers the guidance in paragraph 326-20-30-10 and concludes that the long history with no credit losses for U.S. Treasury securities (adjusted for current conditions and reasonable and supportable forecasts) indicates an expectation that nonpayment of the amortized cost basis is zero, even if the U.S. government were to technically default. Judgment is required to determine the nature, depth, and extent of the analysis required to evaluate the effect of current conditions and reasonable and supportable forecasts on the historical credit loss information, including qualitative factors. In this circumstance, Entity J notes that U.S. Treasury securities are explicitly fully guaranteed by a sovereign entity that can print its own currency and that the sovereign entity’s currency is routinely held by central banks and other major financial institutions, is used in international commerce, and commonly is viewed as a reserve currency, all of which qualitatively indicate that historical credit loss information should be minimally affected by current conditions and reasonable and supportable forecasts. Therefore, Entity J does not record expected credit losses for its U.S. Treasury securities at the end of the reporting period. The qualitative factors considered by Entity J in this Example are not an all-inclusive list of conditions that must be met in order to apply the guidance in paragraph 326-20-30-10.

ASC 326-20-30-10 states that “an entity is not required to measure expected credit losses on a financial asset . . . in which historical credit loss information adjusted for current conditions and reasonable and supportable forecasts results in an expectation that nonpayment of the [financial asset’s] amortized cost basis is zero.” On the basis of Example 8 in ASC 326-20-55-48 through 55-50, we believe that the FASB may have contemplated U.S. Treasury securities and other similar financial assets when it decided to allow an entity to recognize zero credit losses on an asset.
Keep in mind, however, that the FASB did not specifically exclude certain financial assets from the scope of the CECL model on the basis of the level of an asset’s credit risk. Rather, Example 8 illustrates that although it may be easy to conclude that the risk of nonpayment is zero on a U.S. Treasury security, the entity should still apply the CECL model to financial assets, even if the risk of loss associated with those assets is low. Consequently, the entity should apply the CECL model consistently to all of its financial assets regardless of the credit risk associated with each asset. That is, the entity should measure expected credit losses by considering all available relevant information, including details about past events, current conditions, and reasonable and supportable forecasts and their implications related to such losses.

Connecting the Dots — Zero Expected Losses

While the FASB did not explicitly exclude specific assets from the CECL model (other than by illustrating that an entity may conclude that the allowance on a U.S. Treasury security could be zero), the AICPA has published guidance indicating that an entity can expect zero losses on U.S. Treasury securities, Government National Mortgage Association (Ginnie Mae) mortgage-backed securities, and agency mortgage-backed securities (Fannie Mae and Freddie Mac). In reaching its conclusion, the AICPA compared indicators that would cause the entity to incur zero losses with indicators that would cause the entity to incur losses greater than zero. While none of the indicators are individually determinative, the comparison illustrated that, in the current economic environment, there was sufficient evidence that the entity could expect zero losses on the financial assets considered.

4.5 Write-Offs and Recoveries

<table>
<thead>
<tr>
<th>ASC 326-20</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>35-8</strong></td>
</tr>
<tr>
<td><strong>35-8A</strong></td>
</tr>
</tbody>
</table>

4.5.1 Write-Offs

The write-off guidance in ASC 326-20-35-8 and 35-8A is similar to the existing guidance in U.S. GAAP. That is, an entity is required to write off a financial asset when it is “deemed uncollectible.” However, unlike existing GAAP, the write-off guidance now applies to HTM and AFS debt securities (see Section 7.2.4 for a discussion specific to AFS debt securities). As a result, an entity will need to develop a process to determine whether an HTM debt security is uncollectible. This process would be similar to the process the entity uses to determine that other financial assets measured at amortized cost are deemed uncollectible.

4.5.2 Recoveries

Under ASU 2016-13, as originally issued, an entity was required to record recoveries (1) when they are received and (2) as a direct adjustment to earnings or as a reduction to the allowance for credit losses. While ASC 326-20-35-8 provided guidance on when and how to recognize recoveries, the guidance was unclear on whether an entity is required to consider expected recoveries in determining its allowance for expected credit losses. Further, although ASC 326-20-30-1 originally required entities to present the
net amount expected to be collected on a financial asset, ASC 326-20-35-8 appeared to conflict with this guidance because it required an entity to reflect recoveries in the carrying amount of the financial asset only when the entity receives the recovered amounts.

As a result, in ASU 2019-04, the FASB clarifies that an entity should consider recoveries in its allowance for expected credit losses. Specifically, ASC 326-20-30-1, as amended by ASU 2019-04, states that “[e]xpected recoveries of amounts previously written off and expected to be written off shall be included in the valuation account and shall not exceed the aggregate of amounts previously written off and expected to be written off by an entity.” As a result:

- Entities should include expected recoveries within the allowance for expected credit losses and should not directly write up the related assets.
- Because an entity recognizes expected recoveries as an adjustment to the allowance for expected credit losses, the allowance may have a negative balance in situations in which a full or partial write-off has occurred.
- Expected recoveries should not exceed the aggregate of amounts previously written off and amounts that are expected to be written off by the entity.

Example 9 in ASC 326-20 illustrates an entity’s accounting for a recovery of an amount previously written off.

**ASC 326-20**

**Example 9: Recognizing Writeoffs and Recoveries**

55-51 This Example illustrates how an entity may implement the guidance in paragraphs 326-20-35-8 through 35-9 relating to writeoffs and recoveries of expected credit losses on financial assets.

55-52 Bank K currently evaluates its loan to Entity L on an individual basis because Entity L is 90 days past due on its loan payments and the loan no longer exhibits similar risk characteristics with other loans in the portfolio. At the end of December 31, 20X3, the amortized cost basis for Entity L’s loan is $500,000 with an allowance for credit losses of $375,000. During the first quarter of 20X4, Entity L issues a press release stating that it is filing for bankruptcy. Bank K determines that the $500,000 loan made to Entity L is uncollectible. Bank K considers all available information that is relevant and reasonably available, without undue cost or effort, and determines that the information does not support an expectation of a future recovery in accordance with paragraph 326-20-30-7. Bank K measures a full credit loss on the loan to Entity L and writes off its entire loan balance in accordance with paragraph 326-20-35-8, as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit loss expense</td>
<td>$125,000</td>
</tr>
<tr>
<td>Allowance for credit losses</td>
<td>$125,000</td>
</tr>
<tr>
<td>Allowance for credit losses</td>
<td>$500,000</td>
</tr>
<tr>
<td>Loan receivable</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

During March 20X6, Bank K receives a partial payment of $50,000 from Entity L for the loan previously written off. Upon receipt of the payment, Bank K recognizes the recovery in accordance with paragraph 326-20-35-8, as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$50,000</td>
</tr>
<tr>
<td>Allowance for credit losses (recovery)</td>
<td>$50,000</td>
</tr>
</tbody>
</table>
For its March 31, 20X6 financial statements, Bank K estimates expected credit losses on its financial assets and determines that the current estimate is consistent with the estimate at the end of the previous reporting period. During the period, Bank K does not record any change to its allowance for credit losses account other than the recovery of the loan to Entity L. To adjust its allowance for credit losses to reflect the current estimate, Bank K reports the following on March 31, 20X6:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance for credit losses</td>
<td>$50,000</td>
</tr>
<tr>
<td>Credit loss expense</td>
<td>$50,000</td>
</tr>
</tbody>
</table>

Alternatively, Bank K could record the recovery of $50,000 directly as a reduction to credit loss expense, rather than initially recording the cash received against the allowance.

Q&A 4-24   Expected Recoveries and Contractual Interest

Question
When estimating expected credit losses in accordance with ASC 326-20-30-1 by using a method other than a DCF method, is an entity allowed to consider expected recoveries of contractual interest before that interest has been accrued?

Answer
No. Contractual interest that the entity has not accrued would not meet the condition described in ASC 326-20-30-1, which indicates that an entity’s estimated recoveries are limited to “amounts previously written off and expected to be written off.”

Q&A 4-25   Considering Recoveries When Foreclosure Is Probable

Question
If foreclosure on a collateral-dependent financial asset is probable, is an entity allowed to adjust its estimate of expected credit losses (determined on the basis of the fair value of the collateral) for any expected recoveries if the entity has a history of collecting payment after foreclosure or repossession?

Answer
No. ASC 326-20-35-4 indicates that when foreclosure on a collateral-dependent financial asset is probable, an entity measures the estimate of expected credit losses as the difference between the financial asset’s amortized cost and the collateral’s fair value (adjusted for selling costs, when applicable). Once the entity is using fair value to measure the estimate of expected credit losses in accordance with ASC 326-20-35-4, it must not adjust the fair value by any amounts (other than selling costs), including expected recoveries.
4.6  Credit Enhancements

**ASC 326-20**

30-12 The estimate of expected credit losses shall reflect how credit enhancements (other than those that are freestanding contracts) mitigate expected credit losses on financial assets, including consideration of the financial condition of the guarantor, the willingness of the guarantor to pay, and/or whether any subordinated interests are expected to be capable of absorbing credit losses on any underlying financial assets. However, when estimating expected credit losses, an entity shall not combine a financial asset with a separate freestanding contract that serves to mitigate credit loss. As a result, the estimate of expected credit losses on a financial asset (or group of financial assets) shall not be offset by a freestanding contract (for example, a purchased credit-default swap) that may mitigate expected credit losses on the financial asset (or group of financial assets).

Among other factors that may affect expected credit losses on a financial asset (or group of similar financial assets), an entity should consider whether the asset includes an embedded credit enhancement provided by a third-party guarantor (e.g., private mortgage insurance). In determining whether an enhancement feature is embedded or freestanding, an entity must consider the following definition of a freestanding contract in the ASC master glossary:

A freestanding contract is entered into either:

- a. Separate and apart from any of the entity’s other financial instruments or equity transactions
- b. In conjunction with some other transaction and is legally detachable and separately exercisable.

If the financial asset includes an embedded credit enhancement feature, the entity should consider how the cash flows associated with such a feature should be incorporated into the expectation of cash flows that are recoverable on the financial asset. By contrast, the entity must not consider cash flows associated with a freestanding credit enhancement contract (e.g., credit insurance purchased by the entity, including credit default swaps) even though the objective of obtaining such a contract is the same as if it were embedded in the financial asset (i.e., to mitigate credit exposure). To avoid double counting, an entity is prohibited from considering the effects of a freestanding credit enhancement feature when estimating expected credit losses. For example, the cash flows from a credit default swap that is a credit enhancement of a loan asset should not be included in the measurement of expected credit losses because such a swap would be recognized separately as a derivative financial instrument. Even if the freestanding credit insurance is not accounted for as a derivative, cash flows from freestanding credit insurance should not be considered in the estimation of expected losses on the related “covered” assets.

4.6.1  Freestanding Credit Insurance and Other Credit Risk Mitigation Contracts

Although ASC 326-20 is clear that an entity must not consider cash flows associated with a freestanding credit enhancement contract when estimating its expected credit losses, questions have arisen regarding how an entity must account for these freestanding contracts. ASC 326-20 does not address freestanding contracts that mitigate credit risk on financial assets.

To address these questions, the FASB staff stated, in response to a technical inquiry, that it would be appropriate for an entity that is applying ASU 2016-13 to recognize an insurance recovery asset on a freestanding credit insurance contract at the time expected credit losses are recorded. The staff also noted that there may be other acceptable approaches to recognizing freestanding contracts, including recognition of the insurance recovery asset on an incurred basis. However, the staff clarified that its views on freestanding contracts pertain only to contracts that (1) qualify for the scope exception in ASC
815-10-15-13(c) or (d) related to applying derivative accounting and (2) pass the risk transfer test in ASC 340-30 and ASC 944-20.

**Connecting the Dots — Recording the Recovery Asset**

We believe that, in accounting for recoveries from freestanding insurance contracts, it is appropriate for entities to analogize to the guidance on indemnification assets in ASC 805. That guidance requires entities to measure an indemnification asset on the same basis as the indemnified item.

An approach in which a recovery asset is recorded at the same time an expected credit loss is recorded in earnings under ASC 326 is generally referred to as the “mirror image approach.” Under the mirror image approach, the expected recovery asset would be measured in a manner consistent with the expected credit loss; accordingly, the accounting for the insured instruments would be “matched” and the economics of the arrangement would be reflected. Further, the credit insurance recovery asset would be estimated by using the same assumptions as the loss estimate on the underlying assets and would result in the recording of equal amounts for the allowance for loan losses and the credit insurance recovery asset (provided that the insurance covered the full amount of the expected credit loss). Therefore, an entity would most likely recognize in earnings a “day one recovery of expected credit losses” on purchased credit insurance.

Keep in mind, however, that ASC 326-20 applies to the insurance recovery asset recognized on a freestanding insurance contract. That is, just as expected credit losses must be measured on a reinsurance receivable, an entity must measure expected credit losses on an insurance recovery asset.

Although the credit insurance recovery asset is measured by using assumptions that are consistent with those used to estimate expected credit losses, the credit insurance recovery asset should not be presented net or offset against the allowance for credit losses related to the insured instruments. Moreover, the amounts recorded in the income statement in connection with the credit insurance recovery asset should not be presented net against the related credit loss expense.

**4.7 Considerations Related to TDRs Under ASC 326**

ASU 2016-13 does not affect the guidance in ASC 310-40 on identifying whether a modification is a TDR. That is, an entity would still continue to apply the guidance in ASC 310-40-15-5 that states that “[a] restructuring of a debt constitutes a troubled debt restructuring . . . if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.” Consequently, the CECL model will not affect an entity's (1) process for determining whether a concession has been granted to the borrower as part of a modification, (2) analysis of whether the borrower is experiencing financial difficulty, and (3) accounting for the TDR on an individual loan basis.¹¹

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¹¹ Section 4013 of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) provides temporary relief from the accounting and reporting requirements for TDRs with respect to certain loan modifications related to coronavirus disease 2019 (“COVID-19”) that are offered by insured depository institutions and credit unions. See Section 10.3.5.3 for more information.
However, when discussing how an entity must estimate expected credit losses over the asset's contractual life, ASC 326-20-30-6 states, in part:

An entity shall not extend the contractual term for expected extensions, renewals, and modifications unless either of the following applies:

a. The entity has a reasonable expectation at the reporting date that it will execute a troubled debt restructuring with the borrower.

b. The extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.

Given this guidance, stakeholders have asked questions regarding the nature of TDRs that an entity must consider in making the estimate (e.g., contractual term extensions, interest rate concessions), when and how to consider TDRs in making the estimate, and whether to consider reasonably expected TDRs on a portfolio basis or at the level of the individual financial asset.

These issues were initially addressed by the TRG at its June 2017 meeting and were later discussed by the FASB at its September 6, 2017, meeting. At that meeting, the Board indicated that ASU 2016-13's new guidance was intended to accelerate the recognition of an economic concession granted in a TDR from when the TDR is executed (as required under existing U.S. GAAP) to when the TDR is reasonably expected. As a result, the Board clarified that the allowance for expected credit losses should include all effects of a TDR when an individual asset can be specifically identified as a reasonably expected TDR.

In addition, the FASB acknowledged that depending on the nature of the economic concession granted in a TDR and the method used by an entity to measure the allowance for expected credit losses, such an allowance may not include the effects of the concession. For example, an entity's allowance for expected credit losses may not include the effects of an interest rate concession if the entity measures the allowance by using a principal-only loss rate approach. Because ASU 2016-13 requires an entity to include all effects of TDRs in its allowance for expected credit losses, the FASB indicated that an entity must use a DCF method or a reconcilable method if the TDR involves a concession that can only be measured by using a DCF method (e.g., an interest rate or term concession).

Q&A 4-26  Measuring Credit Losses on a TDR

Under current U.S. GAAP, an entity is required to measure credit losses on a TDR by using a DCF method on an individual financial asset basis.

Question

Is an entity also required to measure expected credit losses on a TDR on an individual asset basis under the guidance in ASU 2016-13?

Answer

It depends. While the allowance for expected credit losses on a TDR comprises losses expected as a result of providing a concession from the restructuring, it also includes losses expected after the restructuring occurs. As a result, the unit of account in the measurement of expected credit losses on a TDR is no different from the unit of account required for all other assets measured at amortized cost (see Section 3.2 for more information). That is, an entity is required to evaluate expected credit losses on TDRs on a collective (i.e., pool) basis if the TDRs share similar risk characteristics. If a TDR's risk characteristics are not similar to those of any of the other TDRs, then the entity must evaluate the expected credit losses on an individual asset basis.
entity’s other TDRs, the entity would be required to measure the expected losses on the TDR individually. Paragraph BC105 of ASU 2016-13 addresses the Board’s rationale for its decision about the unit of account for TDRs:

Separately, the Board rejected an approach that would have required expected credit losses on troubled debt restructurings to always be measured by using a discounted cash flow method on an individual basis because such a requirement would be inconsistent with the ability to estimate expected credit losses using approaches other than a discounted cash flow method for assets measured at amortized cost. This decision allows entities to assess credit risk on troubled debt restructurings individually, or in a pool using other expected credit loss methods such as loss rates. Entities may provide modification programs to troubled borrowers that meet certain characteristics of financial difficulties, such that the loan modifications may be easily pooled together to assess credit risk. To the extent that those estimates may be more easily determinable with approaches other than the discounted cash flow method, the Board preferred to provide that flexibility.

Q&A 4-27  Measurement Approaches for TDRs

Question
Does an entity have the same flexibility when choosing credit loss measurement approaches for TDRs as it does when choosing credit loss measurement approaches for assets that are not determined to be TDRs?

Answer
Generally, yes. Paragraph BC105 of ASU 2016-13 states that “the Board rejected an approach that would have required expected credit losses on troubled debt restructurings to always be measured by using a discounted cash flow method . . . because such a requirement would be inconsistent with the ability to estimate expected credit losses using approaches other than a discounted cash flow method for assets measured at amortized cost.” However, the FASB acknowledged that depending on the nature of the economic concession granted in a TDR and the method an entity uses to measure the allowance for expected credit losses, such an allowance may not include the effects of the concession. For example, an entity’s allowance for expected credit losses may not include the effects of an interest rate concession if the entity measures the allowance by using a principal-only loss rate approach. Because ASU 2016-13 requires an entity to include all effects of TDRs in its allowance for expected credit losses, the FASB indicated that an entity must use a DCF method or a reconcilable method if the TDR involves a concession that can only be measured by using a DCF method (e.g., an interest rate or term concession).

In addition, under ASC 326-20-35-4, when an entity determines that foreclosure of the collateral is probable, the entity must measure the allowance for credit losses on the basis of the fair value of the collateral (see Section 4.4.6.1 for more information about collateral-dependent financial assets).

Q&A 4-28  TDR as a New Loan

Under current U.S. GAAP, an entity is not permitted to treat a TDR as a new loan.

Question
Under ASU 2016-13, can an entity treat a TDR as a new loan and recognize it at fair value?
Answer

No. A TDR cannot be considered a new loan under ASU 2016-13. ASC 310-40-35-10 states that “[a] loan restructured in a troubled debt restructuring shall not be accounted for as a new loan because a troubled debt restructuring is part of a creditor’s ongoing effort to recover its investment in the original loan.” Therefore, an entity should not establish a new fair value for a loan restructured in a TDR. Further, ASC 310-40-35-12 reiterates that a TDR does not result in a new loan and requires that “the interest rate used to discount expected future cash flows on a restructured loan . . . be the same interest rate used to discount expected future cash flows on the original loan” and not the rate specified in the restructuring.

As discussed in paragraphs BC100 and BC101 of ASU 2016-13, a TDR is not considered to be a new loan because “the modified financial asset following a troubled debt restructuring [is] a continuation of the original financial asset.” Therefore, the Board concluded that the interest rate used is the same because, “within the context of the amortized cost framework, the effective interest rate on a financial asset following a troubled debt restructuring should be the financial asset’s pre-modification original effective interest rate (as opposed to a post-troubled-debt-restructuring modified rate).”

However, if a TDR is subsequently restructured, a financial institution should consider the September 2014 Call Report supplemental instructions issued by the Federal Financial Institutions Examination Council (FFIEC). The supplemental instructions state, in part:

When a loan has previously been modified in a troubled debt restructuring (TDR), the lending institution and the borrower may subsequently enter into another restructuring agreement. The facts and circumstances of each subsequent restructuring of a TDR loan should be carefully evaluated to determine the appropriate accounting by the institution under U.S. [GAAP]. Under certain circumstances it may be acceptable not to account for the subsequently restructured loan as a TDR. The federal financial institution regulatory agencies will not object to an institution no longer treating such a loan as a TDR if at the time of the subsequent restructuring the borrower is not experiencing financial difficulties and, under the terms of the subsequent restructuring agreement, no concession has been granted by the institution to the borrower. To meet these conditions for removing the TDR designation, the subsequent restructuring agreement must specify market terms, including a contractual interest rate not less than a market interest rate for new debt with similar credit risk characteristics and other terms no less favorable to the institution than those it would offer for such new debt. When assessing whether a concession has been granted by the institution, the agencies consider any principal forgiveness on a cumulative basis to be a continuing concession. When determining whether the borrower is experiencing financial difficulties, the institution's assessment of the borrower's financial condition and prospects for repayment after the restructuring should be supported by a current, well-documented credit evaluation performed at the time of the restructuring.

If at the time of the subsequent restructuring the institution appropriately demonstrates that a loan meets the conditions discussed above, the impairment on the loan need no longer be measured as a TDR in accordance with ASC Subtopic 310-10, Receivables — Overall (formerly FASB Statement No. 114), and the loan need no longer be disclosed as a TDR in the Call Report, except as noted below. Accordingly, going forward, loan impairment should be measured under ASC Subtopic 450-20, Contingencies — Loss Contingencies (formerly FASB Statement No. 5). Even though the loan need no longer be measured for impairment as a TDR or disclosed as a TDR, the recorded investment in the loan should not change at the time of the subsequent restructuring (unless cash is advanced or received). [Emphasis added]

According to the FFIEC's instructions, an entity may treat a subsequent restructuring of a TDR as a new loan if it determines that (1) at the time of the subsequent restructuring, the borrower is not experiencing financial difficulties and (2) under the terms of the subsequent restructuring agreement, the entity has not granted any concession to the borrower.
**Q&A 4-29  Reasonable Expectation of Executing a TDR**

ASC 326-20-30-6 states that an entity is not permitted to extend the contractual term unless it “has a reasonable expectation at the reporting date that it will execute a troubled debt restructuring.”

**Question**

How does an entity determine whether it has a reasonable expectation of executing a TDR?

**Answer**

An entity must use judgment in determining whether it reasonably expects to execute a TDR. Although the Board indicated that the new guidance in ASU 2016-13 was intended to accelerate the recognition of an economic concession granted in a TDR from when the TDR is executed (as required under previous U.S. GAAP) to when the TDR is reasonably expected, ASU 2016-13 does not provide guidance on how an entity may conclude whether it reasonably expects to execute a TDR. Nonetheless, we generally believe that a logical interpretation of the phrase “reasonable expectation” would be to consider the point at which the lender internally decides to offer a modification to the borrower to maximize its recovery of cash flows. Keep in mind that this could occur before a borrower agrees to the modified terms or even before it is presented with these terms.

**Example**

**Assessing Reasonable Expectation of Executing a TDR — Trial Modification Programs**

Entity A believes that the best way to maximize the return on a loan is to offer a trial modification to certain qualifying borrowers that are experiencing financial difficulty. Under the trial modification program, A will accept terms that differ from the contractual terms of the loan for a trial period (e.g., three months). If the borrower is able to comply with the terms of the trial modification (e.g., make the modified payments for the required period), A is required to permanently replace the loan’s original contractual terms with the terms of the trial modification. However, if the borrower is not able to comply with the terms of the trial modification, A is not required to permanently replace the loan’s original contractual terms with the terms of the trial modification and may seek payment of the amounts that are past due in accordance with the contractual terms; A may also potentially consider other remedies (e.g., foreclosure).

In this example, although it is unknown whether the borrower will be able to comply with the terms of the trial modification, we believe that A’s decision to offer the trial modification is evidence that A is willing to provide a concession to the borrower to maximize its recovery of cash flows. Accordingly, we think that A would reasonably expect to execute a TDR at the time it offers the trial modification to the borrower, irrespective of whether the borrower agrees to, or complies with, the terms of the trial modification.

Note that this example is intended to describe how an entity would apply ASC 326-20-30-6 in determining when a trial modification should be considered a TDR. It is not intended to provide guidance on whether a trial modification should be considered a TDR, because all trial modifications are TDRs.
4.8 Considerations Related to Postacquisition Accounting for Acquired Loans

An entity may acquire loans in a business combination or in an asset acquisition. Loans acquired in a business combination are initially recognized at fair value in accordance with ASC 805-20-25-1. Loans acquired in an asset acquisition are initially recognized at the amount paid to the seller plus any fees paid or less any fees received in accordance with ASC 310-20-30-5. Other sections of the Codification may address the initial recognition of loans acquired in exchange for noncash consideration or loans acquired in an asset acquisition that includes other assets acquired or liabilities assumed. ASC 310 requires an investor to initially classify acquired loans as “held for investment” or “held for sale.” For more information about the reclassification of the loans, see Section 4.10.

4.8.1 Postacquisition Accounting for Acquired Loans Receivable Classified as Held for Investment

If the fair value option in ASC 825 is elected as of the acquisition date, the acquired loans are subsequently measured at fair value through earnings. Section 12.4.1 of Deloitte’s A Roadmap to Fair Value Measurements and Disclosures (Including the Fair Value Option) addresses the separate presentation of interest income when the fair value option has been elected.

If the fair value option in ASC 825 is not elected as of the acquisition date, the investor should recognize the acquired loans at amortized cost and would need to evaluate whether to apply the PCD model to the acquired loans. The PCD model applies to acquired financial assets (or acquired groups of financial assets with similar risk characteristics) that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination. See Chapter 6 for more information about the PCD model, including guidance on the recognition of income and expected credit losses on PCD assets.

If the investor determines that the PCD model does not apply to the acquired loans, the investor should subsequently account for them by applying the following guidance in ASC 310-20 and ASC 326-20 on income recognition and expected credit losses, respectively:

• ASC 310-20 addresses specific matters related to the application of the interest method to loans within its scope. Under ASC 310-20, the interest method is used to recognize, as a level-yield adjustment, the difference between the initial recorded investment in the loan and the principal amount of the loan.

• ASC 326-20 addresses the measurement of expected credit losses for financial assets measured at amortized cost. Upon acquiring the loan(s), the investor would be required to record an allowance for expected credit losses on acquired assets within the scope of ASC 326 (even if the acquired loans were initially recognized at fair value in a business combination or at the amount paid to the seller if acquired in an asset acquisition).

4.8.2 Postacquisition Accounting for Acquired Loans Receivable Classified as Held for Sale

If the fair value option in ASC 825 is elected as of the acquisition date, the acquired loans are subsequently measured at fair value through earnings. Section 12.4.1 of Deloitte’s A Roadmap to Fair Value Measurements and Disclosures (Including the Fair Value Option) addresses the separate presentation of interest income when the fair value option has been elected.
If the fair value option in ASC 825 is not elected as of the acquisition date, the investor should subsequently measure loans classified as held for sale at the lower of cost or fair value, as required by ASC 310-10-35-48 for nonmortgage loans held for sale and ASC 948-310-35-1 for mortgage loans held for sale. Purchase discounts on mortgage loans are not amortized as interest income when the loans are classified as held for sale. Similarly, purchase discounts on nonmortgage loans are not amortized as interest income when the loans are classified as held for sale. Rather, recognition of interest income on held-for-sale loans is generally based on the stated coupon rate on the loan receivable.

### 4.9 Subsequent Events

<table>
<thead>
<tr>
<th>ASC 855-10</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>55-1</strong> The following are examples of recognized subsequent events addressed in paragraph 855-10-25-1:</td>
</tr>
<tr>
<td>a. If the events that gave rise to litigation had taken place before the balance sheet date and that litigation is settled after the balance sheet date but before the financial statements are issued or are available to be issued, for an amount different from the liability recorded in the accounts, then the settlement amount should be considered in estimating the amount of liability recognized in the financial statements at the balance sheet date.</td>
</tr>
<tr>
<td>b. Subsequent events affecting the realization of assets, such as inventories, or the settlement of estimated liabilities, should be recognized in the financial statements when those events represent the culmination of conditions that existed over a relatively long period of time.</td>
</tr>
</tbody>
</table>

| **55-2** The following are examples of nonrecognized subsequent events addressed in paragraph 855-10-25-3: |
| a. Sale of a bond or capital stock issued after the balance sheet date but before financial statements are issued or are available to be issued |
| b. A business combination that occurs after the balance sheet date but before financial statements are issued or are available to be issued (Topic 805 requires specific disclosures in such cases.) |
| c. Settlement of litigation when the event giving rise to the claim took place after the balance sheet date but before financial statements are issued or are available to be issued |
| d. Loss of plant or inventories as a result of fire or natural disaster that occurred after the balance sheet date but before financial statements are issued or are available to be issued |
| e. Changes in estimated credit losses on receivables arising after the balance sheet date but before financial statements are issued or are available to be issued |
| f. Changes in the fair value of assets or liabilities (financial or nonfinancial) or foreign exchange rates after the balance sheet date but before financial statements are issued or are available to be issued |
| g. Entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees after the balance sheet date but before financial statements are issued or are available to be issued. |

Although ASU 2016-13 did not significantly amend the guidance in ASC 855-10 on subsequent events, it did make conforming amendments to reflect the change from an incurred loss model to the CECL expected loss model. However, given the change to an expected loss model that incorporates forward-looking information, questions have arisen about whether an entity is required to consider certain events that occur or information that arises after the reporting date when estimating its expected credit losses as of the reporting date. While we believe that an entity must exercise significant judgment when evaluating whether information that arises after the balance sheet date should be included in the entity's estimate of expected credit losses, a recent speech by the SEC staff is informative in this regard and provides a framework for an entity's evaluation of subsequent events.
Specifically, at the 2018 AICPA Conference on Current SEC and PCAOB Developments, OCA Senior Associate Chief Accountant Kevin Vaughn addressed the staff’s observations about a recent consultation related to a registrant’s evaluation of subsequent events after its adoption of ASU 2016-13. The consultation addressed the following three scenarios in which information (1) is received after the balance sheet date but before the financial statements are issued or available to be issued and (2) significantly differs from that expected by management:

- **Scenario 1** — An entity receives a loan servicer report that includes loan activity (e.g., delinquencies and prepayments) that occurred on or before the balance sheet date.
- **Scenario 2** — An entity receives an appraisal report detailing the fair value of loan collateral as of the balance sheet date.
- **Scenario 3** — The government announces unemployment rates for a period that includes the balance sheet date.

The SEC staff indicated that in the first two scenarios, it would object to the registrant’s exclusion of the information from its process for estimating expected credit losses. The staff noted that in both scenarios, an important consideration “was that this information was loan-specific information about factual conditions that existed at the balance sheet date.” By contrast, because the information in Scenario 3 is used to make projections for periods that extend beyond the balance sheet date and is not loan-specific, the SEC staff would not object if such information is included in, or omitted from, the registrant’s estimation process.

In addition, Mr. Vaughn acknowledged that if other facts and circumstances become known after the balance sheet date, a registrant will need to evaluate whether such information should be incorporated into the estimate of expected credit losses. He shared the following views on how an entity should perform subsequent-event evaluations in estimating expected credit losses:

- **Category 1** — A registrant receives loan-specific information related to facts that exist on the balance sheet date. The registrant should include such information in its estimation process.
- **Category 2** — A registrant receives information related to forecasting before it completes its estimation process. The registrant is permitted but not required to include such information in its estimation process (unless the information indicates a material weakness or a deficiency in the registrant’s CECL process, in which case the registrant must include such information).
- **Category 3** — A registrant receives information related to forecasting after it completes its estimation process. The registrant would not include such information in its process (unless the information indicates a material weakness or a deficiency in the registrant’s CECL process, in which case the registrant must include such information).

### 4.10 Transfers Between Classification Categories

Financial assets reported at amortized cost are within the scope of ASC 326-20. By contrast, HFS loans and AFS debt securities are not within the scope of the guidance on expected credit losses in ASC 326-20 since (1) HFS loans are reported at the lower of amortized cost basis or fair value as of the balance sheet date and (2) AFS debt securities are reported at fair value as of the balance sheet date. However, upon either (1) the transfer of an HFS loan to an HFI loan or (2) the transfer of an AFS debt security to an HTM debt security, the transferred loan (i.e., HFI loan or HTM debt security) then becomes subject to ASC 326-20.
ASU 2016-13 does not provide guidance on how an entity should apply the CECL model when a loan that is HFS is transferred into an HFI classification (or vice versa) or when a debt security is transferred from AFS to HTM (or vice versa).\textsuperscript{12} As a result, in ASU 2019-04, the FASB provided guidance on transfers between classification categories. The table below summarizes this guidance.

<table>
<thead>
<tr>
<th>HFS Loan to HFI Loan</th>
<th>HFI Loan to HFS Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. On the transfer date, reverse any previous valuation allowance that was recorded in the income statement for the HFS loan.</td>
<td>1. On the transfer date, reverse any previous valuation allowance that was recorded in the income statement for the HFI loan.</td>
</tr>
<tr>
<td>2. Transfer the loan to HFI at its amortized cost reduced by any previous write-offs (but excluding any valuation allowance).</td>
<td>2. Transfer the loan to HFS at its amortized cost reduced by any previous write-offs (but excluding any valuation allowance).</td>
</tr>
<tr>
<td>3. Evaluate the HFI loan for expected credit losses in accordance with ASC 326-20.</td>
<td>3. Evaluate the HFS loan for expected credit losses in accordance with ASC 310-10.</td>
</tr>
<tr>
<td>4. The income statement effect of the reversal of the previous allowance and the establishment of a new allowance should be recognized in the income statement on a gross basis.</td>
<td>4. The income statement effect of the reversal of the previous allowance and the establishment of a new allowance should be recognized in the income statement on a gross basis.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>HTM Debt Security to AFS Debt Security</th>
<th>AFS Debt Security to HTM Debt Security</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. On the transfer date, reverse into earnings any allowance for credit losses that was previously recorded.</td>
<td>1. On the transfer date, reverse into earnings any allowance for credit losses that was previously recorded.</td>
</tr>
<tr>
<td>2. Transfer the debt security to the AFS category at the security's amortized cost basis reduced by any previous write-offs (but excluding any valuation allowance).</td>
<td>2. Transfer the debt security to the HTM category at the security's amortized cost basis reduced by any previous write-offs (but excluding any valuation allowance) plus or minus the amount of the remaining unrealized gains or losses reported in accumulated OCI.</td>
</tr>
<tr>
<td>3. Evaluate the AFS debt security for expected credit losses in accordance with ASC 326-30.</td>
<td>3. Evaluate the HTM debt security for expected credit losses in accordance with ASC 326-20.</td>
</tr>
<tr>
<td>4. Report in other comprehensive income (OCI) any unrealized gains or losses on the transfer date.</td>
<td>4. Continue to report any unrealized gains or losses that exist on the transfer date in a separate component of equity. The gains or losses should be amortized over the remaining life of the security as an adjustment to the security's yield.</td>
</tr>
<tr>
<td>5. Consider whether the transfer between classification categories affects the entity’s intent and ability to hold HTM debt securities.</td>
<td>5. The income statement effect of the reversal of the previous allowance and the establishment of a new allowance should be recognized in the income statement on a gross basis.</td>
</tr>
</tbody>
</table>

\textsuperscript{12} This issue was initially addressed by the TRG at its June 2018 meeting and led to the FASB’s issuance of ASU 2019-04.
ASC 320-10-35-10 through 35-16 provide guidance on transfers between the classifications of investments in debt and equity securities (i.e., trading, available for sale, and held to maturity). Transfers involving the trading classification are expected to be rare. Transfers out of the held-to-maturity classification may call into question the entity’s ability to use that classification for a period. Transfers from available for sale to held to maturity are not restricted, provided that the entity has the positive intent and ability to hold the transferred security to its maturity.

**Example 4-1**

**Transfer From Held to Maturity to Available for Sale**

Company X has an investment in a bond that is classified as held to maturity. The bond was acquired for $1,000 with a par value of $1,000. Upon initial recognition of the bond, X recognized an allowance of $70 for credit losses. During the following year, X transfers the bond from held to maturity to available for sale. As of the transfer date, the bond's amortized cost and fair value are $1,000 and $900, respectively. In addition, as of the transfer date, because the bond is now classified as available for sale, X determines, in accordance with ASC 326-30, that $90 of the unrealized loss is related to credit and $10 is related to interest rate changes.

As of the transfer date, X would record the following journal entries:

<table>
<thead>
<tr>
<th>Account Description</th>
<th>Amount</th>
<th>Account Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance for credit losses</td>
<td>70</td>
<td>Credit loss expense</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To reverse the previously recognized allowance for credit losses.</td>
<td></td>
</tr>
<tr>
<td>AFS debt security</td>
<td>1,000</td>
<td>HTM debt security</td>
<td>1,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To reclassify the security from HTM to AFS.</td>
<td></td>
</tr>
<tr>
<td>Credit loss expense</td>
<td>90</td>
<td>Allowance for credit losses</td>
<td>90</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To recognize in earnings the expected credit losses determined in accordance with ASC 326-30.</td>
<td></td>
</tr>
<tr>
<td>AFS debt security — OCI</td>
<td>10</td>
<td>Fair value adjustment on AFS debt security</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To recognize in OCI the change in fair value attributable to interest rate changes.</td>
<td></td>
</tr>
</tbody>
</table>
**Example 4-2**

**Transfer From Available for Sale to Held to Maturity**

Company Z purchased a security and classified it as available for sale. The security was acquired at its par value of $4,000. Immediately before the transfer date, the security's fair value is $3,500 and its allowance for credit losses is $300 (accordingly, Z recognizes in OCI an unrealized loss of $200 that is due to non-credit-related factors). Once Z transfers the security from AFS to HTM, it estimates the allowance for credit losses on the security to be $350 in accordance with ASC 326-20.

As of the transfer date, X would record the following journal entries:

```
Allowance for credit losses                    300
Credit loss expense                            300
   To reverse the previously recognized allowance for credit losses.

HTM debt security                              3,800
AFS debt security — unrealized loss            200
   AFS debt security                           4,000
   To reclassify the security from AFS to HTM at amortized cost less the remaining unrealized losses reported in OCI.

Credit loss expense                            350
   Allowance for credit losses                 350
   To recognize in earnings the credit losses determined in accordance with ASC 326-20.
```

Keep in mind that the unrealized loss of $200 as of the transfer date will continue to be recorded in AOCI; however, it should be amortized prospectively over the remaining life of the security from AOCI. The amortization should be performed in a manner consistent with the recognition of a premium or discount (e.g., the effective interest method). In addition, the transfer will create a discount of $200 on the carrying amount of the security that should be amortized prospectively over the remaining life of the security. Typically, this amortization will have no net impact on the reported yield of the security because the amortization of the amount in AOCI and the amortization of the discount will offset each other. Effectively, the amortization of the unrealized loss in AOCI will reduce the debt discount, thereby increasing the carrying amount of the investment.
5.1 Off-Balance-Sheet Arrangements

Off-balance-sheet arrangements, such as commitments to extend credit, guarantees, and standby letters of credit, are subject to credit risk; therefore, arrangements that are not considered derivatives under ASC 815 are within the scope of the CECL model. Accordingly, under ASC 326, an entity's method for determining the estimate of expected credit losses on the funded portion of a loan commitment must be similar to its method for determining the estimate for other loans. For an unfunded portion of a loan commitment, an entity must estimate expected credit losses over the full contractual period over which it is exposed to credit risk under an unconditional present legal obligation to extend credit. Such an estimate takes into account both the likelihood that funding will occur and the expected credit losses on commitments to be funded.

Q&A 5-1 Allowances for Credit Card Loans

Question
Should an allowance for expected credit losses be provided on credit card loans for which the issuer has the unconditional right to cancel the commitment at any time?
Answer

An allowance for expected credit losses on credit card loans would only be required for the funded portion, not for the unfunded portion for which the issuer has an unconditional right to cancel the commitment.

ASC 326-20-30-11 states that an entity must “estimate expected credit losses . . . over the contractual period in which the entity is exposed to credit risk via a present contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the issuer.” Therefore, if an entity has the unconditional ability to cancel the unfunded portion of a loan commitment, it would not be required to estimate expected credit losses on that portion, even if it historically has never exercised its cancellation right. In other words, if the issuer has the unconditional right to cancel the commitment at any time, it should not record an allowance for unfunded commitments because it does not have a present contractual obligation to extend credit on the unfunded commitments.

The example in ASC 326-20-55-55 and 55-56 illustrates application of this guidance:

55-55 Bank M has a significant credit card portfolio, including funded balances on existing cards and unfunded commitments (available credit) on credit cards. Bank M’s card holder agreements stipulate that the available credit may be unconditionally cancelled at any time.

55-56 When determining the allowance for credit losses, Bank M estimates the expected credit losses over the remaining lives of the funded credit card loans. Bank M does not record an allowance for unfunded commitments on the unfunded credit cards because it has the ability to unconditionally cancel the available lines of credit. Even though Bank M has had a past practice of extending credit on credit cards before it has detected a borrower’s default event, it does not have a present contractual obligation to extend credit. Therefore, an allowance for unfunded commitments should not be established because credit risk on commitments that are unconditionally cancellable by the issuer are not considered to be a liability. [Emphasis added]

In addition, an entity should not recognize a contingent liability under ASC 450 for the operational risk associated with extending loans in the future under unconditionally cancelable credit commitments related to accounts that are performing or are in default.

Q&A 5-2 Effect of a Required Cancellation Notice Period on a Commitment to Extend Credit

Question

Should allowances for credit losses be provided on the unfunded portion of lines of credit if the issuer has the unconditional right to cancel the commitment but only after a specific notice period is provided?

Answer

Yes, for expected losses related to estimated fundings during the notice period. In estimating expected credit losses, an entity should report its credit loss exposure for the period of exposure, which would include a specific notice period if applicable. ASC 326-20-30-11 states, in part:

[A]n entity shall estimate expected credit losses . . . over the contractual period in which the entity is exposed to credit risk via a present contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the issuer. . . . For that period of exposure, the estimate of expected credit losses should consider both the likelihood that funding will occur . . . and an estimate of expected credit losses on commitments expected to be funded over its estimated life.
Since a contractual period of exposure includes the notice period, the estimate of expected credit losses should include expected credit losses related to expected future borrowings during the notice period. The entity is not required to estimate losses for any expected borrowings that would occur beyond the period when the issuer has an unconditional right to cancel the commitment (i.e., after the notice period).

**Q&A 5-3 Recognition of the Allowance for Credit Losses Related to Unfunded Loan Commitments Assumed in a Business Combination**

Unfunded loan commitments assumed by an acquirer in a business combination must be measured and recognized at fair value as of the acquisition date in accordance with ASC 805.

**Question**

How should an acquirer recognize the allowance for credit losses related to unfunded loan commitments assumed in a business combination?

**Answer**

We believe that an acquirer should recognize a separate liability under ASC 326-20 for expected credit losses related to an unfunded portion of a loan commitment acquired if that commitment is noncancelable by the acquirer. In a manner consistent with how other unfunded loan commitments are accounted for under ASC 326-20, the acquirer must estimate expected credit losses over the full contractual period in which it is exposed to credit risk under an unconditional present legal obligation to extend the credit. Such an estimate takes into account both the likelihood that funding will occur and the expected credit losses on commitments to be funded.

**Q&A 5-4 Accounting for the Off-Balance-Sheet Credit Exposure Related to a Forward Commitment to Purchase Loans**

As stated in **Q&A 2-1**, a forward commitment to purchase loans from a third party is within the scope of ASC 326-20 because it exposes the purchaser to the credit risk associated with the underlying loans to be purchased if it is neither (1) unconditionally cancelable by the issuer nor (2) accounted for as a derivative under ASC 815.

**Question 1**

How should an entity measure and recognize the liability for off-balance-sheet credit exposure related to a forward commitment to purchase identified loans from a third party?

**Answer**

The accounting for off-balance-sheet credit exposure related to a forward commitment to purchase loans depends on whether the loans are determined to be PCD as of the date on which the forward commitment is entered into. If the loans are not determined to be PCD, the entity would recognize a liability at inception of the commitment and would reflect the credit losses expected over the loans’ contractual term.
If the loans are determined to be PCD as of the date on which the forward commitment is entered into, the entity would not recognize a liability for the credit exposure related to a forward commitment to purchase the loans. Instead, it would recognize an allowance for expected credit losses by applying the gross-up approach upon acquiring the assets, as discussed in Chapter 6. That is, when the entity acquires the PCD assets, it would recognize the allowance for expected credit losses as an adjustment that increases the assets’ cost bases. If the entity applies the gross-up approach when the loans are acquired (and does not recognize a liability at inception of the commitment), the entity would recognize credit exposure on PCD loans and credit exposure on forward commitments to acquired PCD loans in a similar manner.

**Question 2**

When should an entity measure and recognize the liability for off-balance-sheet credit exposure related to a forward commitment to purchase loans from a third party when the loans are not specifically identified as of the commitment inception date?

**Answer**

We generally believe that an entity should measure and recognize a liability for off-balance-sheet credit exposure related to a forward commitment to purchase loans from a third party as of the commitment inception date even if the specific loans to be purchased are not specifically identified. In such an arrangement, the entity has entered into a noncancelable commitment to purchase loans for which it is exposed to credit losses and therefore should recognize a liability for expected credit losses upon inception of the commitment. We believe that the entity should analyze all facts and circumstances related to the forward commitment to assess the type and quality of loans expected to be purchased. In addition, the entity should use judgment to (1) identify those loans that are expected to be accounted for as PCD and (2) measure and recognize the liability for expected credit losses.

### 5.1.1 Guarantees

#### 5.1.1.1 Overview

**ASC 460-10**

15-4 Except as provided in paragraph 460-10-15-7, the provisions of this Topic apply to the following types of guarantee contracts:

a. Contracts that contingently require a guarantor to make payments (as described in the following paragraph) to a guaranteed party based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party. For related implementation guidance, see paragraph 460-10-55-2.

b. Contracts that contingently require a guarantor to make payments (as described in the following paragraph) to a guaranteed party based on another entity’s failure to perform under an obligating agreement (performance guarantees). For related implementation guidance, see paragraph 460-10-55-12.

c. Indemnification agreements (contracts) that contingently require an indemnifying party (guarantor) to make payments to an indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability, or an equity security of the indemnified party.

d. Indirect guarantees of the indebtedness of others, even though the payment to the guaranteed party may not be based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party.
Guarantee arrangements can take various forms and expose guarantors to varying levels of obligations and risks. ASC 326-20 applies to certain financial guarantee arrangements within the scope of ASC 460 that create off-balance-sheet credit exposure for the guarantor. Examples of financial guarantees that create off-balance-sheet credit exposure include financial standby letters of credit and other types of guarantees related to the nonpayment of a financial obligation. ASC 326-20 does not apply to financial guarantees that create off-balance-sheet exposure and that are (1) accounted for as insurance or (2) within the scope of ASC 815-15. See Chapter 2 for more information about the scope of ASC 326-20.

### 5.1.1.2 Initial Recognition and Measurement

<table>
<thead>
<tr>
<th>ASC 460-10</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>25-2</strong> The issuance of a guarantee obligates the guarantor (the issuer) in two respects:</td>
</tr>
<tr>
<td>a. The guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect).</td>
</tr>
<tr>
<td>b. The guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect).</td>
</tr>
<tr>
<td>For guarantees that are not within the scope of Subtopic 326-20 on financial instruments measured at amortized cost, no bifurcation and no separate accounting for the contingent and noncontingent aspects of the guarantee are required by this Topic. For guarantees that are within the scope of Subtopic 326-20, the expected credit losses (the contingent aspect) shall be measured and accounted for in addition to and separately from the fair value of the guarantee (the noncontingent aspect) in accordance with paragraph 460-10-30-5.</td>
</tr>
</tbody>
</table>

| **25-3** Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering events or conditions occur, the provisions of Section 450-20-25 regarding a guarantor's contingent obligation under a guarantee should not be interpreted as prohibiting a guarantor from initially recognizing a liability for a guarantee even though it is not probable that payments will be required under that guarantee. Similarly, for guarantees within the scope of Subtopic 326-20, the requirement to measure a guarantor's expected credit loss on the guarantee should not be interpreted as prohibiting a guarantor from initially recognizing a liability for the noncontingent aspect of a guarantee. |

| **25-4** At the inception of a guarantee, a guarantor shall recognize in its statement of financial position a liability for that guarantee. This Subsection does not prescribe a specific account for the guarantor's offsetting entry when it recognizes a liability at the inception of a guarantee. That offsetting entry depends on the circumstances in which the guarantee was issued. See paragraph 460-10-55-23 for implementation guidance. |

| **30-2** Except as indicated in paragraphs 460-10-30-3 through 30-5, the objective of the initial measurement of a guarantee liability is the fair value of the guarantee at its inception. For example: |
| a. If a guarantee is issued in a standalone arm's-length transaction with an unrelated party, the liability recognized at the inception of the guarantee shall be the premium received or receivable by the guarantor as a practical expedient. |
| b. If a guarantee is issued as part of a transaction with multiple elements with an unrelated party (such as in conjunction with selling an asset), the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, a guarantor shall consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction with an unrelated party as a practical expedient. |
| c. If a guarantee is issued as a contribution to an unrelated party, the liability recognized at the inception of the guarantee shall be measured at its fair value, consistent with the requirement to measure the contribution made at fair value, as prescribed in Section 720-25-30. For related implementation guidance, see paragraph 460-10-55-14. |
Chapter 5 — Application of the CECL Model to Off-Balance-Sheet Commitments, Trade and Lease Receivables, and Reinsurance Receivables

ASC 460-10 (continued)

30-5 At the inception of a guarantee within the scope of Subtopic 326-20 on financial instruments measured at amortized cost, the guarantor is required to recognize both of the following as liabilities:

a. The amount that satisfies the fair value objective in accordance with paragraph 460-10-30-2
b. The contingent liability related to the expected credit loss for the guarantee measured under Subtopic 326-20.

ASC 460-10-25-2 states that a guarantee comprises a noncontingent obligation and a contingent obligation. The noncontingent obligation is the “obligation to stand ready to perform over the term of the guarantee” if certain events or conditions occur, while the contingent obligation is the “obligation to make future payments” if certain events or conditions occur.

For financial guarantees not within the scope of ASC 326-20, ASC 460 requires the guarantor to initially recognize at fair value a guarantee liability comprising both the noncontingent obligation and the contingent obligation (i.e., the guarantor is not required to separately recognize at fair value a liability for the noncontingent and contingent aspects of the guarantee). However, for financial guarantees within the scope of ASC 326-20, the guarantor must also recognize a liability related to the expected credit losses on the guarantee, estimated in accordance with ASC 326-20.

A guarantor’s estimation of expected credit losses related to the contingent element of the financial guarantee should take into account both (1) the likelihood that the guarantor will have to fulfill its obligation and (2) an estimate of expected credit losses related to the guarantee obligation.

Example 5-1

Accounting for a Financial Guarantee Within the Scope of ASC 326-20

Entity X is a guarantor of debt incurred by Entity Y. The guarantee arrangement stipulates that X must guarantee payment of 100 percent of Y’s debt obligations owed to a third-party debtor for a specified time frame. Entity X is not an insurance entity, and the guarantee is not within the scope of ASC 815.

On July 1, 20X1, Y borrows $5 million from a third-party debtor for which X is obligated to guarantee repayment under the guarantee arrangement. Entity X receives an up-front cash premium payment of $250,000 for the guarantee and the cash premium is considered to be at arm’s length. Entity X measures the fair value of its stand-ready obligation (i.e., the noncontingent obligation) to guarantee Y’s repayment under the debt arrangement to be $250,000 on the basis of the arm’s-length premium it received. Entity X applies ASC 326-20 and measures its estimate of expected credit losses related to the guarantee to be $100,000 (i.e., the contingent obligation). Entity X would record the following journal entry for the guarantee arrangement:

<table>
<thead>
<tr>
<th>Journal Entry: July 1, 20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
</tr>
<tr>
<td>Credit loss expense</td>
</tr>
<tr>
<td>Financial guarantee — stand-ready obligation (noncontingent)</td>
</tr>
<tr>
<td>Liability for off-balance-sheet credit losses (contingent)</td>
</tr>
</tbody>
</table>
Connecting the Dots — Changes to Guarantee Liability Recognition Under the CECL Model

Before the adoption of ASU 2016-13, a guarantor was not required to bifurcate and separately account for the contingent and noncontingent aspects of a financial guarantee under ASC 460. Rather, the guarantor was required to initially recognize the guarantee liability at the greater of the following:

- The noncontingent liability stand-ready obligation of the guarantee measured at fair value in accordance with ASC 460-10-30-2.
- The contingent liability measured in accordance with ASC 450-20-30.

However, ASU 2016-13 amended ASC 460-10-30-5 to remove the entity’s ability to initially and subsequently recognize the “greater of” the unamortized noncontingent obligation (ASC 460) or the contingent obligation (ASC 450) for financial guarantees within the scope of ASC 326-20. In other words, a guarantor must measure and recognize a liability for the contingent element of the guarantee obligation in accordance with ASC 326-20 in addition to the liability for the noncontingent element under ASC 460. See Chapter 9 for transition guidance related to guarantees within the scope of ASC 326-20. In certain circumstances, application of the guidance in ASC 460-10-30-5 may result in a scenario in which the sum of the noncontingent and contingent liabilities exceeds the total amount that the guarantor is obligated to pay. Consider the following example:

**Example 5-2**

**Accounting for a Financial Guarantee Within the Scope of ASC 326-20**

Entity X is a guarantor for debt incurred by Entity Y. The guarantee arrangement stipulates that X must guarantee payment of 30 percent of Y’s debt obligations owed to a third-party debtor for a specified time frame. The other 70 percent of Y’s debt obligations is guaranteed by an independent third-party entity. Entity X is not an insurance entity and the guarantee is not within the scope of ASC 815.

On July 1, 20X1, Entity Y borrows $10 million from a third-party debtor with a term of three years for which Entity X is obligated to guarantee repayment of $3 million ($10 million multiplied by X’s 30 percent guarantee obligation). Entity X receives an up-front cash premium payment of $300,000 for the guarantee, and the cash premium is considered to be at arm’s length. Entity X measures the fair value of its stand-ready obligation (i.e., the noncontingent obligation) to guarantee Entity Y’s repayment under the debt arrangement to be $300,000 on the basis of the arm’s-length premium it received. At inception, X applies ASC 326-20 and measures its estimate of expected credit losses related to the guarantee to be $100,000 (i.e., the contingent element). On July 1, 20X1, X would record the following journal entry for the guarantee arrangement:

**Journal Entry: July 1, 20X1**

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>300,000</td>
</tr>
<tr>
<td>Credit loss expense</td>
<td>100,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial guarantee — stand-ready obligation (noncontingent)</td>
<td>300,000</td>
</tr>
<tr>
<td>Liability for off-balance-sheet credit losses (contingent)</td>
<td>100,000</td>
</tr>
</tbody>
</table>
Example 5-2 (continued)

In the latter half of 20X1, there is a significant macroeconomic decline in key input factors affecting Y’s business that is expected to persist over the contractual term of the debt. As a result, Y experiences significant credit deterioration and there is general concern that Y will not be able to service the entire debt obligation. Entity X applies ASC 326-20 and remeasures its estimate of expected credit losses related to the guarantee as of December 31, 20X1, to be $2.8 million. Entity X’s subsequent-measurement accounting policy for the noncontingent guarantee liability is to amortize the obligation on a straight-line basis over the life of the guarantee, which is equal to the term of the debt (i.e., three years). As of December 31, 20X1, the unamortized noncontingent guarantee obligation is $250,000. Entity X would record the following journal entry on December 31, 20X1, to reflect the change in the liability for off-balance-sheet credit losses:

**Journal Entry: December 31, 20X1**

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit loss expense</td>
<td>2,700,000</td>
</tr>
<tr>
<td>Liability for off-balance-sheet</td>
<td>2,700,000</td>
</tr>
<tr>
<td>credit losses (contingent)</td>
<td></td>
</tr>
</tbody>
</table>

In this example, X’s total liability under the guarantee as of December 31, 20X1, is $3.05 million, which exceeds the total amount of debt of $3 million that X is obligated to pay. While this example is meant to portray extreme facts and circumstances, it illustrates a potential outcome of applying the conceptual framework of measuring and recognizing the noncontingent and contingent obligations of guarantees within the scope of ASC 326-20.

Q&A 5-5  Credit Guarantee Between Entities Under Common Control

As discussed in Chapter 2, we generally believe that guarantee arrangements between common-control entities that are related to third-party credit exposure are within the scope of ASC 326-20. Consider the following example:

**Example**

Entity X and Entity Y are wholly owned subsidiaries of Parent. As a result, X and Y are entities under common control. Entity X originates loans to third-party entities. Entity Y enters into a credit guarantee with X under which Y must reimburse X in the event that the third-party loans were to default. Entity Y cannot unconditionally cancel the guarantee arrangement, and the guarantee is not within the scope of ASC 815. Entity Y prepares separate, stand-alone financial statements.

**Question**

In its separate, stand-alone financial statements, should Y separately measure and recognize the expected credit losses related to the contingent element of its guarantee obligation with X?

**Answer**

Yes. Entity Y is exposed to the credit risk of the third-party entities through its guarantee arrangement with X. Therefore, Y must measure and recognize the contingent element (i.e., the expected credit losses) separately from the noncontingent element (i.e., the stand-ready obligation) of the guarantee.

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1. The sum of the unamortized noncontingent guarantee obligation of $250,000 and the liability for off-balance-sheet credit losses of $2.8 million.
### 5.1.1.3 Subsequent Measurement

**ASC 460-10**

**35-1** This Subsection does not describe in detail how the guarantor’s liability for its obligations under the guarantee would be measured after its initial recognition. The liability that the guarantor initially recognized under paragraph 460-10-25-4 would typically be reduced (by a credit to earnings) as the guarantor is released from risk under the guarantee.

**35-2** Depending on the nature of the guarantee, the guarantor’s release from risk has typically been recognized over the term of the guarantee using one of the following three methods:

- a. Only upon either expiration or settlement of the guarantee.
- b. By a systematic and rational amortization method.
- c. As the fair value of the guarantee changes.

Although those three methods are currently being used in practice for subsequent accounting, this Subsection does not provide comprehensive guidance regarding the circumstances in which each of those methods would be appropriate. A guarantor is not free to choose any of the three methods in deciding how the liability for its obligations under the guarantee is measured subsequent to the initial recognition of that liability. A guarantor shall not use fair value in subsequently accounting for the liability for its obligations under a previously issued guarantee unless the use of that method can be justified under generally accepted accounting principles (GAAP). For example, fair value is used to subsequently measure guarantees accounted for as derivative instruments under Topic 815.

**35-4** The discussion in paragraph 460-10-35-2 about how a guarantor typically reduces the liability that it initially recognized does not encompass the recognition and subsequent adjustment of the contingent liability related to the contingent loss for the guarantee. The contingent aspect of the guarantee shall be accounted for in accordance with Subtopic 450-20 unless the guarantee is accounted for as a derivative instrument under Topic 815 or the guarantee is within the scope of Subtopic 326-20 on financial instruments measured at amortized cost. For guarantees within the scope of Subtopic 326-20, the expected credit losses (the contingent aspect) of the guarantee shall be accounted for in accordance with that Subtopic in addition to and separately from the fair value of the guarantee liability (the noncontingent aspect) accounted for in accordance with paragraph 460-10-30-5.

A guarantor subsequently measures the noncontingent and contingent elements of financial guarantees within the scope of ASC 326-20 differently because the noncontingent obligation is measured under ASC 460 and the contingent obligation is measured under ASC 326-20.

The guidance in ASC 460 does not specifically prescribe how a guarantor subsequently measures the noncontingent element of the guarantee obligation. Instead, ASC 460 indicates that the liability is typically reduced through the income statement as the guarantor is released from risk under the guarantee and cites three methods for making such a reduction:

- Upon either expiration or settlement of the guarantee.
- Using a systematic and rational amortization method.
- Through changes in the fair value of the guarantee liability.
Entities cannot freely choose to elect one of the above subsequent-accounting alternatives. Often, a systematic and rational amortization method is appropriate. At the 2003 AICPA Conference on Current SEC Developments, the SEC staff stated that “[i]t would seem a systematic and rational amortization method would most likely be the appropriate [subsequent] accounting” for the obligation to stand ready. For some guarantees, an entity is required or permitted by U.S. GAAP to use a fair value model for subsequent measurement as follows:

- A fair value model is required for a guarantee that meets the definition of a derivative and is within the scope of the derivative accounting guidance in ASC 815-10.
- For a guarantee that meets the definition of a financial instrument or is otherwise within the scope of the guidance in ASC 825-10 on the fair value option (e.g., a warranty that permits the warrantor to settle by paying a third party to provide goods or services), an entity is permitted to elect a fair value model unless the guarantee is specifically exempted from the scope of that guidance under ASC 825-10-15-5.

A fair value model cannot be justified solely on the basis of the statement in ASC 460-10-35-2 that for some guarantees, the guarantor’s release from risk is recognized as the fair value of the guarantee changes. ASC 460-10-35-2 states that a “guarantor shall not use fair value in subsequently accounting for the liability for its obligations under a previously issued guarantee unless the use of that method can be justified under generally accepted accounting principles (GAAP).”

The contingent element (i.e., the expected credit losses) of the guarantee within the scope of ASC 326-20 is subsequently measured in accordance with ASC 326-20.

5.2 Trade Receivables and Contract Assets

5.2.1 Trade Receivables

Receivables that result from revenue transactions under ASC 606 are subject to the CECL model. ASC 606-10-25-1(e) requires an entity to perform an evaluation at contract inception to determine whether it is “probable that the entity will collect substantially all of the consideration to which it will be entitled” for goods or services transferred to the customer (the “collectibility threshold”). This evaluation takes into account “the customer’s ability and intention to pay [the] consideration when it is due.” The purpose of the assessment is to determine whether there is a substantive transaction between the entity and the customer, which is a necessary condition for the contract to be accounted for under ASC 606. Although a customer’s credit risk associated with trade receivables that will be recorded under a contract with a customer is considered as part of the collectibility threshold, the entity’s conclusion that the collectibility threshold is reached does not imply that all receivables that result from the revenue transaction are collectible. That is, once a receivable is recorded, it is unlikely that the entity will be able to assert that there are no expected losses on the trade receivable. The entity must calculate its expected credit losses to determine whether it should recognize an impairment loss related to the trade receivable and, if so, in what amount. The likely result is that the entity will record an allowance for expected credit losses on trade receivables earlier under a CECL model than it would under existing accounting requirements.

ASU 2016-13 includes the following example illustrating how an entity could use a provision matrix to apply the guidance to trade receivables.
Example 5: Estimating Expected Credit Losses for Trade Receivables Using an Aging Schedule

55-37 This Example illustrates one way an entity may estimate expected credit losses for trade receivables using an aging schedule.

55-38 Entity E manufactures and sells products to a broad range of customers, primarily retail stores. Customers typically are provided with payment terms of 90 days with a 2 percent discount if payments are received within 60 days. Entity E has tracked historical loss information for its trade receivables and compiled the following historical credit loss percentages:

- 0.3 percent for receivables that are current
- 8 percent for receivables that are 1–30 days past due
- 26 percent for receivables that are 31–60 days past due
- 58 percent for receivables that are 61–90 days past due
- 82 percent for receivables that are more than 90 days past due.

55-39 Entity E believes that this historical loss information is a reasonable base on which to determine expected credit losses for trade receivables held at the reporting date because the composition of the trade receivables at the reporting date is consistent with that used in developing the historical credit loss percentages (that is, the similar risk characteristics of its customers and its lending practices have not changed significantly over time). However, Entity E has determined that the current and reasonable and supportable forecasted economic conditions have improved as compared with the economic conditions included in the historical information. Specifically, Entity E has observed that unemployment has decreased as of the current reporting date, and Entity E expects there will be an additional decrease in unemployment over the next year. To adjust the historical loss rates to reflect the effects of those differences in current conditions and forecasted changes, Entity E estimates the loss rate to decrease by approximately 10 percent in each age bucket. Entity E developed this estimate based on its knowledge of past experience for which there were similar improvements in the economy.

55-40 At the reporting date, Entity E develops the following aging schedule to estimate expected credit losses.

<table>
<thead>
<tr>
<th>Past-Due Status</th>
<th>Amortized Cost Basis</th>
<th>Credit Loss Rate</th>
<th>Expected Credit Loss Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>$ 5,984,698</td>
<td>0.27%</td>
<td>$ 16,159</td>
</tr>
<tr>
<td>1–30 days past due</td>
<td>8,272</td>
<td>7.2%</td>
<td>596</td>
</tr>
<tr>
<td>31–60 days past due</td>
<td>2,882</td>
<td>23.4%</td>
<td>674</td>
</tr>
<tr>
<td>61–90 days past due</td>
<td>842</td>
<td>52.2%</td>
<td>440</td>
</tr>
<tr>
<td>More than 90 days past due</td>
<td>1,100</td>
<td>73.8%</td>
<td>812</td>
</tr>
<tr>
<td></td>
<td>$ 5,997,794</td>
<td></td>
<td>$ 18,681</td>
</tr>
</tbody>
</table>

The example above illustrates that an entity's use of a provision matrix to apply the CECL model to trade receivables may not differ significantly from its current methods for determining the allowance for doubtful accounts. However, the example also shows that when using such a matrix, the entity is required to consider the following:

- Whether expected credit losses should be recognized for trade receivables that are considered “current” (i.e., not past due). In the example above, a historical loss rate of 0.3 percent is applied to the trade receivables that are classified as current.
Chapter 5 — Application of the CECL Model to Off-Balance-Sheet Commitments, Trade and Lease Receivables, and Reinsurance Receivables

- When using historical loss rates in a provision matrix, the entity must assess whether and, if so, how the historical loss rates differ from what is currently expected over the life of the trade receivables (on the basis of current conditions and reasonable and supportable forecasts).

**Connecting the Dots — Unit of Account**

As discussed in Section 3.2, an entity is required to evaluate financial assets within the scope of the model on a collective (i.e., pool) basis when assets share similar risk characteristics. If a financial asset’s risk characteristics are not similar to those of any of the entity’s other financial assets, the entity would evaluate that asset individually.

As a result, although an entity may be able to continue using a provision matrix to estimate credit losses, it may need to apply the matrix to a more disaggregated level of trade receivables because it is required to estimate expected credit losses collectively only when assets share similar risk characteristics. That is, instead of applying a single provision matrix to all of its trade receivables, the entity may need to establish pools of such receivables on the basis of risk characteristics and then apply a provision matrix to each pool.

Although the CECL model requires entities to perform a different evaluation for trade receivables, we generally do not expect that most entities will see a significant change in the impairment losses recognized on trade receivables. However, entities with long-term trade receivables (e.g., those with due dates that extend beyond one year) may experience more of a change than those with short-term receivables because entities with long-term receivables may need to consider additional adjustments to historical loss experience to reflect their expectations about macroeconomic conditions that could exist past one year.

**5.2.1.1 Credit Risk Versus Variable Consideration**

ASC 606-10-45-4 states that “[u]pon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Subtopic 326-20 and the corresponding amount of revenue recognized shall be presented as a credit loss expense.” However, the amount of revenue recognized in a contract with a customer can change as a result of changes in the transaction price. This is because the amount of consideration to which an entity expects to be entitled for promised goods or services that have been transferred to a customer may vary depending on the occurrence or nonoccurrence of future events, including potential price concessions that an entity might grant. That is, an entity may accept (and is expected to accept) less than the contractually stated amount of consideration in exchange for promised goods or services. Concessions might be granted as a result of product obsolescence but might also be granted because of credit risk assumed by the vendor in the transaction. Consider the example below reproduced from ASC 606.

**ASC 606-10**

**Example 3: Implicit Price Concession**

55-102 An entity, a hospital, provides medical services to an uninsured patient in the emergency room. The entity has not previously provided medical services to this patient but is required by law to provide medical services to all emergency room patients. Because of the patient’s condition upon arrival at the hospital, the entity provides the services immediately and, therefore, before the entity can determine whether the patient is committed to perform its obligations under the contract in exchange for the medical services provided. Consequently, the contract does not meet the criteria in paragraph 606-10-25-1, and in accordance with paragraph 606-10-25-6, the entity will continue to assess its conclusion based on updated facts and circumstances.
After providing services, the entity obtains additional information about the patient including a review of the services provided, standard rates for such services, and the patient's ability and intention to pay the entity for the services provided. During the review, the entity notes its standard rate for the services provided in the emergency room is $10,000. The entity also reviews the patient's information and to be consistent with its policies designates the patient to a customer class based on the entity's assessment of the patient's ability and intention to pay. The entity determines that the services provided are not charity care based on the entity's internal policy and the patient's income level. In addition, the patient does not qualify for governmental subsidies.

Before reassessing whether the criteria in paragraph 606-10-25-1 have been met, the entity considers paragraphs 606-10-32-2 and 606-10-32-7(b). Although the standard rate for the services is $10,000 (which may be the amount invoiced to the patient), the entity expects to accept a lower amount of consideration in exchange for the services. Accordingly, the entity concludes that the transaction price is not $10,000 and, therefore, the promised consideration is variable. The entity reviews its historical cash collections from this customer class and other relevant information about the patient. The entity estimates the variable consideration and determines that it expects to be entitled to $1,000.

In accordance with paragraph 606-10-25-1(e), the entity evaluates the patient's ability and intention to pay (that is, the credit risk of the patient). On the basis of its collection history from patients in this customer class, the entity concludes it is probable that the entity will collect $1,000 (which is the estimate of variable consideration). In addition, on the basis of an assessment of the contract terms and other facts and circumstances, the entity concludes that the other criteria in paragraph 606-10-25-1 also are met. Consequently, the entity accounts for the contract with the patient in accordance with the guidance in this Topic.

As noted in the example above, the entity believes that it is probable that it will collect $1,000 from the patient, which is less than the contractual price of $10,000. Accordingly, the entity records a receivable of $1,000 when it renders services to the patient. Under ASC 326-20, the entity is required to evaluate financial assets on a collective (i.e., pool) basis when assets share similar risk characteristics. Therefore, in this example, the entity would need to consider its portfolio of similar trade receivables to determine whether it would have to record an additional allowance. This is because, although it is probable that the entity will collect $1,000, it is not certain that the entity will collect $1,000 from all similarly situated patients. Accordingly, the entity would most likely need to record an additional allowance for further expected credit losses on the basis of the expected collections across its portfolio of trade receivables.

Entities will need to use significant judgment in determining whether recorded receivables are not collectible because the entities have provided an implicit price concession or because there is incremental credit risk beyond what was contemplated when the transaction price was established. This is particularly true of entities in highly regulated industries, such as health care and consumer energy, which may be required by law to provide certain goods and services to their customers regardless of the customers’ ability to pay. Therefore, entities will need to evaluate all of the relevant facts and circumstances of their arrangements to determine whether they have provided implicit price concessions or whether the anticipated receipt of less than the total contractual consideration represents additional credit risk, as a result of which they may be required to record additional credit losses upon adopting ASC 326-20. These credit losses are measured on the basis of the losses that would be expected to be incurred over the entire contractual term (i.e., the period over which the receivables recorded will be collected).
Q&A 5-6  Measuring Expected Credit Losses on Trade Receivables When the Corresponding Revenue Has Not Been Recognized

In limited circumstances, an entity may have an unconditional right to consideration (i.e., a receivable) before it transfers goods or services to a customer. In those situations, the entity would recognize the receivable as well as a contract liability representing its obligation to transfer goods or services to a customer. This contract liability is commonly referred to as deferred revenue.

**Question**

When determining the receivable balance on which to estimate expected credit losses, is an entity allowed to reduce the receivable by the associated contract liability (i.e., deferred revenue)?

**Answer**

It depends. We generally believe that the entity should only estimate expected credit losses on receivables for which the associated revenue has been recognized. This belief is premised on the fact that the entity does not have credit loss exposure related to goods or services yet to be transferred because if the customer were to default before recognizing revenue, the entity could simply no longer deliver the goods or services and avoid a credit loss. In this case, the entity could use the deferred revenue balance to reduce or “offset” the exposure related to the receivable balance for which the estimate of expected credit losses is being determined.

However, we acknowledge that there may be situations in which an entity is prohibited from recognizing revenue because of certain requirements in ASC 606, even though it has transferred the related goods or services. In this case, it would not be appropriate to reduce the exposure related to the receivable by some or all of the deferred revenue recognized by the entity because it has already delivered the goods or services and therefore cannot reduce its exposure to credit losses by not performing under the terms of the arrangement.

Q&A 5-7  Recognition of Expected Credit Losses on Sales Tax Receivables From Customers

A receivable from a customer that is recognized as part of a revenue transaction may include an amount collected from the customer related to a sales tax imposed by a tax authority. The seller will generally have a corresponding payable for the sales tax amount it is required to remit to the tax authority. In limited circumstances, the seller may not be obligated to pay the sales tax amount to the tax authority if the customer defaults on the receivable.

**Question**

Is an entity required to measure and recognize an allowance for expected credit losses on sales tax receivables from customers?
**Answer**

It depends. We believe that if the entity is required to pay the sales tax amount to a tax authority regardless of whether the customer defaults on the sales tax receivable, the entity is exposed to credit losses and an allowance for expected losses should be recognized in accordance with ASC 326-20. However, if an entity is not obligated to pay the sales tax amount to the tax authority if the customer defaults on the receivable, the entity has no exposure to credit losses and would not be required to recognize an allowance for credit losses.

### 5.2.2 Contract Assets

Contract assets arise when an entity recognizes revenue but the entity’s right to consideration depends on something other than the mere passage of time (e.g., the satisfaction of additional performance obligations in the contract). Contract assets are commonly referred to as unbilled receivables. ASC 606-10-45-3 states that an entity should assess whether a contract asset is impaired in accordance with ASC 310 (before the adoption of ASU 2016-13) or ASC 326-20 (after the adoption of ASU 2016-13). Because the collection of unbilled receivables depends on something other than just the passage of time (e.g., future performance under the contract), contract assets may take longer to recover than trade receivables. Consequently, an entity that has contract asset balances may be more exposed to expected credit losses for recorded amounts than an entity that has only short-term trade receivables. If the entity’s policy for determining incurred losses on trade receivables (e.g., a matrix approach) does not contemplate contract assets, it may need to implement additional policies and procedures to reflect such assets in its allowance for expected credit losses.

The following example illustrates how a contract asset is recorded under ASC 606 and is recovered over a contract period:

#### Example 5-3

On January 1, 20X1, Entity X enters into an arrangement to license its software to Customer Y for five years. As part of the arrangement, X also agrees to provide coterminous postcontract customer support (PCS). In exchange for the license to X’s software and PCS, Y agrees to pay X an annual fee of $500, invoiced at the beginning of each year (total transaction price of $2,500), with payments due within 60 days of invoice (i.e., 60 days after the first of each year).

Entity X concludes the following about its arrangement with Y:

- The promises to deliver the software license and PCS represent distinct performance obligations. Using a stand-alone selling price allocation method, X allocates 60 percent of the total transaction price to the software license and 40 percent to the PCS.
- Entity X’s software is a form of functional intellectual property; therefore, the license grants Y the right to use its intellectual property for the five-year contract term. As a result, X satisfies its performance obligation to transfer the software license at a point in time (i.e., contract inception).
- Entity X’s promise to provide PCS is satisfied over time by using a time-based measure of progress (i.e., ratably over the five-year contract term).
- Entity X concludes that the contract does not contain a significant financing component.²

² Entities may need to apply significant judgment to determine whether the transaction price should be adjusted to account for a significant financing component. See ASC 606-10-32-15 through 32-20 for more information.
Example 5-3 (continued)

In accordance with ASC 606, X recognizes revenue as follows:

**Journal Entry: January 1, 20X1**

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade receivable</td>
<td>500</td>
</tr>
<tr>
<td>Contract asset</td>
<td>1,200</td>
</tr>
<tr>
<td>Revenue — license</td>
<td>1,500*</td>
</tr>
<tr>
<td>Contract liability**</td>
<td>200</td>
</tr>
</tbody>
</table>

* This amount equals the portion of the total transaction price ($2,500) allocated to the software license (60 percent).
** Under ASC 606, contract assets and liabilities in the same contract are presented on a net basis; however, in this example, the assets and liabilities have been broken out to illustrate the amortized cost basis of the contract asset.

Each year, X provides PCS under the contract and bills the customer $500. Of that $500, $300 effectively is applied against the contract asset recorded when the license was transferred to the customer while the other $200 is related to PCS provided each year. Consequently, the contract asset would have a four-year contractual term (the period over which X will collect the contract asset). Upon adopting ASU 2016-13, X will need to estimate the losses that it will incur over the contractual term (i.e., four years) when determining the loss allowance to record on the contract asset.

5.3 Lease Receivables

Unlike receivables arising from operating leases (see Section 2.2 for more information), net investments resulting from sales-type or direct financing leases are within the scope of ASC 326 and lessors will therefore need to determine expected credit losses for such instruments. Under ASC 840, a lessor was required to assess the net investment in a lease for impairments by assessing (1) the lease receivable in accordance with ASC 310 and (2) the unguaranteed residual asset in accordance with ASC 360. However, ASC 842 did not carry forward the dual model for assessing impairment of the net investment in the lease.

In the Background Information and Basis for Conclusions of ASU 2016-02, the FASB noted that including two impairment models would be overly complex and that the benefits of the resulting financial statement information would not justify its costs. Moreover, the Board indicated that the net investment in a lease primarily comprises a financial lease receivable (i.e., the unguaranteed residual asset is often insignificant) and therefore should be accounted for as a financial asset under ASC 310. Thus, although the unguaranteed residual asset included in a lessor’s net investment in a lease does not meet the definition of a financial asset, a lessor that adopts ASU 2016-13 will be required to apply the CECL model to the net investment in the lease, including both the lease receivable and the unguaranteed residual asset.

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3 For simplicity, only the journal entries at contract inception and for annual reporting periods are provided.
Q&A 5-8  Measuring Expected Credit Losses on a Net Investment in a Lease

ASC 842-30-35-3 provides guidance on how a lessor should determine an impairment related to a net investment in a lease. According to that guidance, when a lessor performs its evaluation, the collateral it considers should include the cash flows that the lessor would expect to derive from the underlying asset after the end of the lease term. Specifically, ASC 842-30-35-3 states:

A lessor shall determine the loss allowance related to the net investment in the lease and shall record any loss allowance in accordance with Subtopic 326-20 on financial instruments measured at amortized cost. When determining the loss allowance for a net investment in the lease, a lessor shall take into consideration the collateral relating to the net investment in the lease. The collateral relating to the net investment in the lease represents the cash flows that the lessor would expect to receive (or derive) from the lease receivable and the unguaranteed residual asset during and following the end of the remaining lease term. [Emphasis added]

**Question**
When evaluating the impairment of a net investment in a lease, how should a lessor include the cash flows that it would expect to derive from the underlying asset at the end of the lease term?

**Answer**
The unit of account used when the impairment model is applied from the lessor’s perspective is meant to encompass the amounts related to the entire net investment in the lease, including the residual asset. Therefore, when evaluating the net investment in a sales-type or direct financing lease for impairment, a lessor should use the cash flows it expects to derive from the underlying asset during the remaining lease term as well as those it expects to derive from the underlying asset at the end of the lease term (i.e., cash flows expected to be derived from the residual asset). When determining the cash flows to be derived from the residual asset, the lessor should consider the amounts it would receive for releasing or selling the underlying asset to a third party but should not consider the expected credit risk of the potential future lessee or buyer of the underlying asset (i.e., it would not be appropriate for the lessor to include a credit risk assumption in its analysis since it does not know the identity of the theoretical future lessee or buyer).

Q&A 5-9  Gains and Losses on Subsequent Dispositions of Leased Assets

**Question**
When measuring expected credit losses on a portfolio of net investment in leases, should an entity consider gains arising from the subsequent disposition of leased assets?

**Answer**
Yes. At the June 2018 TRG meeting, the FASB staff stated that “entities should estimate expected cash flows from the subsequent disposition of leased assets (whether those result in expected gains or losses on disposal) when calculating expected credit losses on a portfolio of net investments in leases under the guidance in Subtopic 326-20 if that estimate is reasonable and supportable consistent with the treatment of other inputs to the calculation of expected credit losses.” That is, the FASB staff does not view the pool-level assessment required under ASC 326-20 as precluding the inclusion of “cash flows from the subsequent disposition of leased assets expected to result in gains on disposal from the calculation of expected credit losses.”

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See TRG Memo 7.
However, we believe that the inclusion of expected gains on the disposal of leased assets should not, by itself, cause an entity's allowance for expected credit losses to be negative. That is, while an entity should include in its estimate of expected credit losses the cash flows expected upon the disposition of the leased assets, we believe that the amount of cash flows related to gains on the disposal of such assets should be limited to the amount necessary to offset any expected credit losses on the lease payments.

**Example**

Lessor's portfolio of sales-type leases has a net investment balance of $6 million. On the basis of its historical experience and its reasonable and supportable forecasts, Lessor estimates that 4 percent will default. Given the projected net investment balance at the time of the defaults and the estimated proceeds from the disposition of the leased assets, Lessor expects $200,000 of credit losses. In addition, it expects to recover $50,000 from the sale of the assets included in its performing leases (i.e., those that will not default during the lease term). On the basis of the FASB staff's response at the TRG meeting, Lessor would estimate its expected credit losses as the sum of (1) its expected credit losses resulting from expected defaults plus (2) the gains it expects to recover from the disposition of assets on the leases that do not default. That is, Lessor's expected credit losses would be $150,000, calculated as the net amount expected to be collected at the pool level.

### 5.4 Reinsurance Receivables

A reinsurance transaction is one in which a reinsurer (an assuming entity) assumes all or part of a risk undertaken originally by another insurer (a ceding entity) for consideration. As noted in Chapter 2, ASC 326-20 applies to all reinsurance receivables that result from insurance transactions within the scope of ASC 944 regardless of the underlying measurement basis of the receivables (i.e., measured at amortized cost or on a discounted basis). The CECL model does not have any special provisions or guidance that specifically applies to reinsurance receivables. However, we believe that an entity will need to carefully consider the following when applying the CECL model to reinsurance receivables:

- **Isolating credit risk** — Determining what portion of the collectibility concerns about reinsurance receivables is related to credit risk versus other risks (e.g., dispute risk, legal risk).
- **Unit of account** — ASC 326-20 requires entities to perform a collective assessment if the reinsurance receivables share similar risk characteristics.

#### 5.4.1 Isolating Credit Risk

ASC 944-310-35-4 states that “the ceding entity shall assess the collectibility of those [reinsurance] recoverables in accordance with Subtopic 450-20.” Accordingly, under current U.S. GAAP, an entity is not required to consider the reasons why collectibility concerns exist. Rather, ASC 944 requires entities to evaluate such concerns in accordance with ASC 450-20, even if they result from a combination of different risks associated with the asset.

However, ASU 2016-13 amended ASC 944-310-35-4 to state that although “[a]n entity shall measure contingent losses relating to disputed amounts in accordance with Subtopic 450-20 on loss contingencies[,] the ceding entity shall measure expected credit losses relating to reinsurance recoverables in accordance with Subtopic 326-20 on financial instruments measured at amortized cost” (emphasis added). Consequently, under ASU 2016-13, an entity is required to isolate the collectibility concerns that are related only to credit risk and measure the expected credit losses in accordance with ASC 326. The requirement to bifurcate risks to isolate credit risk may be challenging for entities that have reinsurance receivables.
5.4.2 Unit of Account

As described in Chapter 3, the CECL model does not prescribe a unit of account (e.g., an individual asset or a group of financial assets) in the measurement of expected credit losses. However, an entity is required to evaluate financial assets within the scope of the model on a collective (i.e., pool) basis when assets share similar risk characteristics. If a financial asset's risk characteristics are not similar to those of any of the entity's other financial assets, the entity would evaluate that asset individually.

Although entities will be required to use judgment when evaluating the risk characteristics of all financial assets, they will need to pay particular attention to the specific risk characteristics of reinsurance receivables. Example 17 in ASC 326-20 illustrates the evaluation of different types of risks related to reinsurance receivables.

<table>
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<th>ASC 326-20</th>
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**Example 17: Identifying Similar Risk Characteristics in Reinsurance Recoverables**

55-81 Reinsurance recoverables may comprise a variety of risks that affect collectibility including:

- a. Credit risk of the reinsurer/assuming company
- b. Contractual coverage disputes between the reinsurer/assuming company and the insurer/ceding company including contract administration issues
- c. Other noncontractual, noncoverage issues including reinsurance billing and allocation issues.

55-82 This Subtopic only requires measurement of expected losses related to the credit risk of the reinsurer/assuming company.

55-83 In situations in which similar risk characteristics are not present in the reinsurance recoverables, the ceding insurer should measure expected credit losses on an individual basis. Similar risk characteristics may not exist because any one or a combination of the following factors exists, including, but not limited to:

- a. Customized reinsurance agreements associated with individual risk geographies
- b. Different size and financial conditions of reinsurers that may be either domestic or international
- c. Different attachment points among reinsurance agreements
- d. Different collateral terms of the reinsurance agreements (such as collateral trusts or letters of credit)
- e. The existence of state-sponsored reinsurance programs.

55-84 However, similar risk characteristics may exist for certain reinsurance recoverables because any one or combination of the following exists:

- a. Reinsurance agreements that have standardized terms
- b. Reinsurance agreements that involve similar insured risks and underwriting practices
- c. Reinsurance counterparties that have similar financial characteristics and face similar economic conditions.

55-85 Judgment should be applied by ceding insurers in determining if and when similar risks exist within their reinsurance recoverables.
Chapter 6 — Purchased Credit-Deteriorated Assets

6.1 Introduction
Since the beginning of its credit losses project, the FASB has sought to develop a model in which an entity would recognize in net income, in each reporting period (including upon initial recognition), a credit loss expense that arises from an allowance for expected credit losses that reflects management's current estimate of such losses for both originated and purchased assets. However, as discussed in paragraph BC85 of ASU 2016-13, the Board questioned whether the same model should be applied to all originated and purchased assets:

[R]ecognizing interest revenue on the basis of contractual cash flows for all purchased assets could result in situations in which an entity accretes to an amount that it does not expect to collect, which would result in artificially inflated yields. For this reason, the Board concluded that when recognizing interest income on certain assets, it is inappropriate to accrete from the purchase price to the contractual cash flows. Specifically, when a purchased asset has deteriorated more than insignificantly since origination, it is more decision useful to exclude the credit discount from the amount accreted to interest income. As a result, the discount embedded in the purchase price that is attributable to credit losses at the date of acquisition of a purchased financial asset with credit deterioration should not be recognized as interest income.

On the basis of that logic, the Board developed an alternative credit loss and interest income recognition model for acquired assets for which a certain level of credit deterioration has occurred since origination. The alternative model applies to PCD assets (see discussion below of what constitutes a PCD asset). An entity's method for measuring expected credit losses on PCD assets should be consistent with its method for measuring such losses on originated and purchased non-credit-deteriorated assets. Upon acquiring a PCD asset, the entity would recognize its allowance for expected credit losses as an adjustment that increases the asset's cost basis (the “gross-up” approach). After initial recognition of the PCD asset and its related allowance, the entity would continue to apply the CECL model to the asset — that is, any changes in the estimate of cash flows that the entity expects to collect (favorable or unfavorable) would be recognized immediately as credit loss expense in the income statement. Interest income recognition would be based on the purchase price plus the initial allowance accreting to the contractual cash flows.

6.2 Scope of the PCD Model
ASU 2016-13 adds the following definition of PCD assets to the ASC master glossary:

Acquired individual financial assets (or acquired groups of financial assets with similar risk characteristics) that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer's assessment.
ASC 326 does not specify either the cause of “more-than-insignificant deterioration” or the factors an entity should consider when assessing whether the deterioration in the credit quality of an asset (or a group of assets) has been more than insignificant since origination. Paragraph BC90 of ASU 2016-13 notes that the FASB did not want to identify which assets would meet the definition of a PCD asset:

Some stakeholders requested clarification on which purchased financial assets should be recognized through a gross-up approach. The Board discussed the definition of purchased assets with credit deterioration and did not intend for the gross-up approach to be limited to nonaccrual loans or other assets that may have been considered to be an “impaired” asset before the issuance of the amendments in this Update. The Board was concerned that stakeholders would misinterpret the guidance and apply the guidance to the same scope of assets as Subtopic 310-30. As a result, the Board clarified that a gross-up approach should be applied to purchased financial assets with a more-than-insignificant amount of credit deterioration since origination. This change in wording was recommended by user stakeholders. In addition, the Board concluded that this will expand the population of purchased financial assets that are eligible to be considered purchased financial assets with credit deterioration.

Although ASC 326 does not discuss what constitutes a more-than-insignificant deterioration in credit quality, it does provide an example illustrating one way in which an entity may evaluate the credit quality of purchased financial assets.

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**Example 11: Identifying Purchased Financial Assets With Credit Deterioration**

55-57 This Example illustrates factors that may be considered when assessing whether the purchased financial assets have more than an insignificant deterioration in credit quality since origination.

55-58 Entity N purchases a portfolio of financial assets subsequently measured at amortized cost basis with varying levels of credit quality. When determining which assets should be considered to be in the scope of the guidance for purchased financial assets with credit deterioration, Entity N considers the factors in paragraph 326-20-55-4 that are relevant for determining collectibility.

55-59 Entity N assesses what is more-than-insignificant credit deterioration since origination and considers the purchased assets with the following characteristics to be consistent with the factors that affect collectibility in paragraph 326-20-55-4. Entity N records the allowance for credit losses in accordance with paragraph 326-20-30-13 for the following assets:

- Financial assets that are delinquent as of the acquisition date
- Financial assets that have been downgraded since origination
- Financial assets that have been placed on nonaccrual status
- Financial assets for which, after origination, credit spreads have widened beyond the threshold specified in its policy.

55-60 Judgment is required when determining whether purchased financial assets should be recorded as purchased financial assets with credit deterioration. Entity N’s considerations represent only a few of the possible considerations. There may be other acceptable considerations and policies applied by an entity to identify purchased financial assets with credit deterioration.
Example 11 in ASC 326-20 illustrates that an entity could use the factors in ASC 326-20-55-4 to evaluate whether the deterioration of an asset's credit quality has been more than insignificant. ASC 326-20-55-4 states, in part:

Examples of factors an entity may consider include any of the following, depending on the nature of the asset (not all of these may be relevant to every situation, and other factors not on the list may be relevant):

a. The borrower's financial condition, credit rating, credit score, asset quality, or business prospects
b. The borrower's ability to make scheduled interest or principal payments
c. The remaining payment terms of the financial asset(s)
d. The remaining time to maturity and the timing and extent of prepayments on the financial asset(s)
e. The nature and volume of the entity's financial asset(s)
f. The volume and severity of past due financial asset(s) and the volume and severity of adversely classified or rated financial asset(s)
g. The value of underlying collateral on financial assets in which the collateral-dependent practical expedient has not been utilized
h. The entity's lending policies and procedures, including changes in lending strategies, underwriting standards, collection, writeoff, and recovery practices, as well as knowledge of the borrower's operations or the borrower's standing in the community
i. The quality of the entity's credit review system
j. The experience, ability, and depth of the entity's management, lending staff, and other relevant staff
k. The environmental factors of a borrower and the areas in which the entity's credit is concentrated, such as:
   1. Regulatory, legal, or technological environment to which the entity has exposure
   2. Changes and expected changes in the general market condition of either the geographical area or the industry to which the entity has exposure
   3. Changes and expected changes in international, national, regional, and local economic and business conditions and developments in which the entity operates, including the condition and expected condition of various market segments.

These factors are provided in the context of how an entity might adjust historical loss information on the basis of certain conditions and characteristics that affect the asset's collectibility. While the existence of these factors may signify that collectibility concerns are associated with a particular asset (or group of assets), it may not indicate that the asset (or group of assets) should be considered PCD because an entity can only conclude that an asset is PCD if the deterioration of its credit quality has been more than insignificant since origination.

Connecting the Dots — Considerations Related to AFS Debt Securities Under the PCD Model
The PCD model applies to an AFS debt security that meets the definition of a PCD asset. To determine whether this definition is met, an entity must consider the factors in ASC 326-30-55-1, which are the same factors that an investor uses to identify whether there is a credit loss on an AFS debt security. In addition, the subsequent-accounting guidance in ASC 326-30 on AFS debt securities that are considered PCD assets slightly differs from the PCD model for assets measured at amortized cost (e.g., loans and HTM debt securities). See Section 7.2.5 for further discussion of the accounting for AFS debt securities that are considered PCD assets.
Changing Lanes — Scope of the PCD Model Differs From That of the PCI Model

As noted previously, ASU 2016-13 defines a PCD asset as an acquired asset that has “experienced a more-than-insignificant deterioration in credit quality since origination.” Under current U.S. GAAP, a purchased credit-impaired (PCI) asset accounted for under ASC 310-30 is considered credit-impaired if it is probable that the investor would be unable to collect all contractual cash flows because of deterioration in the asset's credit quality since origination. Consequently, in determining whether the credit deterioration of an acquired asset has been more than insignificant, entities will most likely need to use more judgment when applying the guidance in ASU 2016-13 than they do under current guidance.

Q&A 6-1  PCD Model Applies to BIs

Question
Are BIs in securitized financial assets within the scope of the PCD model?

Answer
It depends. The PCD model applies to assets that meet the definition of PCD assets as well as to certain BIs in debt securities that do not necessarily meet that definition (see Connecting the Dots below). ASC 325-40-30-1A (added by ASU 2016-13) states:

An entity shall apply the initial measurement guidance for purchased financial assets with credit deterioration in Subtopic 326-20 to a beneficial interest classified as held-to-maturity and in Subtopic 326-30 to a beneficial interest classified as available for sale, if it meets either of the following conditions:

a. There is a significant difference between contractual cash flows and expected cash flows at the date of recognition.

b. The beneficial interests meet the definition of purchased financial assets with credit deterioration.

For more information about BIs accounted for under ASC 325-40, see Section 6.4.

Connecting the Dots — PCD Model May Apply to a BI That Does Not Meet the Definition of a PCD Asset

Under ASC 325-40-30-1A (see Q&A 6-1 above), an entity may need to account for a BI under the respective PCD model in ASC 326-20 or ASC 326-30, even if the BI does not meet the definition of a PCD asset. For example, the entity may be required to apply the PCD model to certain BIs in new securitizations (i.e., securitizations for which there is no deterioration in credit quality because they are new) since there may be a significant difference between contractual cash flows and expected cash flows on the date of recognition.

Q&A 6-2  Application of PCD Model to Assets Acquired in a Business Combination

Question
Does the PCD model apply to assets acquired in a business combination?
Answer

Yes. The PCD model applies to any acquired asset whose deterioration in credit quality has been more than insignificant since origination. Paragraph BC88 of ASU 2016-13 states that “the Board concluded that there is no inherent difference between assets acquired in a business combination and those that are purchased outside a business combination.”

An entity will still have to evaluate whether the individual financial assets (or groups of financial assets with similar risk characteristics) acquired in a business combination meet the definition of a PCD asset before applying the PCD model. This may differ from the current practice in which an entity can elect to apply ASC 310-30 to a pool of acquired assets even if it cannot assert that each individual asset acquired is within the scope of ASC 310-30.¹

Note that while it may generally be relatively simple to determine whether the PCD model applies to acquired assets in a business combination, an entity may be required to perform an additional step if those acquired assets were previously written off by the seller. We believe that, in those instances, the acquirer would first need to evaluate whether it still has a contractual right to the cash flows of the asset at the time of acquisition and therefore has an asset to recognize. If the acquirer determines that it has a contractual right to the cash flows of a financial asset that was previously written off, we believe that it would then apply the PCD model to the acquired assets as of the acquisition date.

Q&A 6-3 Partially Funded Lines of Credit That Are PCD

Question

How should an acquirer account for draws on a partially funded line of credit that are PCD at acquisition and noncancelable by the acquirer?

Answer

Upon initially acquiring the partially drawn line of credit, the acquirer should account for the funded portion (that is considered to be PCD) in a manner similar to how it would account for any other PCD asset, as described in ASC 326-20-30-13. The accounting for the unfunded portion of the line of credit would be the same as that prescribed in ASC 326-20-30-11 for all unfunded loan commitments. That is, a liability for the expected credit losses should be recognized for the unfunded portion of the line of credit for which subsequent adjustments as of each reporting date are reported in net income as credit loss expense. In addition, adjustments to the allowance for expected credit losses on the funded portion of the line of credit are also reported in net income as credit loss expense.

As the entity continues to draw down on the line of credit, the acquirer would revise its estimate for credit losses recognized on the unfunded portion of the line of credit (i.e., potentially reducing its liability for off-balance-sheet credit exposure) while adjusting the allowance for expected credit losses on the funded loan amount (to reflect the newly funded amount).

¹ In a December 18, 2009, letter to the SEC staff, the AICPA documented the SEC staff’s position that after a purchase of loans in a business acquisition or an asset purchase, an entity is permitted to make an accounting policy election to accrete the discount on the basis of either contractual cash flows (by using an ASC 310-20 approach) or expected cash flows (by using an ASC 310-30 approach) for portfolios of acquired assets for which the entity does not individually evaluate each asset to determine whether it meets the scope requirements of ASC 310-30. Accordingly, some loans in the portfolio may individually meet the scope criteria while others may not.
Q&A 6-4 Whether Pushdown Accounting Results in Applying PCD Accounting at the Subsidiary Level

Question
If an acquiree elects to apply pushdown accounting under ASC 805-50, should it reflect the parent-level PCD accounting in its separate, stand-alone financial statements?

Answer
Yes. Under ASC 805-50-30-10, if an acquiree elects to apply pushdown accounting, the carrying amounts of its assets and liabilities in its separate financial statements are adjusted to reflect the amounts recognized in the acquirer’s consolidated financial statements as of the date on which control was obtained. As a result, if the acquirer applies (or would have applied) PCD accounting at the consolidated level to assets acquired and the acquiree elects to apply pushdown accounting, the acquiree would need to adjust its assets to reflect the application of PCD accounting in its separate, stand-alone financial statements. Note that an acquiree that elects pushdown accounting must apply it in its entirety; the acquiree cannot pick and choose which assets or liabilities to recognize in its separate financial statements.

Q&A 6-5 Accounting for a Net Investment in a Lease by Using the PCD Model

Question
Should a lessor consider a decline in the fair value of the residual asset in an acquired net investment in a sales-type or direct financing lease when evaluating whether the net investment in the lease meets the definition of a PCD asset?

Answer
Yes. The unit of account used when the impairment model is applied from the lessor’s perspective is meant to encompass amounts related to the entire net investment in the lease, which would include the residual asset. Therefore, we believe that when evaluating whether the deterioration in the credit quality of an acquired net investment in a sales-type or direct financing lease has been more than insignificant since origination, the lessor should consider declines in the (1) lessee’s credit quality that are related to lease payments and (2) fair value of the underlying residual asset.

6.2.1 Unit of Account for PCD Assets
The unit of account used in the PCD model depends on the type of financial asset to which the entity is applying the PCD model. An entity is allowed to evaluate the applicability of the PCD model to loans, HTM debt securities, and other assets measured at amortized cost on a collective basis if they share similar risk characteristics (see Section 3.2). However, the entity is not permitted to determine whether PCD accounting applies to AFS debt securities on a collective or pool basis; instead, it must make that determination on the basis of each individual AFS debt security. For more information about the PCD assessment for AFS debt securities, see Q&A 7-8.
ASC 310-30-40-1 states that, among other things, “once a pool of [PCI] loans is assembled, the integrity of the pool shall be maintained” and that a loan could only be removed if it met certain conditions. ASU 2016-13 removes that language. As a result, the general principles in ASC 326-20 that address the unit of account apply similarly to all assets measured at amortized cost. That is, an entity must evaluate financial assets within the scope of the model on a collective (i.e., pool) basis if they share similar risk characteristics. If a financial asset’s risk characteristics are not similar to those of any of the entity’s other financial assets, the entity would evaluate that financial asset individually. For more information about when to remove a financial asset from a pool of financial assets, including PCD assets, see Q&A 3-1.

However, note that the transition guidance in ASU 2016-13 allows an entity to continue to apply ASC 310-30 to pools of PCI assets if it elects to maintain those pools when adopting ASU 2016-13. As discussed in Q&A 9-1, entities have a choice of maintaining their existing pools accounted for under ASC 310-30 either at adoption only or on an ongoing basis after adoption. Furthermore, an entity’s approach to maintaining its existing pools should be determined on a pool-by-pool basis. As a result, while ASC 326-20 does not require an entity to maintain the integrity of a pool of PCD assets, an entity would be required to do so if it elected to maintain its pools of PCI assets upon adopting ASU 2016-13.

### 6.3 Recognition and Measurement Under the PCD Model

#### 6.3.1 Overview

<table>
<thead>
<tr>
<th>ASC 326-20</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>30-13</strong> An entity shall record the allowance for credit losses for purchased financial assets with credit deterioration in accordance with paragraphs 326-20-30-2 through 30-10, 326-20-30-12, and 326-20-30-13A. An entity shall add the allowance for credit losses at the date of acquisition to the purchase price to determine the initial amortized cost basis for purchased financial assets with credit deterioration. Any noncredit discount or premium resulting from acquiring a pool of purchased financial assets with credit deterioration shall be allocated to each individual asset. At the acquisition date, the initial allowance for credit losses determined on a collective basis shall be allocated to individual assets to appropriately allocate any noncredit discount or premium.</td>
</tr>
<tr>
<td><strong>30-13A</strong> The allowance for credit losses for purchased financial assets with credit deterioration shall include expected recoveries of amounts previously written off and expected to be written off by the entity and shall not exceed the aggregate of amounts previously written off and expected to be written off by the entity.</td>
</tr>
<tr>
<td>a. If the entity estimates expected credit losses using a method other than a discounted cash flow method in accordance with paragraph 326-20-30-4, expected recoveries shall not include any amounts that result in an acceleration of the noncredit discount.</td>
</tr>
<tr>
<td>b. The entity may include increases in expected cash flows after acquisition.</td>
</tr>
<tr>
<td>(See Examples 18 and 19 in paragraphs 326-20-55-86 through 55-90.)</td>
</tr>
<tr>
<td><strong>30-14</strong> If an entity estimates expected credit losses using a discounted cash flow method, the entity shall discount expected credit losses at the rate that equates the present value of the purchaser’s estimate of the asset’s future cash flows with the purchase price of the asset. If an entity estimates expected credit losses using a method other than a discounted cash flow method, the entity shall estimate expected credit losses on the basis of the unpaid principal balance (face value) of the financial asset(s). See paragraphs 326-20-55-66 through 55-78 for implementation guidance and examples.</td>
</tr>
</tbody>
</table>
As previously stated, an entity’s initial recognition of expected credit losses for PCD assets differs from that for non-PCD assets. Upon acquiring a PCD asset, the entity would recognize its allowance for expected credit losses as an adjustment that increases the asset’s cost basis (the “gross-up” approach). After initial recognition of the PCD asset and its related allowance, the entity would continue to apply the CECL model to the asset — that is, it would immediately recognize in the income statement any changes in its estimate of the cash flows it expects to collect (favorable or unfavorable). Consequently, any subsequent changes to the entity’s estimate of expected credit losses — whether unfavorable or favorable — would be recorded as credit loss expense (or a reduction of expense) during the period of change. Interest income recognition would be based on the purchase price plus the initial allowance accreting to the contractual cash flows.

**Changing Lanes — Eliminating Asymmetrical Accounting From U.S. GAAP**

Currently, an entity that is accounting for PCI assets recognizes unfavorable changes in expected cash flows as an immediate credit impairment but treats favorable changes in expected cash flows as prospective yield adjustments. The CECL model’s approach to PCD assets eliminates this asymmetrical treatment of cash flow changes by requiring an entity to record all subsequent changes to its estimate of expected credit losses — whether unfavorable or favorable — as impairment expense (or a reduction of expense) during the period of change. However, in a manner consistent with current practice, the model precludes an entity from recognizing as interest income the discount embedded in the purchase price that is attributable to the expected credit losses as of the acquisition date.

### 6.3.2 Initial Recognition

A key difference between the PCD model and the credit losses model lies in how an entity recognizes expected credit losses on a PCD asset when it is acquired. As described in ASC 326-20-30-1, for financial assets not considered to be PCD, “[a]n entity shall report in net income (as a credit loss expense) the amount necessary to adjust the allowance for credit losses for management’s current estimate of expected credit losses on financial asset(s)” (emphasis added). However, as previously stated, the FASB believes that there is a certain subset of assets for which the entity should not apply the guidance in ASC 326-20-30-1, specifically the requirement to recognize in net income the credit losses the entity expects upon acquisition.

As a result, for an asset that meets the definition of a PCD asset, the FASB believes that an entity should apply the gross-up approach when initially recognizing expected credit losses upon acquisition. That is, upon acquiring the PCD asset, the entity would recognize such losses as an adjustment to the asset’s cost basis. Because the entity applies the gross-up approach to recognize expected credit losses on PCD assets, it does not recognize in net income the initial expected credit losses on those assets.
Example 12 in ASC 326-20 illustrates how an entity would apply the PCD model, specifically the gross-up approach to recognizing expected credit losses as an adjustment to the amortized cost basis of the acquired assets.

**ASC 326-20**

*Example 12: Recognizing Purchased Financial Assets With Credit Deterioration*

**55-61** This Example illustrates application of the guidance to an individual purchased financial asset with credit deterioration.

**55-62** Under paragraphs 326-20-30-13 and 310-10-35-53B, for purchased financial assets with credit deterioration, the discount embedded in the purchase price that is attributable to expected credit losses should not be recognized as interest income and also should not be reported as a credit loss expense upon acquisition.

**55-63** Bank O records purchased financial assets with credit deterioration in its existing systems by recognizing the amortized cost basis of the asset, at acquisition, as equal to the sum of the purchase price and the associated allowance for credit loss at the date of acquisition. The difference between amortized cost basis and the par amount of the debt is recognized as a noncredit discount or premium. By doing so, the credit-related discount is not accreted to interest income after the acquisition date.

**55-64** Assume that Bank O pays $750,000 for a financial asset with a par amount of $1 million. The instrument is measured at amortized cost basis. At the time of purchase, the allowance for credit losses on the unpaid principal balance is estimated to be $175,000. At the purchase date, the statement of financial position would reflect an amortized cost basis for the financial asset of $925,000 (that is, the amount paid plus the allowance for credit loss) and an associated allowance for credit losses of $175,000. The difference between par of $1 million and the amortized cost of $925,000 is a non-credit-related discount. The acquisition-date journal entry is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan — par amount</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Loan — noncredit discount</td>
<td>$75,000</td>
</tr>
<tr>
<td>Allowance for credit losses</td>
<td>175,000</td>
</tr>
<tr>
<td>Cash</td>
<td>750,000</td>
</tr>
</tbody>
</table>

**55-65** Subsequently, the $75,000 noncredit discount would be accreted into interest income over the life of the financial asset consistent with other Topics. The $175,000 allowance for credit losses should be updated in subsequent periods consistent with the guidance in Section 326-20-35, with changes in the allowance for credit losses on the unpaid principal balance reported immediately in the statement of financial performance as a credit loss expense.

### 6.3.3 Initial and Subsequent Measurement

ASC 326-20-30-14 permits an entity to use various methods to estimate expected credit losses for PCD assets. This guidance is similar to that for non-PCD assets in ASC 326-20-30-3 (see Section 4.4 for more information). ASC 326-20-30-14 states, in part:

If an entity estimates expected credit losses using a discounted cash flow method, the entity shall discount expected credit losses at the rate that equates the present value of the purchaser’s estimate of the asset’s future cash flows with the purchase price of the asset. If an entity estimates expected credit losses using a method other than a discounted cash flow method, the entity shall estimate expected credit losses on the basis of the unpaid principal balance (face value) of the financial asset(s).
Although there are similarities between the methods an entity uses to estimate expected credit losses for PCD assets and those for non-PCD assets, there are also two distinct differences:

- Application of the DCF method:
  - **Non-PCD assets** — ASC 326-20-30-4 requires an entity to discount expected credit losses by using the asset’s EIR (i.e., the rate of return implicit in the financial asset).
  - **PCD assets** — ASC 326-20-30-14 requires an entity to discount expected credit losses by using a “rate that equates the present value of the purchaser’s estimate of the asset’s future cash flows with the purchase price of the asset.” For an illustration of how an entity would apply the DCF method to estimate expected credit losses on PCD assets, see Example 14 in ASC 326-20-55-72 through 55-78.

- Application of a method other than the DCF method (e.g., a loss-rate method):
  - **Non-PCD assets** — ASC 326-20-30-5 requires an entity to estimate expected credit losses on the basis of an asset’s amortized cost.
  - **PCD assets** — ASC 326-20-30-14 requires an entity to estimate expected credit losses “on the basis of [the asset’s] unpaid principal balance.” For an illustration of how an entity would apply a loss-rate method to estimate expected credit losses on PCD assets, see Example 13 in ASC 326-20-55-66 through 55-71.

Paragraphs BC92 and BC93 of ASU 2016-13 provide the FASB’s rationale for the differences between the measurement guidance for PCD assets and that for non-PCD assets:

**BC92.** For purchased financial assets with credit deterioration, the Board decided to include additional guidance on how to determine the amortized cost basis and effective interest rate due to circularity concerns. Stakeholders noted that there could be a circularity issue because the amortized cost basis of the purchased asset with credit deterioration should include the allowance for credit losses, which may not be measured until one knows the amortized cost basis. Similarly, a circularity concern was expressed on determining the effective interest rate when measuring expected credit losses using a discounted cash flow approach. Again, the effective interest rate could not be determined for the amortized cost basis of the asset if one did not know the effective interest rate to discount the expected credit loss.

**BC93.** After receiving feedback from stakeholders on how best to operationalize the accounting for purchased financial assets with credit deterioration, the Board decided that when using a method to estimate expected credit losses that does not project future interest and principal cash flows (for example, a loss rate approach), the allowance for credit losses should be based on the unpaid principal balance (or par) amount of the asset. When using a discounted cash flow approach to estimate expected credit losses, the expected credit losses should be discounted at the rate that equates the present value of estimated future cash flows with the purchase price of the financial asset. The Board concluded that this guidance, which stakeholders did not object to, eliminates circularity concerns and maintains the flexibility to use various approaches to measure credit risk.

After initial recognition of the PCD asset and its related allowance, an entity would continue to apply the CECL model to the asset — that is, any changes to the estimate of cash flows that the entity expects to collect (favorable or unfavorable) would be recognized immediately in the income statement (such recognition differs from how the original estimate of expected credit losses was recognized under the gross-up approach).
Q&A 6-6  Modification of a PCD Asset

Question

Should an entity evaluate whether a modification of a PCD asset meets the definition of a TDR?

Answer

Yes. ASU 2016-13 deleted the guidance in ASC 310-40-15-11(d) that allowed an entity not to evaluate whether a modification of an individual PCI asset within a pool accounted for under ASC 310-30 was considered a TDR. As a result of that amendment, an entity is now required to determine whether a modification of an individual PCD asset is a TDR in accordance with ASC 310-40-15-5.

However, note that the transition guidance in ASU 2016-13 allows an entity to continue to apply ASC 310-30 to pools of PCI assets if it elects to maintain those pools when adopting ASU 2016-13. Accordingly, we believe that an entity that makes this election would not be required to evaluate whether a modification of an individual PCI asset within a pool accounted for under ASC 310-30 is a TDR. See Q&A 9-1 for more information about this transition guidance.

6.3.3.1  Expected Recoveries

<table>
<thead>
<tr>
<th>ASC 326-20</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>30-13A</strong>  The allowance for credit losses for purchased financial assets with credit deterioration shall include expected recoveries of amounts previously written off and expected to be written off by the entity and shall not exceed the aggregate of amounts previously written off and expected to be written off by the entity.</td>
</tr>
<tr>
<td>a. If the entity estimates expected credit losses using a method other than a discounted cash flow method in accordance with paragraph 326-20-30-4, expected recoveries shall not include any amounts that result in an acceleration of the noncredit discount.</td>
</tr>
<tr>
<td>b. The entity may include increases in expected cash flows after acquisition.</td>
</tr>
</tbody>
</table>

(See Examples 18 and 19 in paragraphs 326-20-55-86 through 55-90.)

ASU 2019-04 amended ASU 2016-13 to clarify that an entity should consider recoveries in its allowance for expected credit losses. However, stakeholders questioned whether an entity was required to apply this guidance to PCD assets. As a result, in ASU 2019-11, the FASB clarified that when measuring expected credit losses on a PCD asset by using an approach other than a DCF method, an entity may include increases in expected cash flows after acquisition and amounts written off or expected to be written off. However, the ASU also states that an entity is prohibited from accelerating the recognition of the asset's noncredit discount. Accordingly:

- Entities should include expected recoveries within the allowance for expected credit losses and should not directly write up the related assets.
- Because an entity recognizes expected recoveries as an adjustment to the allowance for expected credit losses, the allowance may have a negative balance in situations in which a full or partial write-off has occurred.
- Unlike the guidance on recoveries that applies to non-PCD financial assets (see Section 4.5.2), ASU 2019-11’s guidance on expected recoveries is not limited to that on the aggregate of amounts previously written off and amounts that are expected to be written off by the entity.
When a non-DCF approach is applied to a PCD asset, an entity could determine its negative allowance for a previously written-off PCD asset by performing the following two steps:

1. Subtracting the noncredit discount that existed just before write-off from the total recoveries expected to be received.
2. Applying subsequent cash recoveries to the negative allowance until the negative allowance is reduced to zero. Any additional collections would be recognized as income.

We believe that the application of these two steps achieves the FASB’s objective of not allowing entities to accelerate the recognition of the noncredit discount when writing off a PCD asset because the noncredit discount is immediately deducted from any expected recoveries. Once the noncredit discount is deducted, any increases in expected recoveries would have the effect of increasing the negative allowance and reducing the credit loss provision.

We acknowledge that there could be other acceptable methods of applying the guidance in ASC 326-20-30-13A(a) that prohibits an entity from prematurely recognizing the noncredit discount.

6.4 Considerations Related to BIs

Under ASC 325-40, as amended by ASU 2016-13, an entity should measure an allowance for expected credit losses for a purchased or retained BI in a manner consistent with how it measures an allowance for expected credit losses for PCD assets if the BI is (1) within the scope of ASC 325-40, (2) classified as AFS or HTM, and (3) meets the definition of a PCD asset or there is a significant difference between the contractual cash flows and expected cash flows of the BI.

Therefore, if a BI is within the scope of the PCD asset model, at initial recognition, the BI holder would present an allowance for expected credit losses equal to the estimate of expected credit losses and add that allowance to the purchase price to determine the initial amortized cost basis of the BI. Any subsequent changes to the entity’s estimate of expected credit losses — whether unfavorable or favorable — would be recorded as a credit loss expense (or the reduction of an expense) during the period of change. In addition, the entity must accrete changes in expected cash flows attributable to factors other than credit into interest income over the asset’s life. Changes in cash flows due to prepayments are considered credit-related and are therefore reflected as a change to the entity’s estimate of expected credit losses.

Under the CECL model, an entity must determine the contractual cash flows of BIs in securitized transactions. However, the BIs in certain structures may not have easily determinable contractual cash flows (e.g., when a BI holder receives only residual cash flows of a securitization structure). Further, ASU 2016-13 does not define the term “contractual cash flows.” In these situations, the entity may need to use a proxy for the contractual cash flows of the BI (e.g., the gross contractual cash flows of the underlying debt instrument).
Q&A 6-7 Prepayment Expectations in BIs

**Question**
Should an entity assume that there will be no prepayments when determining the contractual cash flows of BIs in securitized transactions?

**Answer**
No. As discussed at the June 2017 TRG meeting, while ASC 325-40-30-1A uses the term “contractual cash flows,” it would be reasonable for entities to determine such cash flows on the basis of the expected prepayments of the assets underlying the securitization on the acquisition date. However, in determining contractual cash flows, entities should assume that there will be no defaults. The rationale for allowing an expected level of prepayments but no expected level of defaults was to prevent expected prepayments alone from causing a BI to be accounted for under the PCD model.

Q&A 6-8 Accounting for BIs Classified as HTM Debt Securities — Comparison Between PCD and Non-PCD Guidance

**Question**
How does the guidance in ASC 325-40 on non-PCD BIs classified as HTM debt securities differ from the PCD model for BIs classified as HTM debt securities in ASC 326-20-30-13 through 30-15?

**Answer**

*Initial Accounting Under ASC 325-40*
Under ASC 325-40 (as amended by ASU 2016-13), entities must initially estimate the timing and amount of all future cash inflows from a BI within the scope of ASC 325-40 by employing assumptions used in the determination of fair value at recognition. The excess of those expected future cash flows over the initial investment is the accretable yield. Entities recognize this excess as interest income over the life of the investment by using the effective interest method.

*Subsequent Accounting Under ASC 325-40*
A subsequent adjustment to expected cash flows is recognized as a yield adjustment affecting interest income or, if related to credit, may be recognized through earnings by means of an allowance for credit losses. In other words, a cumulative adverse change in expected cash flows would be recognized as an allowance, and a cumulative favorable change in expected cash flows would be recognized as a prospective yield adjustment.

*Initial Accounting Under the PCD Model in ASC 326-20*
Under the PCD accounting model in ASC 326-20, entities are required to gross up the cost basis of a PCD asset by the estimated credit losses as of the date of acquisition and establish a corresponding allowance for credit losses. The initial allowance is based on the difference between expected cash flows and contractual cash flows (adjusted for prepayments as discussed in Q&A 6-7 above).
Subsequent Accounting Under the PCD Model in ASC 326-20

For PCD assets within the scope of ASC 325-40 that are classified as HTM debt securities, cumulative adverse changes in expected cash flows would be recognized currently as an increase to the allowance for credit losses (in a manner similar to recognition under the normal ASC 325-40 model, as amended by ASU 2016-13).

However, favorable changes in expected cash flows would first be recognized as a decrease to the allowance for credit losses (recognized currently in earnings). Favorable changes in expected cash flows would be recognized as a prospective yield adjustment only when the allowance for credit losses is reduced to zero.

Q&A 6-9 Requirement for Using a DCF Approach to Measure Credit Losses on BIs

Question
An entity is permitted to use various measurement methods to estimate expected credit losses on assets within the scope of ASC 326 (see Section 4.4). Does an entity have the same flexibility when measuring expected credit losses on BIs in securitization transactions?

Answer
No. ASC 325-40-35-7 requires an entity to use a DCF approach to measure expected credit losses on a BI in a securitization transaction within the scope of ASC 325-40. While this requirement is similar to that in existing U.S. GAAP, the requirement to use a DCF approach may result in differences between how an entity measures expected credit losses on HTM debt securities that are BIs within the scope of ASC 325-40 and how it measures such losses on other HTM debt securities. In other words, the entity may choose to use a loss-rate approach when measuring expected credit losses on an HTM debt security that is not a BI within the scope of ASC 325-40 but may be required to use a DCF approach when measuring expected credit losses on an HTM debt security that is a BI in a securitization transaction within the scope of ASC 325-40.
Chapter 7 — Available-for-Sale Debt Securities

7.1 Introduction

The CECL model does not apply to AFS debt securities. Instead, the FASB decided to make targeted improvements to the existing OTTI model in ASC 320 for AFS debt securities to eliminate the concept of “other than temporary” from that model. Although the Board originally sought to develop an expected credit losses model that would apply similarly to loans and debt securities, feedback received from stakeholders throughout the model’s development indicated that an entity manages AFS debt securities differently from how it manages other assets measured at amortized cost (e.g., loans and HTM debt securities). Accordingly, in paragraph BC81 of ASU 2016-13, the Board states that “the same credit loss model cannot apply because there are different measurement attributes. The measurement attribute for available-for-sale debt securities necessitates a separate credit loss model because an entity may realize the total value of the securities either through collection of contractual cash flows or through sales of the securities.”

The targeted changes to the existing OTTI model can be summarized as follows (see Section 7.2.3.1 for more information):

- The entity must use an allowance approach (as opposed to permanently writing down the security’s cost basis).
- The entity must limit the allowance to the amount at which the security’s fair value is less than its amortized cost basis.
- The entity may not consider the length of time fair value has been less than amortized cost.
- The entity may not consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists.

These targeted changes do not apply to an AFS debt security if (1) the entity intends to sell the security or (2) it is more likely than not that the entity will be required to sell the security before the recovery of the security’s amortized cost basis. In such cases, the entity would write down the debt security’s amortized cost to its fair value, as required under existing U.S. GAAP. The flowchart below illustrates how an entity identifies and assesses impairment on AFS debt securities.
7.1.1 Generally Consistent With Existing U.S. GAAP

Is the security's fair value less than its amortized cost?

- No: No impairment has occurred, and recognition of credit losses is not required.
- Yes:
  - Does the entity intend, or will it more likely than not be required, to sell the security before the recovery of its amortized cost basis?
    - No: A credit loss does not exist. However, the impairment should be recognized in OCI.
    - Yes: The entity should write down the security's amortized cost basis to its fair value and recognize any additional impairment in income.
  - Is the present value of cash flows expected to be collected less than the amortized cost basis of the security?
    - No: A credit loss exists. Recognize an allowance for the expected credit loss, limited by the difference between fair value and amortized cost. Continue to recognize non-credit-related losses in OCI.
    - Yes: Modified by ASU 2016-13
Chapter 7 — Available-for-Sale Debt Securities

7.2 Identifying an Impairment

7.2.1 Whether Fair Value Is Less Than Amortized Cost

<table>
<thead>
<tr>
<th>ASC 326-30</th>
</tr>
</thead>
<tbody>
<tr>
<td>35-1 An investment is impaired if the fair value of the investment is less than its amortized cost basis.</td>
</tr>
<tr>
<td>35-4 Impairment shall be assessed at the individual security level (referred to as an investment). Individual security level means the level and method of aggregation used by the reporting entity to measure realized and unrealized gains and losses on its debt securities. (For example, debt securities bearing the same Committee on Uniform Security Identification Procedures [CUSIP] number that were purchased in separate trade lots may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized and unrealized gains and losses for the debt securities.) Providing a general allowance for an unidentified impairment in a portfolio of debt securities is not appropriate.</td>
</tr>
</tbody>
</table>

Other than moving guidance from ASC 320-10 to ASC 326-30, ASU 2016-13 did not affect how an entity identifies whether there is an impairment on an AFS debt security. That is, an entity is still required to assess whether the security’s fair value is less than its amortized cost and this evaluation must be performed on an individual security level.

Q&A 7-1 Expected Loss Presumption

Question
If the fair value of an AFS debt security is less than its amortized cost, is there a presumption that a credit loss must be recognized?

Answer
Not necessarily. For AFS debt securities that an entity does not intend and is not more likely than not required to sell, ASC 326-30 requires the entity to recognize in net income the impairment amount related only to credit and to recognize in OCI the noncredit impairment amount. However, ASU 2016-13 requires an entity to use an allowance approach for AFS debt securities when recognizing credit losses (as opposed to a permanent write-down of the AFS security’s cost basis). ASC 326-30-35-2 states:

For [AFS debt securities], an entity shall determine whether a decline in fair value below the amortized cost basis has resulted from a credit loss or other factors. An entity shall record impairment relating to credit losses through an allowance for credit losses. However, the allowance shall be limited by the amount that the fair value is less than the amortized cost basis. Impairment that has not been recorded through an allowance for credit losses shall be recorded through other comprehensive income, net of applicable taxes. An entity shall consider the guidance in paragraphs 326-30-35-6 and 326-30-55-1 through 55-4 when determining whether a credit loss exists. [Emphasis added]

Entities should consider the following factors (not all-inclusive) when determining whether a credit loss exists (for more information about determining whether a credit loss exists, see Section 7.2.3):

- Adverse conditions related to the security, an industry, or a geographic area.
- The payment structure of the debt security and the likelihood that the issuer will be able to make payments that increase in the future.
- Failure of the issuer to make scheduled payments and all available information relevant to the security’s collectibility.
- Changes in the ratings assigned by a rating agency.
- Other credit enhancements that affect the security's expected performance.

The fair value of an AFS security may fall below amortized cost solely because of changes in interest rates or market liquidity, which are considered noncredit events. In that case, the entire unrealized loss will be recognized in OCI unless either (1) the entity intends to sell the security or (2) it is more likely than not that the entity will be required to sell the security. If the entity intends to sell the security or will more likely than not be required to sell it before recovery of its amortized cost basis, the entity must write down the amortized cost basis of the AFS security to its fair value as of the reporting date.

**Q&A 7-2  Management's Responsibilities**

**Question**
What are management's responsibilities with respect to evaluating investments to identify and account for impairment?

**Answer**
ASC 326-30-35-4 states that management must perform an evaluation for impairment in each reporting period “at the individual security level.” When performing this assessment, management should employ a systematic and rational method for determining whether (1) an investment is impaired and (2) a credit loss exists or the investment’s amortized cost basis needs to be written down to its current fair value. Management should document all factors it considered in reaching its conclusions about whether an investment is impaired; such documentation would typically include:

- The nature of the investment.
- The cause or causes of the impairment.
- An evaluation of management’s intent to sell any debt securities as of the measurement date (see Section 7.2.2 for more information).
- Management’s assessment of whether it is more likely than not that it will be required to sell a particular debt security before the recovery of its amortized cost basis (see Section 7.2.2 for more information).
- All information relevant to the collectibility of a debt security that was considered in management’s conclusion about whether a credit loss exists (see Q&A 7-1 for more information about the assessment of the collectibility of debt securities).

**7.2.1.1 Accrued Interest**

**ASC 326-30**

30-1A If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the fair value and the amortized cost basis of the available-for-sale debt security, an entity may develop its estimate of expected credit losses by measuring components of the amortized cost basis on a combined basis or by separately measuring the applicable accrued interest component from the other components of amortized cost basis.
In addition to its amendments on accrued interest for financial assets measured at amortized cost (see Section 4.4.4.1), ASU 2019-04 amended the guidance on how an entity considers accrued interest when measuring expected credit losses on AFS debt securities. The ASU states that for an AFS debt security, an entity is permitted to (1) evaluate for impairment and measure the allowance for credit losses on accrued interest receivable balances separately from other components of the security's amortized cost basis and (2) make an accounting policy election not to measure an allowance for credit losses on accrued interest receivable amounts if the entity excludes the accrued interest from both the fair value and amortized cost basis of the security, writes off the uncollectible accrued interest receivable balance in a timely manner, and provides certain disclosures (see Section 8.2.7).

### 7.2.2 Intent or Requirement to Sell

**ASC 326-30**

35-10 If an entity intends to sell the debt security (that is, it has decided to sell the security), or more likely than not will be required to sell the security before recovery of its amortized cost basis, any allowance for credit losses shall be written off and the amortized cost basis shall be written down to the debt security's fair value at the reporting date with any incremental impairment reported in earnings. If an entity does not intend to sell the debt security, the entity shall consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis (for example, whether its cash or working capital requirements or contractual or regulatory obligations indicate that the security will be required to be sold before the forecasted recovery occurs). In assessing whether the entity more likely than not will be required to sell the security before recovery of its amortized cost basis, the entity shall consider the factors in paragraphs 326-30-55-1 through 55-2.

### 7.2.2.1 Intent to Sell

An investor is required to assess, in each reporting period, whether it intends to sell an impaired AFS debt security. Under ASC 326-30-35-10, if the investor intends to sell the security, it must write down the security's amortized cost basis to its fair value, write off any existing allowance for credit losses, and recognize in earnings any incremental impairment.

An investor is considered to have the intent to sell an impaired AFS debt security if it has decided to sell that security as of the reporting date. If the entity decided to sell the impaired security in a prior period (and thus recognized an impairment loss in that prior period) but has not sold the security by the end of a subsequent period, it would be required to assess whether it still has the intent to sell the security as of the end of that subsequent period. If the entity continues to have such intent, any further declines in fair value should be recognized as an additional impairment through earnings. If the entity revokes its decision to sell in a subsequent period, thereby asserting that it no longer has the intent to sell the security, it is not permitted to reverse any prior-period impairments recognized in earnings. (See Section 7.2.4 for a discussion of accounting for an AFS debt security after a write-down.)
In assessing whether it has decided to sell an AFS debt security, the entity should consider all available evidence, including the following:

- The investor or its agent (e.g., a third party that manages the investor’s securities portfolio) has approved the sale of the security (see Q&A 7-3 below).
- The investor has directed its agent to sell the security, and this sale is contingent on an event that is expected to occur (see example below).
- The security is part of a group of securities that the investor or its agent has identified as being for sale.
- The security or group of securities is being marketed to be sold at a price that does not significantly exceed fair value.
- The security is sold shortly after the balance sheet date, and the facts and circumstances suggest that the decision to sell was made before that date. (See Q&A 7-5 for a more detailed discussion of impaired debt securities sold at a loss after the balance sheet date.)

### Example 7-1

Company A holds an AFS debt security with a carrying (par) amount of $100, a fair value of $70, and a remaining maturity of five years. Further, A expects that, if it were to hold the security, it would recover the security’s full carrying amount and does not consider a credit loss to have occurred. On March 31, 20X1, A directs its third-party portfolio manager to sell the security if the value reaches $80.

Although A intends to sell the security, that intention is contingent on a future event (i.e., that the security’s value reaches $80). However, A expects to fully recover the security’s carrying amount by the maturity date. That is, A expects the security’s value to reach $80 before maturity because of the mere passage of time. Therefore, A would be considered to have the present intent to sell the security and, accordingly, should write the security’s amortized cost basis down to $70 and record an impairment loss of $30 in earnings.

If A has not sold the security by the end of a subsequent period, A would still be considered to have the present intent to sell it. Further declines in value would necessitate further write-downs in the amortized cost basis and would be considered impairment losses unless A revokes its intention to sell or the security’s value is no longer expected to reach $80 as a result of credit losses (however, the security would still be evaluated for an allowance for credit losses on the basis of the current amortized cost basis). If A revokes its decision to sell the security in a subsequent period, thereby asserting that it no longer has the intent to sell, it is not permitted to reverse any prior-period impairments recognized in earnings.

### Q&A 7-3  Considerations Related to a Managed Investment Portfolio When the Manager Has Discretion to Sell

ASC 326-30-35-10 states, in part:

If an entity intends to sell the [AFS] debt security (that is, it has decided to sell the security), or more likely than not will be required to sell the security before recovery of its amortized cost basis, any allowance for credit losses shall be written off and the amortized cost basis shall be written down to the debt security’s fair value at the reporting date with any incremental impairment reported in earnings.

**Question**

If an AFS debt security is managed by an independent investment adviser that has discretion to purchase and sell debt securities without management approval, how would an investor assert that it does not intend, or is not more likely than not required, to sell the security before recovery of the security’s amortized cost basis?
Answer

When evaluating whether there is an intent to sell, management should understand whether the investment manager has decided to sell impaired AFS debt securities as of the balance sheet date. Further, management should evaluate the facts and circumstances if the third-party manager subsequently sells an impaired AFS debt security after that date. See Q&A 7-5 for a discussion of impaired AFS debt securities sold after the balance sheet date.

In evaluating whether it is more likely than not that the entity will be required to sell an AFS debt security before recovery of the security's amortized cost basis (see Section 7.2.2.2), management should consider the facts and circumstances that may affect this assessment. An entity may be required to sell a debt security for legal, regulatory, or operational reasons. For example, the entity may need to sell an AFS debt security because it matures later than the date on which it must be sold to meet a contractual obligation. In such cases, management would need to consider whether it is more likely than not that this required sale will occur before the expected recovery. A history of “voluntary” sales of AFS debt securities in an investment portfolio, including sales to meet tax and other investment objectives, is not relevant in the assessment of the likelihood of required sales from the portfolio in the future, regardless of whether the voluntary sales were based on the actions of management or an independent investment adviser. In addition, the possibility that AFS debt securities could be sold anytime at the discretion of the third-party investment manager is insufficient to support an assertion by management that it is more likely than not that the investor will be required to sell the security before recovery of its amortized cost basis (although this factor should be considered in the evaluation of whether there is an intent to sell AFS debt securities, as discussed above).

Note that the impairment model for AFS debt securities differs from that for HTM debt securities. The entity should separately evaluate AFS debt securities and HTM debt securities if they are managed by the same third-party investment manager.

Q&A 7-4 Evaluating Impairment of Investments in AFS Auction Rate Securities — Intent to Sell

Auction rate securities (ARSs) are distinct from other, more traditional securities. ARSs generally have long-term stated maturities; issuers are not required to redeem them until 20 to 30 years after issuance. However, from an investor’s perspective, ARSs have certain economic characteristics of short-term investments because of their rate-setting mechanism. The return on these securities is designed to track short-term interest rates through a “Dutch” auction process, which resets the coupon (or dividend) rate.

The auction process gives an investor three options as of each remarketing date: (1) hold its ARS “at market” without participating in the auction process; (2) hold its ARS “at rate,” allowing the investor to participate in the auction process; or (3) tender its ARS, allowing the investor to sell its securities into the auction process provided that the auction does not fail. Existing investors that choose to hold their ARSs “at rate” and potential new investors enter into a “blind” competitive-bid process in which they specify the lowest interest/dividend rate and quantity they are willing to accept. The lowest rate at which all of the securities can be placed (including to investors that choose the “at market” option) becomes the interest/dividend rate for these securities until the next auction date.

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1 In this Q&A, it is assumed that an independent investment adviser has discretion to sell debt securities without management approval. To the extent that agreements with independent investment advisers give management discretion to hold or sell at the individual security level, management’s intent will also be relevant. These agreements are often tailored to meet the needs of management as well as any regulatory requirements, and an entity must thoroughly understand the agreements’ terms and conditions to determine whose intent is relevant.
A failed auction may occur if the demand for the ARS is insufficient to allow existing investors to liquidate their holdings in the auction process. For example, if there is a lack of demand for an ARS issuance and no rate is established in the auction process that would clear the entire issuance, a failed auction would occur and current investors would be forced to continue holding their positions (generally, investors in a failed auction receive a maximum predetermined interest rate from the issuer unless and until sufficient bids are received by the next auction date). In typical ARS issuances, investors cannot require the issuer to redeem the securities resulting from a failed auction.

An investor may sell its ARS into the secondary market. However, when an auction has failed, the secondary market may be inactive or nonexistent and the fair value of the ARS may be less than par. Depending on market conditions and the underlying collateral of the ARS, the discount from par may be significant.

Generally, investments in ARSs are debt securities that should be accounted for under ASC 320. If the ARS is designated as an AFS debt security and its fair value is less than its carrying amount, management should evaluate the security to determine whether the recognition of an impairment loss is required. If, for example, management intends to sell the ARS, an impairment loss would be recognized.

**Question**

Does the existence of an auction process for an ARS affect the evaluation of whether the investor has an intent to sell it?

**Answer**

Generally, no. If the investor elects to tender its ARS, the security is typically tendered at its par amount. If this amount is equal to or greater than the investor’s amortized cost basis, the investor would expect to recover its entire amortized cost basis. In such instances, an intent to sell before recovery does not exist because the tendering of the securities is contingent on the investor’s receiving at least its entire amortized cost basis in return. If the investor elects to hold its ARS “at market” or “at rate,” an intent to sell does not exist since the investor would continue to hold the ARS regardless of the outcome of the auction.

If management determines that it does not intend to sell, or that it is not more likely than not that it will be required to sell, the ARS before recovery, the entity must assess whether a “credit loss” has occurred (e.g., if an auction fails). See Section 7.2.3 for a discussion of the calculation of credit losses.

### 7.2.2.2 Assessment of Whether It Is More Likely Than Not That the Entity Will Be Required to Sell

As discussed above, if an entity does not intend to sell an impaired AFS debt security, it will still need to assess whether it is more likely than not that it will be required to sell the security before recovery of the security’s amortized cost basis. Such an evaluation should take into account (1) the factors that might affect whether the entity is required to sell the security and (2) the probability that those factors will occur during the expected recovery period.

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2 This may be the case for more complex ARSs issued by trusts in which the underlying collateral of the trust is made up of asset-backed securities, including securities backed by subprime mortgage loans. Given the complexity of many ARSs and the credit profile and other risks associated with the underlying collateral, the potential exists for a failed auction.

3 ASC 326-30-35-6 states that when “assessing whether a credit loss exists, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security.”
Factors that influence whether the entity may be required to sell the impaired AFS debt security include, but are not limited to, the following:

- The entity’s cash and working capital requirements:
  - The entity’s liquidity position, whether the entity expects that it will have to sell the debt security to meet expected cash requirements (e.g., to repay its existing obligations).
  - Whether there have been any adverse changes in the entity’s business or industry that could compel the entity to sell the debt security to meet working capital requirements.

- Any contractual or regulatory obligations that may cause the debt security to be sold:
  - Whether it is likely that a third party (e.g., a regulator) could force the entity to sell the debt security.
  - Whether the entity has contracts that would require it to sell specific debt securities upon the occurrence of certain events.

Once the entity has identified the factors that are relevant to determining whether it will be required to sell an impaired AFS debt security, it must consider the probability that those factors will occur during the anticipated recovery period. In evaluating the existence of a credit loss and estimating the debt security’s recovery period, the entity should consider the guidance in ASC 326-30-55-1:

There are numerous factors to be considered in determining whether a credit loss exists. The length of time a security has been in an unrealized loss position should not be a factor, by itself or in combination with others, that an entity would use to conclude that a credit loss does not exist. The following list is not meant to be all inclusive. All of the following factors should be considered:

a. The extent to which the fair value is less than the amortized cost basis
b. Adverse conditions specifically related to the security, an industry, or geographic area; for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, changes in the financial condition of the underlying loan obligors. Examples of those changes include any of the following:
   1. Changes in technology
   2. The discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security
   3. Changes in the quality of the credit enhancement.

c. The payment structure of the debt security (for example, nontraditional loan terms as described in paragraphs 825-10-55-1 through 55-2) and the likelihood of the issuer being able to make payments that increase in the future

d. Failure of the issuer of the security to make scheduled interest or principal payments

e. Any changes to the rating of the security by a rating agency.

A write-down of an AFS debt security’s amortized cost to fair value is required if — in light of all relevant factors and the probability that those factors will occur during the expected recovery period — an entity determines that it is more likely than not that it will be required to sell the impaired security before recovery of the security’s amortized cost basis. Consequently, the entity must recognize any incremental impairment loss (i.e., the difference between the security’s fair value and amortized cost basis, less any existing allowance for credit losses) in earnings.
An entity must use professional judgment in determining the factors to consider and the probability that such factors will occur during the recovery period. In addition, the entity should document its conclusions regarding whether it is more likely than not that it will be required to sell the impaired AFS debt security before recovery. The entity should also be mindful of the information disclosed in its financial statements and MD&A and of how to reconcile that information with its assertion that it is more likely than not that it will be required to sell the impaired AFS debt security before recovery of the security’s amortized cost basis.

**Q&A 7-5  Sale of an Impaired AFS Debt Security at a Loss After the Balance Sheet Date**

**Question**

Does a sale of an impaired AFS debt security at a loss after the balance sheet date indicate that the security’s amortized cost basis should have been written down to its fair value as of the balance sheet date and that any incremental impairment loss should have been recognized in earnings?

**Answer**

Not necessarily. Under ASC 326-30, an entity’s objective is to write down an AFS debt security’s amortized cost basis to its fair value, write off any allowance for credit losses, and record any incremental impairment loss in earnings in the period in which the investor (1) decides to sell the security or (2) determines that it is more likely than not that it will be required to sell the security before recovery of the security’s amortized cost basis (the “MLTN assertion”). Accordingly, if an impaired AFS debt security is sold after the balance sheet date, the entity must consider whether those sales are inconsistent with its assertions as of the balance sheet date. In doing so, it should consider (1) when the decision to sell was made or (2) whether the impaired debt security was sold as a result of a requirement to sell the security and when it became more likely than not that it would be required to sell.

To assess whether subsequent sales of impaired AFS debt securities are consistent with the entity’s “lack of intent to sell” assertion as of the balance sheet date, the entity should determine when it decided to sell the impaired security. In performing this assessment, the entity should consider factors that include, but are not limited to, the following:

- How soon the entity sold the security after the balance sheet date.
- When the process of selling the security started and how long it took to sell the security (e.g., the length of the marketing period). The entity should consider whether the security is actively traded and whether the period between the decision to sell and the actual selling was in line with the customary marketing period for the security.
- Whether there were standing orders to sell the security as of the balance sheet date.

Assume that an entity originally asserts as of the balance sheet date that it did not intend to sell the impaired AFS debt security. If the entity then concludes that the decision to sell the security was made after the balance sheet date, the original assertion as of the balance sheet date would be supported. Decisions to sell after the balance sheet date could be made for various reasons, including changing market conditions that affect an entity’s risk appetite and investment strategies.
In determining whether the subsequent sale of the impaired AFS debt security is consistent with its MLTN assertion as of the balance sheet date, an entity must first determine whether the subsequent sale occurred as a result of a requirement to sell (e.g., because of regulatory or contractual obligations or cash flow or working capital requirements). If the subsequent sale is not a result of a requirement to sell, the MLTN assertion as of the balance sheet date would be supported. However, if this subsequent sale resulted from a requirement to sell, the entity should consider whether there has been a change in the factors that it considered as of the balance sheet date, a change in the probability of those factors occurring, or both.

Such an assessment is based, in part, on management’s intent. Accordingly, an entity must exercise professional judgment in performing this evaluation and should prepare documentation that supports its “lack of intent to sell” and the MLTN assertions as of the balance sheet date. The entity should also consider contemporaneously documenting (1) when a decision to sell has been made and (2) a requirement to sell the securities and when it becomes more likely than not that it will need to comply with such a requirement. That said, the threshold for not having the intent to sell is lower than that for having the intent and ability to hold the security until recovery.

7.2.3 Whether a Credit Loss Exists

**ASC 326-30**

35-2 For individual debt securities classified as available-for-sale securities, an entity shall determine whether a decline in fair value below the amortized cost basis has resulted from a credit loss or other factors. An entity shall record impairment relating to credit losses through an allowance for credit losses. However, the allowance shall be limited by the amount that the fair value is less than the amortized cost basis. Impairment that has not been recorded through an allowance for credit losses shall be recorded through other comprehensive income, net of applicable taxes. An entity shall consider the guidance in paragraphs 326-30-35-6 and 326-30-55-1 through 55-4 when determining whether a credit loss exists.

35-3 At each reporting date, an entity shall record an allowance for credit losses that reflects the amount of the impairment related to credit losses, limited by the amount that fair value is less than the amortized cost basis. Changes in the allowance shall be recorded in the period of the change as credit loss expense (or reversal of credit loss expense).

35-6 In assessing whether a credit loss exists, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis of the security, a credit loss exists and an allowance for credit losses shall be recorded for the credit loss, limited by the amount that the fair value is less than amortized cost basis. Credit losses on an impaired security shall continue to be measured using the present value of expected future cash flows.

35-7 In determining whether a credit loss exists, an entity shall consider the factors in paragraphs 326-30-55-1 through 55-4 and use its best estimate of the present value of cash flows expected to be collected from the debt security. One way of estimating that amount would be to consider the methodology described in paragraphs 326-30-35-8 through 35-10. Briefly, the entity would discount the expected cash flows at the effective interest rate implicit in the security at the date of acquisition.
When an entity has an impaired AFS debt security and (1) the entity does not intend to sell the security and (2) it is not more likely than not that it will be required to sell the security before the recovery of the security’s amortized cost basis, the entity will need to consider whether the decline in fair value is related to a credit loss in accordance with ASC 326-30-35-2. If the entity cannot qualitatively conclude that a credit loss does not exist (see Q&A 7-6), it must perform this assessment quantitatively. Specifically, ASC 326-30-35-6 states that “[i]f the present value of cash flows expected to be collected is less than the amortized cost basis of the security, a credit loss exists and an allowance for credit losses shall be recorded for the credit loss, limited by the amount that the fair value is less than amortized cost basis.”

Therefore, the amount of credit loss for an impaired AFS debt security is the excess of (1) the security’s amortized cost basis over (2) the present value of the investor’s best estimate of the cash flows expected to be collected from the security. In accordance with ASC 326-30-35-8, the investor calculates the present value on the basis of its best estimate of the expected future cash flows by using “past events, current conditions, and . . . reasonable and supportable forecasts.” As indicated in ASC 326-20-30-4, the investor discounts the expected future cash flows “at the financial asset’s effective interest rate.” The ASC master glossary, as amended by ASU 2016-13, defines the effective interest rate as the rate implicit in the security as of the acquisition date (i.e., the contractual interest rate “adjusted for any net deferred fees or costs, premium, or discount existing” as of the acquisition date).

When calculating the present value of the expected future cash flows, an entity should consider the guidance in ASC 326-30-55-2 through 55-4:

55-2 An entity should consider available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of cash flows expected to be collected. That information should include all of the following:
   a. The remaining payment terms of the security
   b. Prepayment speeds
   c. The financial condition of the issuer(s)
   d. Expected defaults
   e. The value of any underlying collateral.

55-3 To achieve the objective in paragraph 326-30-55-2, the entity should consider, for example, all of the following to the extent they influence the estimate of expected cash flows on a security:
   a. Industry analyst reports and forecasts
   b. Credit ratings
   c. Other market data that are relevant to the collectibility of the security.
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**55-4** An entity also should consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract as discussed in paragraph 326-30-35-5), the willingness of the guarantor to pay, and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by nontraditional loans; see paragraph 825-10-55-1). Thus, an entity should consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including balloon payments). An entity also should consider how the value of any collateral would affect the expected performance of the security. If the fair value of the collateral has declined, an entity should assess the effect of that decline on its ability to collect the balloon payment.

**Q&A 7-6 Cash Flow Analysis for an Impaired AFS Debt Security**

When an investor holds an impaired AFS debt security that it does not intend and will not more likely than not be required to sell before the recovery of the security’s amortized cost basis, the investor must determine whether it expects to recover the entire amortized cost basis (i.e., whether a credit loss exists).

Note that for securities within the scope of ASC 325-40, an investor considers, as of each reporting date, current information and events to determine whether there has been a favorable or adverse change in estimated cash flows compared with previous projections. On the basis of such considerations, the investor may adjust the accretable yield for these securities. This Q&A does not address the requirements of this guidance.

**Question**

Is an investor always required to perform, as of each reporting date, a quantitative analysis for each impaired AFS debt security to conclude that a credit loss does not exist?

**Answer**

No. An investor must perform a quantitative analysis when determining the amount of a credit loss, but it does not always need to perform such an analysis to conclude that a credit loss does not exist. That is, in certain circumstances, it may be sufficient for an investor to conclude that a credit loss does not exist by performing a qualitative analysis of whether it expects to recover the entire amortized cost basis of the debt security (i.e., whether a credit loss exists).

ASC 326-30-55-1 lists the following factors (not all-inclusive) for entities to consider in determining whether a credit loss exists:

a. The extent to which the fair value is less than the amortized cost basis

b. Adverse conditions specifically related to the security, an industry, or geographic area; for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, changes in the financial condition of the underlying loan obligors. Examples of those changes include any of the following:

   1. Changes in technology
   2. The discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security
   3. Changes in the quality of the credit enhancement.

The factors are not necessarily relevant to every credit loss determination and may be helpful in attributing an impairment to something other than credit losses. Note that one or more of these factors may be more relevant to the analysis than others, and an entity must consider all available information about past events, current conditions, and reasonable and supportable forecasts to conclude that a credit loss related to a debt security does not exist. An entity must evaluate all facts and circumstances associated with the debt security and use significant judgment in performing such an assessment.
c. The payment structure of the debt security (for example, nontraditional loan terms as described in paragraphs 825-10-55-1 through 55-2) and the likelihood of the issuer being able to make payments that increase in the future
d. Failure of the issuer of the security to make scheduled interest or principal payments
e. Any changes to the rating of the security by a rating agency.

In addition, entities should consider the following factors addressed in ASC 326-30-55-2 through 55-4:

- Changes in prepayment speeds.
- Expected defaults.
- Credit enhancements, including guarantees (and the financial condition of the guarantor) and the “value of any underlying collateral.”
- Reports and forecasts by industry analysts.
- Sector credit ratings.
- The presence of “any subordinated interests [that] are capable of absorbing estimated losses on the loans underlying the security.”
- Other relevant market data (e.g., applicable credit default swap spreads of the issuer, relevant market indexes, or changes in market interest rates after the acquisition of the security).

If, after performing a qualitative assessment, an entity is unable to obtain sufficient evidence that a credit loss does not exist for a particular debt security (i.e., that the entity will recover the entire amortized cost basis of the debt security), it will need to perform a detailed quantitative cash flow analysis for that security.

### 7.2.3.1 Changes to the Existing Impairment Model

While the guidance in ASU 2016-13 will not affect the determination of whether a credit loss exists on an AFS debt security (i.e., the comparison of the present value of cash flows expected to be collected with the security’s amortized cost basis), the ASU made some targeted amendments to the existing impairment model for AFS debt securities, as described in the sections below.

#### 7.2.3.1.1 Use of an Allowance Approach

One of the FASB’s objectives in developing an expected credit losses model for an AFS debt security was to allow entities to recognize such losses on a more timely basis. The Board believed that the existing requirement for entities to recognize an OTTI as a direct write-down to the AFS debt security’s amortized cost basis, among other things, made them reluctant to recognize OTTIs. In other words, in the FASB’s view, since the model did not allow entities to reflect improvements in such a security’s credit quality, it caused delays in the recognition of OTTIs. Consequently, the Board decided to require entities to use an allowance when recognizing expected credit losses on an AFS debt security. This requirement is consistent with the requirement to use an allowance approach for all other financial assets that are within the scope of ASC 326-20. As stated in ASC 326-30-35-3, any changes in the allowance for expected credit losses on an AFS debt security would be recognized as an adjustment to the entity’s credit loss expense.
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7.2.3.1.2 Credit Losses Limited by a Fair Value Floor

ASC 326-30-35-3 requires an entity to recognize as an allowance an AFS debt security’s expected credit losses, limited by the difference between the security’s fair value and its amortized cost basis. Paragraph BC83 of ASU 2016-13 states, in part:

[A]n entity could look to limit its credit loss exposure by selling a security if the total fair value loss was less than the credit loss measured for the security. That outcome could occur if a portion of the fair value attributable to non-credit-related factors offset the portion of fair value attributable to credit factors. Given the importance of fair value in the measurement of available-for-sale securities, the Board decided to incorporate a fair value floor in the amended model.

Example 7-2

Entity ABC holds a corporate bond that it classifies as an AFS debt security. On the reporting date, the security’s amortized cost is $1,000 and its fair value is $930. In assessing whether there is a credit loss on the security, ABC compares the present value of cash flows it expects to collect from the security with its amortized cost and determines that a credit loss of $100 is expected. However, in accordance with ASC 326-30-35-3, ABC must recognize only $70 as an allowance for credit losses because the security’s fair value is $930 on the reporting date. In other words, since ABC could limit its exposure to credit losses by selling the security at its fair value on the reporting date ($930), it should only recognize $70 ($1,000 – $930) as its allowance for expected credit losses.

7.2.3.1.3 Information to Consider When Estimating Credit Losses

ASC 326-30-55-1 carries forward much of the guidance in ASC 320-10-35-33F on the factors an entity considers when determining whether a credit loss exists. However, because ASU 2016-13 removes the distinction between whether an impairment is temporary or other than temporary, it also amends that guidance by removing an entity’s ability to consider:

- The length of time in which fair value has been less than amortized cost.
- Recoveries in the securities’ fair value after the balance sheet date.

Example 7-3

Entity X owns a corporate debt security (that does not have nontraditional terms) with a fair value of $90 and an amortized cost basis of $100. Entity X classifies the security as AFS and does not intend to sell it. Further, X concludes that it is not more likely than not that it will be required to sell the debt security before the recovery of the security’s amortized cost basis. To determine whether it will recover the security’s entire amortized cost basis and whether it has incurred a credit loss on the security, X considers, among other factors, (1) the fact that the corporate issuer was making, and is expected to continue to make, timely payments of principal and interest; (2) the relevant factors in ASC 326-30-55-2 through 55-4; and (3) other relevant market indicators.

On the basis of this qualitative assessment, X obtains sufficient evidence that it expects to recover the entire amortized cost basis of the corporate debt security and therefore concludes that a credit loss does not exist. In this circumstance, X did not need to perform a quantitative analysis to make such an assertion.
Q&A 7-7  Whether Changes in Prepayment Assumptions Alone Cause a Credit Loss in Asset-Backed AFS Debt Securities Outside the Scope of ASC 325-40 and PCD Accounting

Changes in prepayment speeds for the assets underlying an asset-backed security (e.g., a mortgage-backed security) often affect the present value of the cash flows expected to be collected from the security. For example, assume that an entity purchases a pass-through security that gives it the right to a pro rata share of the cash flows from an underlying pool of fixed-rate prepayable mortgage loans. If the security was purchased at a premium to par, the present value of the cash flows expected to be collected from the security will decrease when prepayments on the underlying mortgage loans increase. However, if the security was purchased at a discount to par, the present value of the cash flows expected to be collected will decrease when prepayments on the underlying mortgage loans decrease.

ASC 326-30-55-2 requires an investor to consider prepayment speeds, among other factors, when estimating the cash flows expected to be collected.

For AFS debt securities that are within the scope of ASC 325-40 and those that are PCD assets, entities are explicitly required to perform a discounted expected cash flow analysis in every period because of the expectation that more than an insignificant amount of the contractual cash flows will not be collected. This Q&A addresses only the accounting for asset-backed AFS debt securities that are not within the scope of ASC 325-40 or PCD accounting and for which prepayments on the assets underlying the asset-backed debt security are made at par, plus accrued and unpaid interest.

Question

In evaluating an asset-backed AFS debt security that is not within the scope of ASC 325-40 or PCD accounting, can an entity conclude that changes in prepayment assumptions alone cause a credit loss?

Answer

It depends. On the basis of informal discussions with the FASB staff after the issuance of FSP FAS 115-2 and FAS 124-2 that addressed the superseded OTTI guidance in ASC 320-10, an entity was allowed to choose one of two views, discussed below, as an accounting policy for an asset-backed AFS debt security that is not within the scope of ASC 325-40 or PCD accounting. We do not believe that the targeted changes to the impairment model for AFS debt securities affect this policy choice. The policy choice an entity elects should be consistently applied.

View A — Changes in Prepayment Assumptions Alone Could Cause a Credit Loss

According to this view, prepayment speeds affect the economic return to the investor in an asset-backed AFS debt security that is acquired at a premium or discount; therefore, an entity should recognize a credit loss when changes in prepayment speeds alone cause the present value of the cash flows expected to be collected to be less than the amortized cost basis of an impaired asset-backed AFS debt security. View A is consistent with the guidance in ASC 326-30-35-6 and ASC 326-30-55-2; accordingly, an entity should consider whether changes in prepayment assumptions alone cause the present value of the cash flows expected to be collected to be less than the amortized cost basis of the impaired asset-backed AFS debt security.
**View B — Changes in Prepayment Assumptions Alone Would Not Cause a Credit Loss**

The guidance in ASC 310-20-35-26 continues to apply to accounting for the impact of prepayments on the amortization or accretion of a discount or premium on an asset-backed AFS debt security. In addition, ASC 326-30-35-2 states, in part, that “[a]n entity should consider available information relevant to the **collectibility** of the security” (emphasis added). Therefore, according to this view, changes in prepayment assumptions alone do not necessarily affect the “collectibility” of cash flows due on the assets underlying an asset-backed AFS debt security.

An entity that adopts View B should, in the absence of a credit loss that occurs for other reasons, continue to apply its accounting policy election under ASC 310-20-35-26 to account for prepayments on an asset-backed debt security. If the entity determines that there is a credit loss for reasons other than mere changes in prepayment assumptions, it would generally be expected to consider anticipated prepayments in determining the cash flows expected to be collected (to calculate the amount of the credit loss). This treatment is consistent with the guidance in ASC 326-20-30-4 and ASC 326-30-35-7 and 35-8, which requires an entity to consider the amount and timing of cash flows in calculating an impairment loss.

Note that for an entity that adopts View B, there will generally not be an impairment on an agency mortgage-backed security (e.g., one that is guaranteed by Freddie Mac or Fannie Mae) in the absence of an intent to sell the security or a conclusion that it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis. That is, given the guarantee from the agency and the implicit support of the agencies by the U.S. government, there generally will not be a credit loss.

### 7.2.3.2 Variable-Rate Instruments

As originally issued, ASU 2016-13 stated that if a financial asset's contractual interest rate varies on the basis of an independent factor, such as an index or rate, “**projections of changes in the factor shall not be made** for purposes of determining the effective interest rate or estimating expected future cash flows” (emphasis added). Since the issuance of the ASU, however, stakeholders have questioned whether it was inconsistent to prohibit an entity from projecting changes in the factor that leads to changes in the financial asset's contractual interest rate while requiring the entity to consider projections when estimating expected cash flows.

As a result, the FASB clarified in ASU 2019-04 that an entity is permitted to consider projections of changes in the factor as long as the projections are the same as those used to estimate expected future cash flows.

Specifically, ASC 326-30-35-11 states:

If the security's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that security's effective interest rate (used to discount expected cash flows as described in paragraph 326-30-35-7) may be calculated based on the factor as it changes over the life of the security or is projected to change over the life of the security, or may be fixed at the rate in effect at the date an entity determines that the security has a credit loss as determined in accordance with paragraphs 326-30-35-1 through 35-2. The entity's choice shall be applied consistently for all securities whose contractual interest rate varies based on subsequent changes in an independent factor. An entity is not required to project changes in the factor for purposes of estimating expected future cash flows. If the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall use the same projections in determining the effective interest rate used to discount those cash flows. In addition, if the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the effective interest rate...
used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-30-35-7A. Subtopic 310-20 on receivables — nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.

Note that a change in cash flows due solely to a change in a variable interest rate on a plain-vanilla debt instrument does not result in a credit loss. Therefore, an entity would need to determine whether changes in estimated cash flows on a variable-rate AFS debt security should be considered a credit loss or are caused only by changes in expected contractual interest payments that resulted from changes in interest rates.

### 7.2.4 Subsequent Measurement

#### 7.2.4.1 Accounting for Debt Securities After an Impairment

<table>
<thead>
<tr>
<th>ASC 326-30</th>
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**35-12** An entity shall reassess the credit losses each reporting period when there is an allowance for credit losses. An entity shall record subsequent changes in the allowance for credit losses on available-for-sale debt securities with a corresponding adjustment recorded in the credit loss expense on available-for-sale debt securities. An entity shall not reverse a previously recorded allowance for credit losses to an amount below zero.

**35-13** An entity shall recognize writeoffs of available-for-sale debt securities in accordance with paragraph 326-20-35-8.

**35-13A** If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the fair value and the amortized cost basis of the available-for-sale debt security, an entity may make an accounting policy election, at the major security-type level, to write off accrued interest receivables by reversing interest income or recognizing credit loss expense, or a combination of both. This accounting policy election shall be considered separately from the accounting policy election in paragraph 326-30-30-1A. An entity that elects this accounting policy shall meet the disclosure requirements in paragraph 326-30-50-3D. An entity may not analogize this guidance to components of amortized cost basis other than accrued interest.

An entity must continually assess its expectation of credit losses on an AFS debt security. If its expectation changes, the entity is required to recognize that change as an adjustment to the allowance for expected credit losses and an adjustment to credit loss expense. However, the allowance for credit losses cannot be reversed to an amount less than zero. In addition, the entity is required to assess whether the AFS debt security has become uncollectible. If so, the entity must apply the guidance in ASC 326-20-35-8 to write off the uncollectible portion of the security and the allowance for expected credit losses. For more information about write-offs, see Section 4.5.1.

#### 7.2.4.2 Accounting for Debt Securities After a Write-Down

<table>
<thead>
<tr>
<th>ASC 326-30</th>
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**35-14** Once an individual debt security has been written down in accordance with paragraph 326-30-35-10, the previous amortized cost basis less writeoffs, including non-credit-related impairment reported in earnings, shall become the new amortized cost basis of the investment. That new amortized cost basis shall not be adjusted for subsequent recoveries in fair value.
As is the case under existing U.S. GAAP, and as discussed in Section 7.2.2, if an entity intends to sell an AFS debt security or it is more likely than not that the entity will be required to sell the security before recovery of the security's amortized cost basis, the entity must write down the amortized cost basis to its fair value, write off any existing allowance for credit losses, and recognize in earnings any incremental impairment.

After such a write-down, the entity must consider the security's fair value to be its new amortized cost basis in accordance with ASC 326-30-35-14 and 35-15. Any subsequent decreases in expected cash flows are recognized as additional impairments, while increases in expected cash flows are recognized as a prospective adjustment to the security's accretable yield.

### 7.2.5 PCD Considerations Related to AFS Debt Securities

**ASC 326-30**

#### 30-2
A purchased debt security classified as available-for-sale shall be considered to be a purchased financial asset with credit deterioration when the indicators of a credit loss in paragraph 326-30-55-1 have been met. The allowance for credit losses for purchased financial assets with credit deterioration shall be measured at the individual security level in accordance with paragraphs 326-30-35-3 through 35-10. The amortized cost basis for purchased financial assets with credit deterioration shall be considered to be the purchase price plus any allowance for credit losses. See paragraphs 326-30-55-1 through 55-7 for implementation guidance.

#### 30-3
Estimated credit losses shall be discounted at the rate that equates the present value of the purchaser's estimate of the security's future cash flows with the purchase price of the asset.

#### 30-4
An entity shall record the holding gain or loss through other comprehensive income, net of applicable taxes.

#### 35-16
An entity shall measure changes in the allowance for credit losses on a purchased financial asset with credit deterioration in accordance with paragraph 326-30-35-6. The entity shall report changes in the allowance for credit losses in net income as credit loss expense (or reversal of credit loss expense) in each reporting period.
As discussed at the beginning of Chapter 6, upon acquiring a PCD asset, an entity will recognize its allowance for expected credit losses as an adjustment that increases the asset’s amortized cost basis (the “gross-up” approach) rather than as an immediate credit loss expense in the income statement. After initially applying the gross-up approach, the entity will recognize as a credit loss expense (or reversal of credit loss expense) any changes in the allowance. To determine whether an AFS security is a PCD asset, an entity must consider the factors in ASC 326-30-55-1, which are the same factors that an investor uses to identify whether a credit loss exists on an AFS debt security. ASC 326-30-55-1 states:

There are numerous factors to be considered in determining whether a credit loss exists. The length of time a security has been in an unrealized loss position should not be a factor, by itself or in combination with others, that an entity would use to conclude that a credit loss does not exist. The following list is not meant to be all inclusive. All of the following factors should be considered:

a. The extent to which the fair value is less than the amortized cost basis
b. Adverse conditions specifically related to the security, an industry, or geographic area; for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, changes in the financial condition of the underlying loan obligors. Examples of those changes include any of the following:
   1. Changes in technology
   2. The discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security
   3. Changes in the quality of the credit enhancement.
c. The payment structure of the debt security (for example, nontraditional loan terms as described in paragraphs 825-10-55-1 through 55-2) and the likelihood of the issuer being able to make payments that increase in the future
d. Failure of the issuer of the security to make scheduled interest or principal payments
e. Any changes to the rating of the security by a rating agency.

Q&A 7-8  PCD Assessment of AFS and HTM Debt Securities

Question
Does an entity use the same criteria for both AFS and HTM debt securities when assessing whether it is required to apply PCD accounting to those securities?

Answer
No. As described above, for an AFS debt security, an entity would consider the factors in ASC 326-30-55-1 to determine whether a credit loss exists on the acquisition date. If so, the investor would use the gross-up approach described in Section 6.3.2 to initially account for the PCD AFS debt security. By contrast, when evaluating whether to apply the PCD model to an HTM debt security, an entity must consider whether there has been a more-than-insignificant deterioration in the security’s credit quality since its origination.

In addition, the unit of account differs depending on whether the entity is evaluating the applicability of the PCD model to an HTM or AFS debt security. While an entity can evaluate the applicability of the PCD model to HTM debt securities on a collective basis if the securities share similar risk characteristics (see Section 6.2.1), it is not permitted to determine whether PCD accounting applies to AFS debt securities on a collective or pool basis. Rather, it must make that determination on the basis of each individual AFS debt security.
Q&A 7-9 Differences Between ASC 325-40 and PCD Accounting for BIs Classified as AFS Debt Securities

Question
How does the guidance in ASC 325-40 on non-PCD BIs differ from the PCD models for BIs classified as AFS debt securities?

Answer
Initial Accounting Under ASC 325-40
Under ASC 325-40 (as amended by ASU 2016-13), entities must initially estimate the timing and amount of all future cash inflows from a BI within the scope of ASC 325-40 by employing assumptions used in the determination of fair value upon recognition. The excess of those expected future cash flows over the initial investment is the accretable yield. Entities recognize this excess as interest income over the life of the investment by using the effective interest method.

Subsequent Accounting Under ASC 325-40
A subsequent adjustment to expected cash flows is recognized as a yield adjustment affecting interest income or, if related to credit, may be recognized through earnings by means of an allowance for credit losses. In other words, a cumulative adverse change in expected cash flows would be recognized as an allowance, and a cumulative favorable change in expected cash flows would be recognized as a prospective yield adjustment.

If there has not been an adverse change in the cash flows expected to be collected but the BI’s fair value is significantly below its amortized cost basis, the entity is required to assess whether it intends to sell the BI or it is more likely than not that it will be required to sell the interest before recovery of the entire amortized cost basis. If so, the entity would be required to write down the BI to its fair value in accordance with ASC 326-30-35-10.

Initial Accounting Under the PCD Model in ASC 326-30
Under the PCD accounting model in ASC 326-30 for AFS debt securities, entities are required to gross up the cost basis of a PCD asset by the estimated credit losses as of the acquisition date and establish a corresponding allowance for credit losses. The initial allowance is based on the difference between expected cash flows and contractual cash flows (adjusted for prepayments, as discussed in Q&A 6-7).
**Subsequent Accounting Under the PCD Model in ASC 326-30**

For a PCD asset within the scope of ASC 325-40 that is classified as an AFS debt security, cumulative adverse changes in expected cash flows would be recognized currently as an increase to the allowance for credit losses (in a manner similar to the accounting under the normal ASC 325-40 model, as amended by ASU 2016-13). However, the allowance is limited to the difference between the AFS debt security’s fair value and its amortized cost. Favorable changes in expected cash flows would first be recognized as a decrease to the allowance for credit losses (recognized currently in earnings). Such changes would be recognized as a prospective yield adjustment only when the allowance for credit losses is reduced to zero. A change in expected cash flows that is attributable solely to a change in a variable interest rate on a plain-vanilla debt instrument does not result in a credit loss and would be accounted for as a prospective yield adjustment.

### 7.2.6 Accounting for Changes in Foreign Exchange Rates for Foreign-Currency-Denominated AFS Debt Securities

When determining whether an impairment exists on an AFS debt security that is denominated in a foreign currency, an entity compares the security’s fair value (measured in the entity’s functional currency at the current exchange rate) with its amortized cost basis (measured at the historical exchange rate). If the fair value of the security is below its amortized cost, the security is impaired. Before adopting ASU 2016-13, an entity that determines an AFS debt security to be other-than-temporarily impaired would recognize in earnings an impairment loss equal to the entire difference between the security’s fair value and its cost basis.

ASC 326-30-35-10 is consistent with this guidance. Specifically, this paragraph states, in part, that “[i]f an entity intends to sell the debt security (that is, it has decided to sell the security), or more likely than not will be required to sell the security before recovery of its amortized cost basis, any allowance for credit losses shall be written off and the amortized cost basis shall be written down to the security’s fair value at the reporting date with any incremental impairment reported in earnings.” Accordingly, under ASU 2016-13, an entity would continue to recognize in earnings the entire change in the fair value of an AFS debt security if (1) it intends to sell the impaired security or (2) it is more likely than not that it will be required to sell the impaired security before recovery.

In addition, ASC 320-10-35-36 (as amended by ASU 2016-13) states, in part, that “[t]he 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.” As a result, if the entity does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery of its amortized cost basis, the entity would recognize in OCI the change in the security’s fair value related to the changes in foreign exchange rates.

### Connecting the Dots — Recognizing Unrealized Losses in Earnings

In light of the amendments made by ASU 2016-13, stakeholders have questioned when unrealized losses related to changes in foreign exchange rates on an AFS debt security should be recognized in earnings and whether the new guidance will delay loss recognition. Consequently, at the TRG’s November 2018 meeting, the FASB staff confirmed that unrealized losses related to foreign exchange rates should be reported in OCI and recognized in earnings “(a) at the maturity of the security, (b) upon the sale of the security, (c) when an entity intends to sell, or (d) when an entity is more likely than not required to sell the security before recovery of its amortized cost basis.” In addition, the staff said that the concern that the amendments made

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5 See TRG Memo 14.
by ASU 2016-13 will result in delayed loss recognition “is beyond the scope of the Credit Losses TRG because the topic relates to reporting changes in fair value related to foreign exchange rates.”

We acknowledge that there is diversity in how an entity may translate its credit loss expense to reflect changes in the spot rate. For example, an entity may translate its credit loss expense at the end of the reporting period by using the spot rate that existed when the asset was acquired or the spot rate that exists at the end of the current reporting period. We believe that either approach is acceptable.

7.2.7 High-Level Comparison of Credit Loss Models for HTM and AFS Debt Securities

The table below compares the credit loss model for HTM securities with that for AFS securities.

<table>
<thead>
<tr>
<th></th>
<th>HTM Debt Security (ASC 326-20)</th>
<th>AFS Debt Security (ASC 326-30)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit of account</td>
<td>Pool-level, if similar risk characteristics exist; otherwise, at the individual debt security level</td>
<td>Individual debt security level</td>
</tr>
<tr>
<td>Measurement of credit losses</td>
<td>The amount needed to reduce the amortized cost basis to reflect the net amount expected to be collected</td>
<td>The excess of the amortized cost basis over the present value of the best estimate of expected future cash flows</td>
</tr>
<tr>
<td>Recognition threshold</td>
<td>Recognize a credit loss upon acquisition of the security</td>
<td>Recognize a credit loss when amortized cost exceeds fair value</td>
</tr>
<tr>
<td>Recognition of credit loss</td>
<td>Apply an allowance approach</td>
<td>Apply an allowance approach</td>
</tr>
<tr>
<td>Write-offs</td>
<td>Write off security when it is deemed uncollectible</td>
<td>Write off security when it is deemed uncollectible</td>
</tr>
</tbody>
</table>
8.1 Presentation

ASC 320-10

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.

ASC 326-20

45-1 For financial assets measured at amortized cost within the scope of this Subtopic, an entity shall separately present on the statement of financial position, the allowance for credit losses that is deducted from the asset’s amortized cost basis.

45-2 For off-balance-sheet credit exposures within the scope of this Subtopic, an entity shall present the estimate of expected credit losses on the statement of financial position as a liability. The liability for credit losses for off-balance-sheet financial instruments shall be reduced in the period in which the off-balance-sheet financial instruments expire, result in the recognition of a financial asset, or are otherwise settled. An estimate of expected credit losses on a financial instrument with off-balance-sheet risk shall be recorded separate from the allowance for credit losses related to a recognized financial instrument.

45-5 An entity may make an accounting policy election, at the class of financing receivable or major security-type level, to present separately on the statement of financial position or within another statement of financial position line item the accrued interest receivable balance, net of the allowance for credit losses (if any). An entity that presents the accrued interest receivable balance, net of the allowance for credit losses (if any), within another statement of financial position line item shall apply the disclosure requirements in paragraph 326-20-50-3A.

ASC 326-30

45-1 An entity shall present available-for-sale debt securities on the statement of financial position at fair value. In addition, an entity shall present parenthetically the amortized cost basis and the allowance for credit losses. If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the fair value and the amortized cost basis of the available-for-sale debt security, an entity may present separately on the statement of financial position or within another statement of financial position line item the accrued interest receivable balance, net of the allowance for credit losses (if any). An entity that presents the accrued interest receivable balance, net of the allowance for credit losses (if any), within another statement of financial position line item shall apply the disclosure requirements in paragraph 326-30-50-3A.

45-2 An entity shall separately present, in the financial statement in which the components of accumulated other comprehensive income are reported, amounts reported therein related to available-for-sale debt securities for which an allowance for credit losses has been recorded.
Like the current presentation requirements in U.S. GAAP, the presentation requirements in ASU 2016-13 vary on the basis of the type of financial asset. For example, in the statement of financial position, an entity's presentation of loans and other debt instruments measured at amortized cost and their corresponding allowances for expected credit losses would differ from its presentation of AFS debt securities and the corresponding allowances for such losses.

The table below summarizes the presentation requirements of ASU 2016-13.

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Asset Balance</th>
<th>Allowance for Expected Credit Losses</th>
<th>Income Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets measured at amortized cost, including:</td>
<td>Present at amortized cost.</td>
<td>Present separately from the asset's amortized cost balance.</td>
<td>Expected credit losses presented as a credit loss expense.</td>
</tr>
<tr>
<td>• Loans.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• HTM debt securities.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Trade and lease receivables.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan commitments and other off-balance-sheet instruments</td>
<td>N/A, since these are unrecognized financial instruments.</td>
<td>Present as a liability. Liabilities cannot be included with other allowances for expected credit losses.</td>
<td>Expected credit losses presented as a credit loss expense.¹</td>
</tr>
<tr>
<td>AFS debt securities</td>
<td>Present at fair value. Entities must also include the security’s amortized cost parenthetically. Changes in fair value unrelated to credit are presented in OCI.</td>
<td>Present parenthetically.</td>
<td>Expected credit losses presented as a credit loss expense.</td>
</tr>
</tbody>
</table>

8.1.1 Other Presentation Considerations

8.1.1.1 Changes in the Present Value of Expected Cash Flows

Changes in the present value of expected future cash flows may result from the passage of time or from changes in the timing and amount of the cash flows the entity expects to receive. Like existing U.S. GAAP, ASC 326 allows an entity that uses a DCF approach to present a change in the present value of expected future cash flows as an adjustment to credit loss expense (both favorable and unfavorable) or as interest income (only if the change is related to the passage of time). An entity that chooses to present the change as interest income must, in accordance with ASC 326-20-50-12 and ASC 326-30-50-8, disclose that policy decision as well as the amount recorded in interest income that represents the change in present value attributable to the passage of time.

¹ In May 2020, the Federal Reserve System, the FDIC, the National Credit Union Administration, and the OCC issued a final interagency policy statement on allowances for credit losses. The proposal on which the final statement was based stated that “[p]rovisions for credit losses on off-balance-sheet credit exposures are included as part of ‘Other noninterest expense’ in Schedule R — Income Statement in the Call Report and in ‘Credit Loss Expense — Off-Balance-Sheet Credit Exposures’ in the Statement of Income and Expense in NCUA Call Report Form 5300.” However, the final statement eliminates any reference to the income statement category in which amounts needed to adjust the liability for expected credit losses for off-balance-sheet credit exposures should be reported in the agencies’ regulatory reports. See Section 10.3.2 for more information.
8.1.1.2 Changes in the Fair Value of the Collateral Securing a Collateral-Dependent Financial Asset

Like existing U.S. GAAP, ASC 326 requires an entity to present changes (both favorable and unfavorable) in the fair value of the collateral securing a collateral-dependent financial asset as an adjustment to credit loss expense.

8.1.1.3 Accrued Interest

ASU 2016-13 defines “amortized cost basis” as “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” (emphasis added). As discussed in Section 4.4.4.1, the ASU’s inclusion of accrued interest in the definition has three significant implications for financial statements with respect to the measurement, presentation, and disclosure of the amortized cost basis and the allowance for credit losses of financial assets:

- When measuring an allowance for credit losses on the amortized cost basis of the assets, entities will be required to include an allowance for the accrued interest that applies to those assets.
- Entities will have to present the accrued interest amount in the amortized cost basis of the financial assets in the same line item on the balance sheet.
- Accrued interest must be included in the disclosures of the amortized cost basis by class of financing receivable and vintage, as required by ASC 326-20-50-5 and 50-6, respectively.

After a discussion of these implications at the June 2018 TRG meeting, the FASB issued ASU 2019-04, which amends the presentation and disclosure requirements of ASC 326 related to accrued interest. Specifically, the ASU states that an entity would be permitted to do the following:

- “Make an accounting policy election to present accrued interest receivable balances and the related allowance for credit losses for those accrued interest receivable balances separately from the associated financial assets on the balance sheet. If the accrued interest receivable balances and the related allowance for credit losses [are presented separately from the associated financial assets but] are not presented as a separate line item on the balance sheet, an entity should disclose the amount of accrued interest receivable balances and the related allowance for credit losses where the balance is presented.”
- “Elect a practical expedient to disclose separately the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements.”
- “Make an accounting policy election to write off accrued interest amounts by reversing interest income or recognizing credit loss expense, or a combination of both.”

For more information about the recognition and measurement changes related to accrued interest, see Section 4.4.4.1.
8.2 Disclosures

8.2.1 Financial Assets Measured at Amortized Cost

8.2.1.1 Overall Objective and Unit of Account

<table>
<thead>
<tr>
<th>ASC 326-20</th>
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</thead>
<tbody>
<tr>
<td><strong>50-2</strong> The disclosure guidance in this Section should enable a user of the financial statements to understand the following:</td>
</tr>
<tr>
<td>a. The credit risk inherent in a portfolio and how management monitors the credit quality of the portfolio</td>
</tr>
<tr>
<td>b. Management's estimate of expected credit losses</td>
</tr>
<tr>
<td>c. Changes in the estimate of expected credit losses that have taken place during the period.</td>
</tr>
</tbody>
</table>

**50-3** For financing receivables, the disclosure guidance in this Subtopic requires an entity to provide information by either portfolio segment or class of financing receivable. Net investment in leases are within the scope of this Subtopic, and the disclosure requirements for financing receivables shall be applied to net investment in leases (including the unguaranteed residual asset). For held-to-maturity, debt securities, the disclosure guidance in this Subtopic requires an entity to provide information by major security type. Paragraphs 326-20-55-10 through 55-14 provide implementation guidance about the terms portfolio segment and class of financing receivable. When disclosing information, an entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy the disclosure requirements in this Section. An entity must strike a balance between not obscuring important information as a result of too much aggregation and not overburdening financial statements with excessive detail that may not assist a financial statement user in understanding the entity's financial assets and allowance for credit losses. For example, an entity should not obscure important information by including it with a large amount of insignificant detail. Similarly, an entity should not disclose information that is so aggregated that it obscures important differences between the different types of financial assets and associated risks.

**50-3A** An entity that makes an accounting policy election to present the accrued interest receivable balance within another statement of financial position line item as described in paragraph 326-20-45-5 shall disclose the amount of accrued interest, net of the allowance for credit losses (if any), and shall disclose in which line item on the statement of financial position that amount is presented.

**50-3B** As a practical expedient, an entity may exclude the accrued interest receivable balance that is included in the amortized cost basis of financing receivables and held-to-maturity securities for the purposes of the disclosure requirements in paragraphs 326-20-50-4 through 50-22. If an entity applies this practical expedient, it shall disclose the total amount of accrued interest excluded from the disclosed amortized cost basis.

**50-3C** An entity that makes the accounting policy election in paragraph 326-20-30-5A shall disclose its accounting policy not to measure an allowance for credit losses for accrued interest receivables. The accounting policy shall include information about what time period or periods, at the class of financing receivable or major security-type level, are considered timely.

**50-3D** An entity that makes the accounting policy election in paragraph 326-20-35-8A shall disclose its accounting policy to write off accrued interest receivables by reversing interest income or recognizing credit loss expense or a combination of both. The entity also shall disclose the amount of accrued interest receivables written off by reversing interest income by portfolio segment or major security type.
ASC Master Glossary

Class of Financing Receivable
A group of financing receivables determined on the basis of both of the following:
  a. Risk characteristics of the financing receivable
  b. An entity's method for monitoring and assessing credit risk.
See paragraphs 326-20-55-11 through 55-14 and 326-20-50-3.

Financing Receivable
A financing arrangement that has both of the following characteristics:
  a. It represents a contractual right to receive money in either of the following ways:
     1. On demand
     2. On fixed or determinable dates.
  b. It is recognized as an asset in the entity's statement of financial position.
See paragraphs 310-10-55-13 through 55-15 for more information on the definition of financing receivable, including a list of items that are excluded from the definition (for example, debt securities).

Portfolio Segment
The level at which an entity develops and documents a systematic methodology to determine its allowance for credit losses. See paragraphs 326-20-50-3 and 326-20-55-10.

Connecting the Dots — A Debt Security Is Not a Financing Receivable
A debt security initially seems to meet the definition of a financing receivable because the holder of the debt security (i.e., the investor) (1) has a contractual right to receive money either on demand or on fixed or determinable dates and (2) recognizes the debt security as an asset in its balance sheet. However, ASC 310-10-55-13 through 55-15 provide guidance on what should be considered a financing receivable, and ASC 310-10-55-15 states that debt securities within the scope of ASC 320 do not meet the definition of financing receivables. The distinction between the two terms is important because, although many of the disclosure requirements of ASC 326 apply to both financing receivables and debt securities (e.g., those in ASC 326-20-50-5 and ASC 326-20-50-11 through 50-18), some only apply to financing receivables (e.g., the vintage disclosure requirements in ASC 326-20-50-6). As a result, an entity must carefully consider which disclosure requirements apply to which type of financial asset within the scope of ASC 326-20. For a summary of the disclosure requirements by type of financial asset, see the table in Section 8.2.6.

ASC 326-20

Disclosure — Application of the Term Portfolio Segment
55-10 This implementation guidance addresses the meaning of the term portfolio segment. All of the following are examples of portfolio segments:
  a. Type of financing receivable
  b. Industry sector of the borrower
  c. Risk rating.
Chapter 8 — Presentation and Disclosure

**AS 326-20 (continued)**

**Disclosure — Application of the Term Class of Financing Receivable**

**55-11** This implementation guidance addresses application of the term *class of financing receivable*. An entity should base its principal determination of class of financing receivable by disaggregating to the level that the entity uses when assessing and monitoring the risk and performance of the portfolio for various types of financing receivables. In its assessment, the entity should consider the risk characteristics of the financing receivables.

**55-12** In determining the appropriate level of its internal reporting to use as a basis for disclosure, an entity should consider the level of detail needed by a user to understand the risks inherent in the entity's financing receivables. An entity could further disaggregate its financing receivables portfolio by considering numerous factors. Examples of factors that the entity should consider include any of the following:

- a. Categorization of borrowers, such as any of the following:
  - 1. Commercial loan borrowers
  - 2. Consumer loan borrowers
  - 3. Related party borrowers.

- b. Type of financing receivable, such as any of the following:
  - 1. Mortgage loans
  - 2. Credit card loans
  - 3. Interest-only loans
  - 4. Finance leases.

- c. Industry sector, such as either of the following:
  - 1. Real estate

- d. Type of collateral, such as any of the following:
  - 1. Residential property
  - 2. Commercial property
  - 3. Government-guaranteed collateral
  - 4. Uncollateralized (unsecured) financing receivables.

- e. Geographic distribution, including both of the following:
  - 1. Domestic

**55-13** An entity also may consider factors related to concentrations of credit risk as discussed in Section 825-10-55.

**55-14** Classes of financing receivables generally are a disaggregation of a portfolio segment. For determining the appropriate classes of financing receivables that are related to a portfolio segment, the portfolio segment is the starting point with further disaggregation in accordance with the guidance in paragraphs 326-20-55-11 through 55-13. The determination of class for financing receivables that are not related to a portfolio segment (because there is no associated allowance) also should be based on the guidance in those paragraphs.
The purpose of the disclosure requirements in ASC 326-20 is to give financial statement users information about the credit risk inherent in an entity's financial statements and to explain management's estimate of expected credit losses and the changes in the allowance for such losses. Many of these disclosure requirements, as well as the unit of account at which the disclosures should be presented, are consistent with the requirements in existing U.S. GAAP. That is, like the requirements of ASC 310-10-50, the disclosure requirements of ASC 326-20 for financing receivables measured at amortized cost are applicable at either the portfolio segment level or by class of financing receivable, depending on the specific disclosure required. In addition, although a net investment in a lease does not meet the definition of a financing receivable, ASC 326-20-50-13 requires a lessor to consider it as such. Further, an entity must provide disclosure information for HTM debt securities by major security type in a manner similar to how it must provide disclosures under ASC 320-10-50. Because the level of disaggregation for financing receivables differs from that for HTM debt securities, an entity would be required to disclose information for financing receivables separately from information about HTM debt securities.

**Connecting the Dots — Major Security Type**

ASU 2016-13 does not define “major security type.” However, ASC 320-10-50-1B states:

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:

- (Shared) activity or business sector
- Vintage
- Geographic concentration
- Credit quality
- Economic characteristic.

Under this guidance, an entity could identify a major security type on the basis of how it manages, monitors, and measures its securities as well as the security's nature and risks. For example, major security types could comprise debt securities that are segregated by industry type, company size, or investment objective; debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies; and corporate debt securities, residential mortgage-backed securities, collateralized debt obligations, and other debt obligations.

**8.2.2 Credit Quality Information**

**ASC 326-20**

**50-4** An entity shall provide information that enables a financial statement user to do both of the following:

- Understand how management monitors the credit quality of its financial assets
- Assess the quantitative and qualitative risks arising from the credit quality of its financial assets.

**50-5** To meet the objectives in paragraph 326-20-50-4, an entity shall provide quantitative and qualitative information by class of financing receivable and major security type about the credit quality of financial assets within the scope of this Subtopic (excluding off-balance-sheet credit exposures and repurchase agreements and securities lending agreements within the scope of Topic 860), including all of the following:

- A description of the credit quality indicator(s)
- The amortized cost basis, by credit quality indicator
- For each credit quality indicator, the date or range of dates in which the information was last updated for that credit quality indicator.
Chapter 8 — Presentation and Disclosure

ASC 326-20 (continued)

50-6 When disclosing credit quality indicators of financing receivables and net investment in leases (except for reinsurance recoverables and funded or unfunded amounts of line-of-credit arrangements, such as credit cards), an entity shall present the amortized cost basis within each credit quality indicator by year of origination (that is, vintage year). For purchased financing receivables and net investment in leases, an entity shall use the initial date of issuance to determine the year of origination, not the date of acquisition. For origination years before the fifth annual period, an entity may present the amortized cost basis of financing receivables and net investments in leases in the aggregate. For interim-period disclosures, the current year-to-date originations in the current reporting period are considered to be the current-period originations. The requirement to present the amortized cost basis within each credit quality indicator by year of origination is not required for an entity that is not a public business entity.

50-6A For the purpose of the disclosure requirement in paragraph 326-20-50-6, an entity shall present the amortized cost basis of line-of-credit arrangements that are converted to term loans in a separate column (see Example 15 in paragraph 326-20-55-79). An entity shall disclose in each reporting period, by class of financing receivable, the amount of line-of-credit arrangements that are converted to term loans in each reporting period.

50-7 Except as provided in paragraph 326-20-50-6A, an entity shall use the guidance in paragraphs 310-20-35-9 through 35-12 when determining whether a modification, extension, or renewal of a financing receivable should be presented as a current-period origination. An entity shall use the guidance in paragraphs 842-10-25-8 through 25-9 when determining whether a lease modification should be presented as a current-period origination.

50-8 If an entity discloses internal risk ratings, then the entity shall provide qualitative information on how those internal risk ratings relate to the likelihood of loss.

50-9 The requirements to disclose credit quality indicators in paragraphs 326-20-50-4 through 50-5 do not apply to receivables measured at the lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

Disclosure — Application of the Term Credit Quality Indicator

55-15 This implementation guidance addresses application of the term credit quality indicator. Examples of credit quality indicators include all of the following:

a. Consumer credit risk scores  
b. Credit-rating-agency ratings  
c. An entity’s internal credit risk grades  
d. Debt-to-value ratios  
e. Collateral  
f. Collection experience  
g. Other internal metrics.

55-16 An entity should use judgment in determining the appropriate credit quality indicator for each class of financing receivable and major security type. As of the balance sheet date, the entity should use the most current information it has obtained for each credit quality indicator.
The objective of providing credit quality disclosures is to help financial statement users understand how an entity continually monitors the credit quality of a financial asset and to provide insight into the asset’s inherent credit quality. Many of the requirements in ASC 326-20 to provide credit quality information about an entity’s financing receivables are similar to those in existing U.S. GAAP. For example, ASC 310-10-50-27 through 50-30 require an entity to provide quantitative and qualitative information about the credit quality of its financing receivables.

Although there are similarities between the amendments in ASU 2016-13 and existing U.S. GAAP, the requirement in ASC 326-20-50-6 for a PBE to “present the amortized cost basis within each credit quality indicator by year of origination (that is, vintage year)” is a significant addition. That paragraph also requires entities to provide the amortized cost basis for each of the five years preceding the financial reporting date and to include this information in the aggregate for the period before those five years.

Although it could be onerous for preparers to provide such detailed information, on the basis of feedback provided during the development of the disclosure requirements, the FASB believes that the benefits of providing such information outweigh the costs associated with preparing it. Paragraph BC114 of ASU 2016-13 states, in part:

The Board performed extensive outreach on the disclosure requirements after hosting a roundtable meeting to listen to the perspectives of both preparers and users. Preparers indicated that vintage-year disclosures are more operable than amortized cost basis rollforward disclosures, and users supported the additional information that would be provided by vintage disclosures about credit quality trends. The Board concluded that the vintage disclosure requirements for financing receivables and net investment in leases will allow users to understand the credit quality trends within the portfolio from period to period. In addition, by utilizing information disclosed in other areas in the financial statements and assumptions from public sources, users may be able to derive their own rollforward of the balances and related allowance for credit losses for each origination year. This will provide useful information because it will help users develop estimates of (a) originations by period for each class of financing receivable, (b) an estimate of the initially expected credit losses and subsequent changes to the estimate, and (c) an estimate of the current-period provision that is attributable to originations and changes in expected credit losses on previously originated loans.

Example 15 in ASC 326-20 illustrates how an entity may comply with the vintage disclosure requirements.
Example 15: Disclosing Credit Quality Indicators of Financing Receivables by Amortized Cost Basis

The following Example illustrates the presentation of credit quality disclosures for a financial institution with a narrow range of loan products offered to local customers — both consumer and commercial. Depending on the size and complexity of an entity’s portfolio of financing receivables, the entity may present disclosures that are more or less detailed than the following Example. An entity may choose other methods of determining the class of financing receivable and may determine different credit quality indicators that reflect how credit risk is monitored. Some entities may have more than one credit quality indicator for certain classes of financing receivables.

<table>
<thead>
<tr>
<th>Term Loans</th>
<th>Amortized Cost Basis by Origination Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Revolving Loans Converted to Term Loans Amortized Cost Basis</td>
</tr>
<tr>
<td>As of December 31, 20X5</td>
<td>20X5</td>
</tr>
<tr>
<td>Residential mortgage:</td>
<td></td>
</tr>
<tr>
<td>Risk rating:</td>
<td></td>
</tr>
<tr>
<td>1–2 internal grade</td>
<td>$ —</td>
</tr>
<tr>
<td>3–4 internal grade</td>
<td>—</td>
</tr>
<tr>
<td>5 internal grade</td>
<td>—</td>
</tr>
<tr>
<td>6 internal grade</td>
<td>—</td>
</tr>
<tr>
<td>7 internal grade</td>
<td>—</td>
</tr>
<tr>
<td>Total residential mortgage loans</td>
<td>$ —</td>
</tr>
<tr>
<td>Residential mortgage loans:</td>
<td></td>
</tr>
<tr>
<td>Current-period gross writeoffs</td>
<td>$ —</td>
</tr>
<tr>
<td>Current-period recoveries</td>
<td>—</td>
</tr>
<tr>
<td>Current-period net writeoffs</td>
<td>$ —</td>
</tr>
<tr>
<td>Consumer:</td>
<td></td>
</tr>
<tr>
<td>Risk rating:</td>
<td></td>
</tr>
<tr>
<td>1–2 internal grade</td>
<td>$ —</td>
</tr>
<tr>
<td>3–4 internal grade</td>
<td>—</td>
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<tr>
<td>5 internal grade</td>
<td>—</td>
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<tr>
<td>6 internal grade</td>
<td>—</td>
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<tr>
<td>7 internal grade</td>
<td>—</td>
</tr>
<tr>
<td>Total consumer</td>
<td>$ —</td>
</tr>
<tr>
<td>Consumer loans:</td>
<td></td>
</tr>
<tr>
<td>Current-period gross writeoffs</td>
<td>$ —</td>
</tr>
<tr>
<td>Current-period recoveries</td>
<td>—</td>
</tr>
<tr>
<td>Current-period net writeoffs</td>
<td>$ —</td>
</tr>
</tbody>
</table>
## ASC 326-20 (continued)

### Term Loans

**Amortized Cost Basis by Origination Year**

<table>
<thead>
<tr>
<th>As of December 31, 20X5</th>
<th>20X5</th>
<th>20X4</th>
<th>20X3</th>
<th>20X2</th>
<th>20X1</th>
<th>Prior</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Revolving Loans Converted to Term Loans Amortized Cost Basis</th>
<th>Revolving Loans Amortized Cost Basis</th>
<th>Total</th>
</tr>
</thead>
</table>

### Commercial business:

- **Risk rating:**
  - 1–2 internal grade
  - 3–4 internal grade
  - 5 internal grade
  - 6 internal grade
  - 7 internal grade

### Commercial business loans:

- **Current-period gross writeoffs**
- **Current-period recoveries**
- **Current-period net writeoffs**

### Commercial mortgage:

- **Risk rating:**
  - 1–2 internal grade
  - 3–4 internal grade
  - 5 internal grade
  - 6 internal grade
  - 7 internal grade

### Commercial mortgage loans:

- **Current-period gross writeoffs**
- **Current-period recoveries**
- **Current-period net writeoffs**
Q&A 8-1 Scope of Vintage Disclosure Requirements

Question
Do the vintage disclosure requirements in ASC 326-20-50-6 only apply to PBEs?

Answer
Yes. ASC 326-20-50-6 indicates that only PBEs are subject to the vintage disclosure requirements. That is, only PBEs must present the amortized cost basis of financing receivables and net investments in leases “by year of origination (that is, vintage year)” for each credit quality indicator. Paragraph BC114 of ASU 2016-13 discusses the FASB’s rationale for requiring only PBEs to provide such disclosures:

This disclosure requirement is applicable to public business entities only because investors in private companies generally have greater access to management to obtain the information they believe is necessary. The Board considered exempting public business entities that are not SEC filers because small community banks may meet the public business entity definition, but the Board concluded that a distinction among public business entities (that is, public business entities that are not SEC filers) is inappropriate. The Board believes the disclosures are relevant for users in all public business entities; however, given cost considerations, the Board decided to allow public business entities that are not SEC filers further transition relief in order to prepare for the disclosure requirements and decided not to require this disclosure for entities that are not public business entities.

However, all entities must comply with the requirement in ASC 326-20-50-5 to disclose credit quality information by class of financing receivable or by major type of security. Such information would include a description of the credit quality indicators and the amortized cost basis by credit quality indicator.

Note that for the initial year of adoption, ASC 326 provides transition guidance on the vintage disclosure requirements in ASC 326-20-50-6. This guidance can be summarized as follows:

• PBEs that meet the U.S. GAAP definition of an SEC filer\(^2\) must disclose credit quality indicators disaggregated by year of origination for a five-year period.

• PBEs that do not meet the U.S. GAAP definition of an SEC filer must disclose credit quality indicators disaggregated by year of origination. However, upon adopting the ASU, those PBEs would only be required to disclose such information for the previous three years and would present an additional year of information until they have provided disclosures for the previous five years.

• Other entities are not required to disclose credit quality indicators disaggregated by year of origination.

See Chapter 9 for more information about transition.

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\(^2\) Under U.S. GAAP, an SEC filer is defined as follows:
An entity that is required to file or furnish its financial statements with either of the following:
   a. The Securities and Exchange Commission (SEC)
   b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.
Q&A 8-2 Vintage Disclosures for Revolving Loans That Are Modified Into Term Loans

Under ASC 326-20-50, entities must disclose credit quality information about their financing receivables and net investments in leases that are measured at amortized cost. That is, ASC 326-20-50-6 requires an entity to present the amortized cost basis within each credit quality indicator by year of origination. However, that paragraph exempts “funded or unfunded amounts of line-of-credit arrangements” (e.g., credit cards) from the requirement because the timing of the underwriting decisions related to those arrangements may not be aligned with the borrower’s use of funds. Instead, entities may aggregate such revolving loan balances and report them in a separate single column, without regard to when the initial underwriting decisions were made.

However, ASC 326-20-50-7 requires an entity to apply the guidance in ASC 310-20 to determine whether a loan that is modified should be considered new. If such a loan is considered a new loan, the entity would report it as a current-year origination in the year of the restructuring to comply with the vintage disclosure requirements in ASC 326-20-50-6.

Question

How should an entity apply the vintage disclosure requirements in ASC 326-20-50-6 to a revolving arrangement that is later converted into a term loan?

Answer

ASU 2019-04 addresses this issue by adding ASC 326-20-50-6A, which states, in part, that “an entity shall present the amortized cost basis of line-of-credit arrangements that are converted to term loans in a separate column (see Example 15 in paragraph 326-20-55-79). An entity shall disclose in each reporting period, by class of financing receivable, the amount of line-of-credit arrangements that are converted to term loans in each reporting period.”

Q&A 8-3 Gross Write-Offs and Gross Recoveries

Example 15 in ASC 326-20-55-79 illustrates how an entity could comply with the disclosure requirements for credit quality information in ASC 326-20-50-4 through 50-9. The example includes a vintage disclosure table showing an entity’s presentation of amortized cost information by vintage year for gross write-offs and gross recoveries.

Question

Does an entity need to provide gross write-offs and gross recoveries by class of financing receivable and by vintage year to comply with the credit quality disclosure requirements in ASC 326-20-50-4 through 50-9?

Answer

No. As the FASB noted at its April 3, 2019, meeting, Example 15 in ASC 326-20-55-79 illustrates only one way in which an entity could comply with the credit quality disclosure requirements in ASC 326-20-50-4 through 50-9. Because the guidance in those paragraphs does not include a requirement to provide gross write-offs and gross recoveries by class of financing receivable and by vintage year, an entity is not required to provide such information to comply with the credit quality disclosure requirements.

3 This issue was originally discussed at the November 2018 TRG meeting.
**8.2.2.1 Vintage Disclosure Requirements — Trade Receivables and Contract Assets Within the Scope of ASC 605 and ASC 606**

ASC 326-20-50-9 states that the “credit quality indicators in paragraphs 326-20-50-4 through 50-5 do not apply to receivables measured at the lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.” Thus, while ASC 326-20-50-9 is clear on the applicability of the vintage disclosure requirements and trade receivables due in one year or less, it is less clear with respect to contract assets.

ASC 606 states that an entity should apply the CECL model to contract assets, but the term “contract asset” is not used in ASC 326-20. While ASC 606-10-45-3 clearly notes that contract assets are subject to the measurement guidance in ASC 326 and that a credit loss of a contract asset “shall be measured, presented, and disclosed in accordance with Subtopic 326-20,” questions have arisen about which disclosure requirements apply to such assets. Some believe that ASC 606 indicates that a contract asset is a financial asset measured at amortized cost that is within the scope of ASC 326-20 for subsequent measurement and disclosure purposes, even though this is not explicitly stated in ASC 326-20. Others believe that a contract asset does not meet the definition of a financial asset measured at amortized cost because the entity does not have the unconditional right to receive cash until the contract asset becomes a trade receivable (i.e., when it has the right to collect the consideration from the customer).

**Connecting the Dots — Contract Assets**

Contract assets may not be converted to receivables and subsequently collected for more than one year. Consequently, if considered to be within the scope of ASC 326-20, such assets may not qualify for the short-term exception for certain disclosures that is described in ASC 326-20-50-9. On the basis of discussions held with the FASB staff, we believe that contract assets do not meet the definition of a financing receivable and are therefore outside the scope of the vintage disclosure requirements in ASC 326-20-50-4 and 50-5. However, once the contract asset is converted to a trade receivable, the entity would need to include that converted trade receivable in its vintage disclosures if it is not due in one year or less.

**8.2.3 Allowance for Credit Losses**

<table>
<thead>
<tr>
<th>ASC 326-20</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>50-10</strong> An entity shall provide information that enables a financial statement user to do the following:</td>
</tr>
<tr>
<td>a. Understand management’s method for developing its allowance for credit losses</td>
</tr>
<tr>
<td>b. Understand the information that management used in developing its current estimate of expected credit losses</td>
</tr>
<tr>
<td>c. Understand the circumstances that caused changes to the allowance for credit losses, thereby affecting the related credit loss expense (or reversal) reported for the period.</td>
</tr>
</tbody>
</table>

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5 The ASC master glossary defines a financial asset as “[c]ash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following: a. Receive cash or another financial instrument from a second entity b. Exchange other financial instruments on potentially favorable terms with the second entity.”
ASC 326-20 (continued)

50-11 To meet the objectives in paragraph 326-20-50-10, an entity shall disclose all of the following by portfolio segment and major security type:

a. A description of how expected loss estimates are developed

b. A description of the entity's accounting policies and methodology to estimate the allowance for credit losses, as well as a discussion of the factors that influenced management's current estimate of expected credit losses, including:
   1. Past events
   2. Current conditions
   3. Reasonable and supportable forecasts about the future.

c. A discussion of risk characteristics relevant to each portfolio segment

d. A discussion of the changes in the factors that influenced management's current estimate of expected credit losses and the reasons for those changes (for example, changes in portfolio composition, underwriting practices, and significant events or conditions that affect the current estimate but were not contemplated or relevant during a previous period)

e. Identification of changes to the entity's accounting policies, changes to the methodology from the prior period, its rationale for those changes, and the quantitative effect of those changes

f. Reasons for significant changes in the amount of writeoffs, if applicable

g. A discussion of the reversion method applied for periods beyond the reasonable and supportable forecast period

h. The amount of any significant purchases of financial assets during each reporting period

i. The amount of any significant sales of financial assets or reclassifications of loans held for sale during each reporting period.

50-12 Paragraph 326-20-45-3 explains that a creditor that measures expected credit losses based on a discounted cash flow method is permitted to report the entire change in present value as credit loss expense (or reversal of credit loss expense) but also may report the change in present value attributable to the passage of time as interest income. Creditors that choose the latter alternative shall disclose the amount recorded to interest income that represents the change in present value attributable to the passage of time.

Rollforward of the Allowance for Credit Losses

50-13 Furthermore, to enable a financial statement user to understand the activity in the allowance for credit losses for each period, an entity shall separately provide by portfolio segment and major security type the quantitative disclosures of the activity in the allowance for credit losses for financial assets within the scope of this Subtopic, including all of the following:

a. The beginning balance in the allowance for credit losses

b. Current-period provision for expected credit losses

c. The initial allowance for credit losses recognized on financial assets accounted for as purchased financial assets with credit deterioration (including beneficial interests that meet the criteria in paragraph 325-40-30-1A), if applicable

d. Writeoffs charged against the allowance

e. Recoveries collected

f. The ending balance in the allowance for credit losses.
Many of the disclosure requirements in ASC 326-20-50-10 through 50-12 that describe an entity’s allowance for credit losses are consistent with those in existing U.S. GAAP. In general, the objective of these requirements is to help financial statement users understand the information and methods that management uses in determining the estimate of expected credit losses. In addition, the disclosures should be presented in sufficient detail for financial statement users to understand the factors or conditions that led to any changes in the allowance for credit losses from the prior period.

The rollforward of the allowance for credit losses is generally the same as that required under ASC 310-10-50-11B, with one notable difference. Because ASC 326 requires an entity to recognize at acquisition an allowance for credit losses on assets deemed to be PCD that is not recognized through a provision for credit losses (i.e., the gross-up approach), the entity must also include the allowance recognized on PCD assets within the rollforward required by ASC 326-20-50-13.

### 8.2.4 Past-Due and Nonaccrual Status

<table>
<thead>
<tr>
<th>ASC 326-20</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Past Due Status</strong></td>
</tr>
<tr>
<td><strong>50-14</strong> To enable a financial statement user to understand the extent of financial assets that are past due, an entity shall provide an aging analysis of the amortized cost basis for financial assets that are past due as of the reporting date, disaggregated by class of financing receivable and major security type. An entity also shall disclose when it considers a financial asset to be past due.</td>
</tr>
<tr>
<td><strong>50-15</strong> The requirements to disclose past-due status in paragraph 326-20-50-14 do not apply to receivables measured at the lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.</td>
</tr>
</tbody>
</table>
### Example 16: Disclosing Past-Due Status

**55-80** The following table illustrates certain of the disclosures in paragraph 326-20-50-14 by class of financing receivable.

<table>
<thead>
<tr>
<th>Age Analysis of Past-Due Financial Assets</th>
<th>As of December 31, 20X5, and 20X4</th>
<th>Past Due</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30-59 Days</td>
<td>60-89 Days</td>
</tr>
<tr>
<td>20X5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial real estate:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial real estate — construction</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Commercial real estate — other</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Consumer:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer — credit card</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Consumer — other</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Consumer — auto</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Residential:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential — prime</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Residential — subprime</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Finance leases</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Total</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>20X4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial real estate:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial real estate — construction</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Commercial real estate — other</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Consumer:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer — credit card</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Consumer — other</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Consumer — auto</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Residential:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential — prime</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Residential — subprime</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Finance leases</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
<tr>
<td>Total</td>
<td>XXXX</td>
<td>XXXX</td>
</tr>
</tbody>
</table>
Chapter 8 — Presentation and Disclosure

**ASC 326-20 (continued)**

**Nonaccrual Status**

**50-16** To enable a financial statement user to understand the credit risk and interest income recognized on financial assets on nonaccrual status, an entity shall disclose all of the following, disaggregated by class of financing receivable and major security type:

a. The amortized cost basis of financial assets on nonaccrual status as of the beginning of the reporting period and the end of the reporting period
b. The amount of interest income recognized during the period on nonaccrual financial assets
c. The amortized cost basis of financial assets that are 90 days or more past due, but are not on nonaccrual status as of the reporting date
d. The amortized cost basis of financial assets on nonaccrual status for which there is no related allowance for credit losses as of the reporting date.

**50-17** An entity's summary of significant accounting policies for financial assets within the scope of this Subtopic shall include all of the following:

a. Nonaccrual policies, including the policies for discontinuing accrual of interest, recording payments received on nonaccrual assets (including the cost recovery method, cash basis method, or some combination of those methods), and resuming accrual of interest, if applicable
b. The policy for determining past-due or delinquency status
c. The policy for recognizing writeoffs within the allowance for credit losses.

**50-18** The requirements to disclose nonaccrual status in paragraphs 326-20-50-16 through 50-17 do not apply to receivables measured at lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

For certain loans, existing interest income recognition methods are based on the initial investment, without a deduction for the allowance for credit losses, which may allow certain entities to recognize interest income on principal that is not expected to be collected. However, certain regulatory policies mitigate this risk by requiring an entity to stop accruing interest when it believes that the collection of principal, interest, or both is in doubt. As a result, some entities may have a nonaccrual policy in which they no longer accrue interest in certain circumstances (e.g., when a borrower is in default for a specified period, such as 90 days past due).

ASU 2016-13 did not amend the existing requirements related to placing a loan on nonaccrual status. However, ASC 326-20 requires an entity to provide information about financial assets that are past due or for which the entity is no longer accruing interest (the disclosure requirements do not apply to the assets described in ASC 326-20-50-15 and ASC 326-20-50-18). While these disclosure requirements are generally consistent with those in ASC 310-10-50-5A through 50-8, an entity is now required to provide additional information for financial assets on nonaccrual status under ASC 326. The table below compares the disclosure requirements for financial assets on nonaccrual status under ASC 326 with those under ASC 310. Requirements added by ASC 326 are in boldface.
<table>
<thead>
<tr>
<th>ASC 310-10-50-6</th>
<th>ASC 326-20-50-17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting policies related to:</td>
<td>Accounting policies related to:</td>
</tr>
<tr>
<td>• Placing an asset on nonaccrual status.</td>
<td>• Placing an asset on nonaccrual status.</td>
</tr>
<tr>
<td>• Recording payments received for assets on nonaccrual status.</td>
<td>• Recording payments for assets on nonaccrual status.</td>
</tr>
<tr>
<td>• Resuming interest accrual.</td>
<td>• Resuming interest accrual.</td>
</tr>
<tr>
<td>• Assessing past-due or delinquency status.</td>
<td>• Assessing past-due or delinquency status.</td>
</tr>
<tr>
<td>• Recognizing write-offs within the allowance for credit losses.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ASC 310-10-50-7</th>
<th>ASC 326-20-50-16</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of each balance sheet date, the entity must present:</td>
<td>As of each balance sheet date, the entity must present:</td>
</tr>
<tr>
<td>• The recorded investment in any financing receivable on nonaccrual status.</td>
<td>• The amortized cost basis of any financial assets on nonaccrual status.</td>
</tr>
<tr>
<td>• The recorded investment in any financing receivable that is past due 90 days or more and is still accruing.</td>
<td>• The amortized cost basis of any financial assets that are past due 90 days or more and are still accruing.</td>
</tr>
<tr>
<td></td>
<td>• The interest income recognized on nonaccrual financial assets during the period.</td>
</tr>
<tr>
<td></td>
<td>• The amortized cost basis of any financial assets on nonaccrual status and for which there is no related credit loss allowance.</td>
</tr>
</tbody>
</table>

### 8.2.5 Other Disclosures

**ASC 326-20**

**Purchased Financial Assets With Credit Deterioration**

50-19 To the extent an entity acquired purchased financial assets with credit deterioration during the current reporting period, an entity shall provide a reconciliation of the difference between the purchase price of the financial assets and the par value of the assets, including:

a. The purchase price  
   b. The allowance for credit losses at the acquisition date based on the acquirer's assessment  
   c. The discount (or premium) attributable to other factors  
   d. The par value.

#### 8.2.5.1 PCD Assets

If, during the financial reporting period, an entity acquires a PCD asset (and therefore applies the gross-up approach to that asset), it must disclose a reconciliation between the PCD asset's purchase price and its par value. Such a reconciliation will enable financial statement users to understand how much of the purchase price discount is related to expected credit losses or other factors (discounts or premiums). The reconciliation should include the items listed in ASC 326-20-50-19(a)–(d) above.

Note that entities are only required to provide this reconciliation in the financial reporting period in which the PCD asset is acquired. It does not need to be disclosed in subsequent periods.
Collateral-Dependent Financial Assets

For a financial asset for which the repayment (on the basis of an entity’s assessment as of the reporting date) is expected to be provided substantially through the operation or sale of the collateral and the borrower is experiencing financial difficulty, an entity shall describe the type of collateral by class of financing receivable and major security type. The entity also shall qualitatively describe, by class of financing receivable and major security type, the extent to which collateral secures its collateral-dependent financial assets, and significant changes in the extent to which collateral secures its collateral-dependent financial assets, whether because of a general deterioration or some other reason.

8.2.5.2 Collateral-Dependent Financial Assets

Under ASC 326-20-50-20, if an asset is determined to be collateral-dependent and the borrower is experiencing financial difficulty (as described in Section 4.4.6.1), the entity must “describe the type of collateral by class of financing receivable and major security type. The entity also shall qualitatively describe, by class of financing receivable and major security type, the extent to which collateral secures its collateral-dependent financial assets, and significant changes in the extent to which collateral secures its collateral-dependent financial assets, whether because of a general deterioration or some other reason.”

Off-Balance-Sheet Credit Exposures

In addition to disclosures required by other Topics, an entity shall disclose a description of the accounting policies and methodology the entity used to estimate its liability for off-balance-sheet credit exposures and related charges for those credit exposures. Such a description shall identify the factors that influenced management’s judgment (for example, historical losses, existing economic conditions, and reasonable and supportable forecasts) and a discussion of risk elements relevant to particular categories of financial instruments.

Off-balance-sheet credit exposures refers to credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815.

8.2.5.3 Off-Balance-Sheet Credit Exposures

In a manner consistent with the disclosure requirements in current U.S. GAAP (ASC 310-10-50-9 and 50-10), an entity must disclose its accounting policy and method for estimating expected credit losses on off-balance-sheet credit exposures. ASC 326-20-50-21 states that “[s]uch a description shall identify the factors that influenced management’s judgment (for example, historical losses, existing economic conditions, and reasonable and supportable forecasts) and a discussion of risk elements relevant to particular categories of financial instruments.”
## 8.2.6 Summary of ASC 326-20 Disclosure Requirements by Asset Type

<table>
<thead>
<tr>
<th>Disclosure Category</th>
<th>ASC Reference</th>
<th>Roadmap Reference</th>
<th>Disclosure Required?</th>
<th>Disaggregated by Portfolio Segment or Class of Financing Receivable</th>
<th>Disaggregated by Major Security Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit quality information</td>
<td>326-20-50-4 and 50-5 and 326-20-50-8</td>
<td>8.2.2</td>
<td>Yes(^{(a), (b)})</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Credit quality information — vintage disclosures</td>
<td>326-20-50-6 and 50-7</td>
<td>8.2.2</td>
<td>Yes(^{(b), (c)})</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Allowance for credit losses</td>
<td>326-20-50-10 through 50-12</td>
<td>8.2.3</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Rollforward of the allowance for credit losses</td>
<td>326-20-50-13</td>
<td>8.2.3</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Past-due status</td>
<td>326-20-50-14</td>
<td>8.2.4</td>
<td>Yes(^{(b)})</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Nonaccrual status</td>
<td>326-20-50-16 and 50-17</td>
<td>8.2.4</td>
<td>Yes(^{(b)})</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>PCD financial assets</td>
<td>326-20-50-19</td>
<td>8.2.5.1</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Collateral-dependent financial assets</td>
<td>326-20-50-20</td>
<td>8.2.5.2</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Off-balance-sheet exposures</td>
<td>326-20-50-21 and 50-22</td>
<td>8.2.5.3</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

\(^{(a)}\) This disclosure requirement does not apply to repurchase agreements and securities lending agreements within the scope of ASC 860.

\(^{(b)}\) As indicated in ASC 326-20-50-9, ASC 326-20-50-15, and ASC 326-20-50-18, these disclosure requirements “do not apply to receivables measured at the lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.”

\(^{(c)}\) On the basis of discussions held with the FASB staff, we believe that contract assets do not meet the definition of a financing receivable and are therefore outside the scope of the vintage disclosure requirements in ASC 326-20-50-4 and 50-5.
8.2.7 AFS Debt Securities

ASC 326-30

General

50-1 For instruments within the scope of this Subtopic, this Section provides the following disclosure guidance related to credit risk and the measurement of credit losses:

a. Available-for-sale debt securities in unrealized loss positions without an allowance for credit losses
b. Allowance for credit losses
c. Purchased financial assets with credit deterioration.

50-2 The disclosure guidance in this Section should enable a user of the financial statements to understand the following:

a. The credit risk inherent in available-for-sale debt securities
b. Management’s estimate of credit losses
c. Changes in the estimate of credit losses that have taken place during the period.

50-3 An entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy the disclosure requirements in this Section and how it disaggregates information into major security types. An entity must strike a balance between obscuring important information as a result of too much aggregation and overburdening financial statements with excessive detail that may not assist a financial statement user to understand an entity’s securities and allowance for credit losses. For example, an entity should not obscure important information by including it with a large amount of insignificant detail. Similarly, an entity should not disclose information that is so aggregated that it obscures important differences between the different types of financial assets and associated risks.

50-3A An entity that makes the accounting policy election to present separately the accrued interest receivable balance within another statement of financial position line item as described in paragraph 326-30-45-1 shall disclose the amount of applicable accrued interest, net of the allowance for credit losses (if any), and shall disclose in which line item on the statement of financial position that amount is presented.

50-3B If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the fair value and the 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 paragraphs 326-30-50-4 through 50-10. 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.

50-3C An entity that makes the accounting policy election in paragraph 326-30-30-1B shall disclose its accounting policy not to measure an allowance for credit losses for accrued interest receivables. The accounting policy shall include information about what time period or periods, at the major security-type level, are considered timely.

50-3D An entity that makes the accounting policy election in paragraph 326-30-35-13A shall disclose its accounting policy to write off accrued interest receivables by reversing interest income or recognizing credit loss expense or a combination of both. The entity also shall disclose the amount of accrued interest receivables written off by reversing interest income by major security type.
Available-for-Sale Debt Securities in Unrealized Loss Positions Without an Allowance for Credit Losses

50-4 For available-for-sale debt securities, including those that fall within the scope of Subtopic 325-40 on beneficial interests in securitized financial assets, in an unrealized loss position for which an allowance for credit losses has not been recorded, an entity shall disclose all of the following in its interim and annual financial statements:

a. As of each date for which a statement of financial position is presented, quantitative information, aggregated by category of investment — each major security type that the entity discloses in accordance with this Subtopic — in tabular form:
   1. The aggregate related fair value of investments with unrealized losses
   2. The aggregate amount of unrealized losses (that is, the amount by which amortized cost basis exceeds fair value).

b. As of the date of the most recent statement of financial position, additional information (in narrative form) that provides sufficient information to allow a financial statement user to understand the quantitative disclosures and the information that the entity considered (both positive and negative) in reaching the conclusion that an allowance for credit losses is unnecessary. The disclosures required may be aggregated by investment categories, but individually significant unrealized losses generally shall not be aggregated. This disclosure could include all of the following:
   1. The nature of the investment(s)
   2. The cause(s) of the impairment(s)
   3. The number of investment positions that are in an unrealized loss position
   4. The severity of the impairment(s)
   5. Other evidence considered by the investor in reaching its conclusion that an allowance for credit losses is not necessary, including, for example, any of the following:
      i. Performance indicators of the underlying assets in the security, including any of the following:
         01. Default rates
         02. Delinquency rates
         03. Percentage of nonperforming assets.
      ii. Debt-to-collateral-value ratios
      iii. Third-party guarantees
      iv. Current levels of subordination
      v. Vintage
      vi. Geographic concentration
      vii. Industry analyst reports
      viii. Credit ratings
      ix. Volatility of the security's fair value
      x. Interest rate changes since purchase
      xi. Any other information that the investor considers relevant.

50-5 The disclosures in (a)(1) through (a)(2) in paragraph 326-30-50-4 shall be disaggregated by those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer.
50-6 The reference point for determining how long an investment has been in a continuous unrealized loss position is the balance sheet date of the reporting period in which the impairment is identified. For entities that do not prepare interim financial information, the reference point is the annual balance sheet date of the period during which the impairment was identified. The continuous unrealized loss position ceases upon the investor becoming aware of a recovery of fair value up to (or beyond) the amortized cost basis of the investment during the period.

Allowance for Credit Losses

50-7 For interim and annual periods in which an allowance for credit losses of an available-for-sale debt security is recorded, an entity shall disclose by major security type, the methodology and significant inputs used to measure the amount related to credit loss, including its accounting policy for recognizing writeoffs of uncollectible available-for-sale debt securities. Examples of significant inputs include, but are not limited to, all of the following:

a. Performance indicators of the underlying assets in the security, including all of the following:
   1. Default rates
   2. Delinquency rates
   3. Percentage of nonperforming assets
b. Debt-to-collateral-value ratios
c. Third-party guarantees
d. Current levels of subordination
e. Vintage
f. Geographic concentration
g. Industry analyst reports and forecasts
h. Credit ratings
i. Other market data that are relevant to the collectibility of the security.

50-8 Paragraph 326-30-45-3 explains that an entity may report the change in the allowance for credit losses due to changes in time value as credit loss expense (or reversal of credit loss expense) but also may report the change as interest income. An entity that chooses the latter alternative shall disclose the amount recorded to interest income that represents the change in present value attributable to the passage of time.
### ASC 326-30 (continued)

#### Rollforward of the Allowance for Credit Losses

**50-9** For each interim and annual reporting period presented, an entity shall disclose by major security type, a tabular rollforward of the allowance for credit losses, which shall include, at a minimum, all of the following:

- a. The beginning balance of the allowance for credit losses on available-for-sale debt securities held by the entity at the beginning of the period
- b. Additions to the allowance for credit losses on securities for which credit losses were not previously recorded
- c. Additions to the allowance for credit losses arising from purchases of available-for-sale debt securities accounted for as purchased financial assets with credit deterioration (including beneficial interests that meet the criteria in paragraph 325-40-30-1A)
- d. Reductions for securities sold during the period (realized)
- e. Reductions in the allowance for credit losses because the entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis
- f. If the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, additional increases or decreases to the allowance for credit losses on securities that had an allowance recorded in a previous period
- g. Writeoffs charged against the allowance
- h. Recoveries of amounts previously written off
- i. The ending balance of the allowance for credit losses related to debt securities held by the entity at the end of the period.

#### Purchased Financial Assets With Credit Deterioration

**50-10** To the extent an entity acquired purchased financial assets with credit deterioration during the current reporting period, an entity shall provide a reconciliation of the difference between the purchase price of the assets and the par value of the available-for-sale debt securities including:

- a. The purchase price
- b. The allowance for credit losses at the acquisition date based on the acquirer’s assessment
- c. The discount (or premium) attributable to other factors
- d. The par value.

Like the disclosure requirements for financial assets measured at amortized cost, the disclosure requirements for AFS debt securities were designed to help financial statement users understand the credit quality of AFS debt securities and how management estimates expected credit losses. As a result, many of the disclosure requirements are similar to those in existing U.S. GAAP (e.g., those in ASC 320-10-50-1 through 50-8B). However, given the change from an OTTI model to an expected credit losses model for AFS debt securities, there are some differences. The table below compares the disclosure requirements for AFS debt securities in existing U.S. GAAP with those in ASC 326. Differences between the disclosure requirements are in boldface.
An entity is required to provide disclosure information for HTM debt securities by “major security type,” which is based on the nature and risks of the security.

**AFS Debt Securities in an Unrealized Loss Position**

- As of each date for which a balance sheet is presented, entities must provide, in tabular format and aggregated by category of investment, quantitative information about:
  - The aggregate related fair value of investments with unrealized losses.
  - The aggregate amount of unrealized losses (i.e., the amount by which the amortized cost basis exceeds fair value).
- Entities must provide sufficient qualitative information “to allow financial statement users to understand the quantitative disclosures and the information that the entity considered (both positive and negative) in reaching the conclusion that the impairment or impairments are not other than temporary.”
- These disclosures are disaggregated by (1) investments that have been in a continuous unrealized loss position for fewer than 12 months and (2) investments that have been in a continuous unrealized loss position for 12 months or longer.
- The reference point for determining how long an investment has been in a continuous unrealized loss position is the reporting date of the period in which the impairment is identified. For entities that do not prepare interim financial information, the reference point is the reporting date of the annual period during which the impairment was identified. The unrealized loss position ceases when:
  - The entity recognizes the difference between the amortized cost and fair value of the security as an OTTI.
  - The investor becomes aware of a recovery of fair value that is up to or more than the security’s amortized cost basis.

**AFS Debt Securities in an Unrealized Loss Position Without an Allowance for Credit Losses**

- As of each date for which a balance sheet is presented, entities must provide, in tabular format and aggregated by category of investment, quantitative information about:
  - The aggregate related fair value of investments with unrealized losses.
  - The aggregate amount of unrealized losses (i.e., the amount by which the amortized cost basis exceeds fair value).
- Entities must provide sufficient qualitative information “to allow a financial statement user to understand the quantitative disclosures and the information that the entity considered (both positive and negative) in reaching the conclusion that an allowance for credit losses is unnecessary” (emphasis added).
- These disclosures are disaggregated by (1) investments that have been in a continuous unrealized loss position for fewer than 12 months and (2) investments that have been in a continuous unrealized loss position for 12 months or longer.
- The reference point for determining how long an investment has been in a continuous unrealized loss position is the reporting date of the period in which the impairment is identified. For entities that do not prepare interim financial information, the reference point is the reporting date of the annual period during which the impairment was identified. The unrealized loss position ceases when **the investor becomes aware of a recovery of fair value that is up to or more than the security’s amortized cost basis**.
(Table continued)

<table>
<thead>
<tr>
<th>ASC 320-10-50</th>
<th>ASC 326-30-50</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Credit Losses Recognized in Earnings</strong></td>
<td><strong>Allowance for Credit Losses</strong></td>
</tr>
<tr>
<td>For interim and annual periods in which the entity recognizes an OTTI, it must disclose the method and inputs used to measure the credit loss.</td>
<td>For interim and annual periods in which there is an allowance for credit losses, the entity must disclose the method and inputs used to measure expected credit losses, including its accounting policy for recognizing the write-offs of uncollectible AFS debt securities.</td>
</tr>
</tbody>
</table>

**Rollforward of Credit Losses Recognized in Earnings**

For each interim and annual reporting period presented, an entity discloses by major security type a tabular rollforward of the credit losses recognized in earnings as follows:

- The beginning balance of the credit losses recognized in OCI:
  - Additions related to (1) increases in credit losses for which an OTTI was recognized and (2) credit losses for which an OTTI was not recognized.
  - Decreases related to (1) reductions for securities sold during the period (realized) and (2) reductions attributable to the entity's intent to sell the security or its belief that it is more likely than not that it will be required to sell the security before recovery of the amortized cost basis.
- The ending balance of the allowance for credit losses.

**Rollforward of the Allowance for Credit Losses**

For each interim and annual reporting period presented, an entity discloses by major security type a tabular rollforward of the allowance for credit losses as follows:

- The beginning balance of the allowance for credit losses:
  - Additions related to (1) increases in expected credit losses for situations in which the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis and (2) the acquisition of AFS debt securities accounted for as PCD assets (including BIs that meet the criteria in ASC 325-40-30-1A).
  - Decreases related to (1) reductions in expected credit losses for situations in which the entity does not intend to sell the security and it is not more likely than not that it will be required to sell the security before recovery of the amortized cost basis, (2) reductions for securities sold during the period (realized), and (3) reductions attributable to the entity's intent to sell the security or its belief that it is more likely than not that it will be required to sell the security before recovery of the amortized cost basis.
  - **Write-offs charged against the allowance.**
  - **Recoveries of amounts previously written off.**
- The ending balance of the allowance for credit losses.
If, during the financial reporting period, an entity acquires AFS PCD assets, it must disclose a reconciliation between the PCD asset’s purchase price and par value that includes the following:

- The purchase price.
- The allowance for credit losses as of the acquisition date.
- The discount (or premium) attributable to other factors.
- The par value.

## 8.2.7.1 Changes in the Present Value of Expected Cash Flows

A change in the present value of expected future cash flows can result from the passage of time, changes in the timing and amount of the cash flows the entity expects to receive, or both. In a manner consistent with the requirements in existing U.S. GAAP, ASC 326-30-45-3 allows an entity to present the change in the present value of expected future cash flows as an adjustment to credit loss expense (both favorable and unfavorable) or as interest income (only if the change is related to the passage of time). In accordance with ASC 326-30-50-8, if the entity chooses to present the change as interest income, it is required to disclose that policy decision as well as “the amount recorded to interest income that represents the change in present value attributable to the passage of time.”
Chapter 9 — Effective Date and Transition

9.1 Effective Dates

ASC 326-10


a. The pending content that links to this paragraph shall be effective as follows:

1. For public business entities that meet the definition of a Securities and Exchange Commission (SEC) filer, excluding entities eligible to be smaller reporting companies as defined by the SEC, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The one-time determination of whether an entity is eligible to be a smaller reporting company shall be based on an entity's most recent determination as of November 15, 2019, in accordance with SEC regulations.


3. For all other entities, for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years.

b. Early application of the pending content that links to this paragraph is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

Note: See paragraph 250-10-S99-6 on disclosure of the impact that recently issued accounting standards will have on the financial statements of a registrant...
9.1.1 Effective Date of ASU 2016-13, as Amended by ASU 2019-10

The effective date of ASU 2016-13, as amended by ASU 2019-10, depends on the nature of the reporting entity:

- For SEC filers,\(^1\) excluding those that meet the definition of a smaller reporting company (SRC),\(^2\) the ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years (“Bucket 1”).
- For all other entities, the ASU is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years (“Bucket 2”).

In addition, entities are permitted to early adopt the new guidance for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.


For entities that have adopted ASU 2016-13, the amendments in ASU 2019-04, ASU 2019-05, and ASU 2019-11 are effective for fiscal years beginning after December 15, 2019, and interim periods therein. An entity may early adopt ASU 2019-04, ASU 2019-05, and ASU 2019-11 in any interim period after their issuance if the entity has adopted ASU 2016-13. ASU 2019-04 states that the amendments should be applied “on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening retained earnings balance in the statement of financial position as of the date an entity adopted the amendments in Update 2016-13.”

For all other entities, the effective date will be the same as the effective date in ASU 2016-13.

9.1.3 Emerging Growth Companies

As noted in Topic 10 of the SEC’s Financial Reporting Manual, “Title I of the [Jumpstart Our Business Startups (JOBS)] Act, which was effective as of April 5, 2012, created a new category of issuers called ‘emerging growth companies, or EGCs’ whose financial reporting and disclosure requirements in certain areas differ from [those of] other categories of issuers.” For example, under SEC rules, an EGC is not required to comply with new or revised accounting standards as of the effective dates for PBEs and may elect to take advantage of the extended transition provisions by applying non-PBE (or private-company) adoption dates for as long as the issuer qualifies as an EGC.

During the 2019 AICPA Conference on Current SEC and PCAOB Developments, SEC Division Deputy Chief Accountant Lindsay McCord addressed transition requirements related to the adoption of the new credit losses standard for EGCs. She clarified that ASU 2019-10 does not benefit non-SRC, EGC registrants that plan to adopt a new standard by using Bucket 2 adoption dates but subsequently lose their EGC status. Therefore, a registrant’s loss of EGC status before the non-PBE adoption date (Bucket 2) would affect its adoption date of a new standard.

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\(^1\) Under U.S. GAAP, an SEC filer is defined as follows:
An entity that is required to file or furnish its financial statements with either of the following:
- The Securities and Exchange Commission (SEC)
- With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.
Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.

\(^2\) SEC Regulation S-K, Item 10(f)(1), defines an SRC, in part, as:
- An issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that:
  - Had a public float of less than $250 million; or
  - Had annual revenues of less than $100 million and either:
    - No public float; or
    - A public float of less than $700 million.
In a manner consistent with the circumstances addressed in Ms. McCord’s remarks and our understanding of the requirements, Example 9-1 below illustrates the application of the transition requirements for the adoption of the new credit losses standard. Although not explicitly discussed by the SEC staff, the scenario addressed in Example 9-2 below further demonstrates our understanding of the transition requirements related to situations in which a registrant loses EGC status after the end of the year containing the Bucket 1 adoption date.

**Example 9-1**

**Calendar-Year-End Non-SRC Registrant Loses Its EGC Status on December 31, 2020**

Assume that a non-SRC registrant is a calendar-year-end EGC that has elected to take advantage of the extended transition provisions and adopt the new credit losses standard by applying private-company adoption dates (Bucket 2).

A registrant that loses its EGC status on December 31, 2020, should do the following:

- Adopt ASC 326 for the annual period beginning on January 1, 2020.
- First present the application of ASC 326 in its 2020 annual financial statements included in its 2020 Form 10-K.
- Present the application of ASC 326 in its selected quarterly financial data (SEC Regulation S-K, Item 302(a)) for its 2020 quarterly periods in its 2020 Form 10-K. Further, we believe that the registrant should provide clear and transparent disclosures that the quarterly financial data presented in its 2020 Form 10-K do not mirror the information in its 2020 Forms 10-Q for the current year.
- Present the application of ASC 326 in its quarterly interim financial statements for its comparable 2020 quarterly periods presented in Forms 10-Q in 2021.

**Example 9-2**

**Calendar-Year-End Non-SRC Registrant Loses Its EGC Status on December 31, 2021**

Assume the same facts as in Example 9-1 except that the registrant loses its EGC status on December 31, 2021. The registrant should do the following:

- Adopt ASC 326 for the annual period beginning on January 1, 2021.
- First present the application of ASC 326 in its 2021 annual financial statements included in its 2021 Form 10-K.
- Present the application of ASC 326 in its selected quarterly financial data (SEC Regulation S-K, Item 302(a)) for its 2021 quarterly periods in its 2021 Form 10-K. Further, we believe that the registrant should provide clear and transparent disclosures that the quarterly financial data presented in its 2021 Form 10-K do not mirror the information in its 2021 Forms 10-Q for the current year.
- Present the application of ASC 326 in its quarterly interim financial statements for its comparable 2021 quarterly periods presented in Forms 10-Q in 2022.
9.2 Transition Approach

ASC 326-10

65-1 The following represents the transition and effective date information related to Accounting Standards Updates No. 2016-13 . . .

c. An entity shall apply the pending content that links to this paragraph by means of a cumulative-effect adjustment to the opening retained earnings as of the beginning of the first reporting period in which the pending content that links to this paragraph is effective.

d. An entity shall apply prospectively the pending content that links to this paragraph for purchased financial assets with credit deterioration to financial assets for which Subtopic 310-30 was previously applied. The prospective application will result in an adjustment to the amortized cost basis of the financial asset to reflect the addition of the allowance for credit losses at the date of adoption. An entity shall not reassess whether recognized financial assets meet the criteria of a purchased financial asset with credit deterioration as of the date of adoption. An entity may elect to maintain pools of loans accounted for under Subtopic 310-30 at adoption. An entity shall not reassess whether modifications to individual acquired financial assets accounted for in pools are troubled debt restructurings as of the date of adoption. The noncredit discount or premium, after the adjustment for the allowance for credit losses, shall be accreted to interest income using the interest method based on the effective interest rate determined after the adjustment for credit losses at the adoption date. The same transition requirements should be applied to beneficial interests for which Subtopic 310-30 was applied previously or for which there is a significant difference between the contractual cash flows and expected cash flows at the date of recognition.

e. An entity shall apply prospectively the pending content that links to this paragraph to debt securities for which an other-than-temporary impairment had been recognized before the date of adoption, such that the amortized cost basis (including previous write-downs) of the debt security is unchanged. In addition, the effective interest rate on a security will remain unchanged as a result of the adoption of the pending content that links to this paragraph. Amounts previously recognized in accumulated other comprehensive income as of the adoption date that relate to improvements in cash flows will continue to be accreted to interest income over the remaining life of the debt security on a level-yield basis. Recoveries of amounts previously written off relating to improvements in cash flows after the date of adoption shall be recorded to income in the period received . . .

j. An entity that adjusts the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments in accordance with paragraphs 326-20-30-4 through 30-4A for troubled debt restructurings that exist as of the date of adoption may, as an accounting policy election, calculate the prepayment-adjusted effective interest rate using the original contractual rate and the prepayment assumptions as of the date of adoption.

For most debt instruments, entities must record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is effective (modified retrospective approach). However, ASU 2016-13 provides the following instrument-specific transition guidance:

- **Other-than-temporarily impaired debt securities** — An entity must prospectively apply (1) the CECL model to HTM debt securities and (2) the changes to the impairment model for AFS debt securities. As a result, previous write-downs of a debt security’s amortized cost basis would not be reversed; rather, only cumulative unfavorable changes in the estimate of expected cash flows of the debt security occurring on or after the ASU’s effective date would be reflected as an allowance for credit losses. Upon adopting the new guidance, an entity would continue to accrete into interest income any amounts previously recognized in OCI before the effective date that are related to improvements in expected cash flows. In addition, an entity would recognize in the period in which they are received recoveries of amounts that were previously written off before adoption of the new guidance. An entity would recognize such write-offs in a manner consistent with how it would recognize recoveries on amounts written off after adopting the new guidance (see Section 4.5.2).
• **PCD assets** — An entity is required to apply the changes to PCD assets prospectively. That is, the change in the definition of a PCD asset applies only to assets acquired on or after the ASU’s effective date. For debt instruments accounted for under ASC 310-30, an entity would apply the gross-up approach as of the transition date (i.e., establish an allowance for expected credit losses and make a corresponding adjustment to the debt instrument’s cost basis).

In addition, an entity would immediately recognize any postadoption changes to the estimate of cash flows that it expects to collect (favorable or unfavorable) in the income statement as credit loss expense (or as a reduction of expense). Accordingly, the yield on a PCD asset as of the date of adoption would be “locked” and would not be affected by subsequent changes in the entity’s estimate of expected credit losses.

• **Certain BIs within the scope of ASC 325-40** — ASC 326-10-65-1 states that entities holding “beneficial interests for which Subtopic 310-30 was applied previously or for which there is a significant difference between the contractual cash flows and expected cash flows at the date of recognition” would apply the same transition requirements as those that apply to PCD assets.

• **TDRs for which the EIRs are adjusted for prepayments** — ASU 2019-11 amended ASU 2016-13 to allow entities to calculate the prepayment-adjusted EIR on preexisting TDRs by using the prepayment assumptions that exist as of the date on which an entity adopts ASU 2016-13, instead of the prepayment-adjusted EIR immediately before the restructuring date.

**Q&A 9-1 Applying the Transition Guidance to Pools of PCI Assets Under ASC 310-30**

ASC 326-10-65-1(d) allows entities to “elect to maintain pools of loans accounted for under Subtopic 310-30 at adoption.” Under current U.S. GAAP, entities are permitted to (1) pool PCI assets acquired in the same fiscal quarter that have similar risk characteristics and (2) use a composite interest rate to estimate the cash flows expected to be collected by the pool. In addition, under ASC 310-30-40-1 (which was superseded by ASU 2016-13), pools of loans must be maintained, and loans may be removed from a pool only in limited circumstances (e.g., sale of a loan, receipt of assets in satisfaction of a loan, a loan write-off).

If a TDR occurs on a loan accounted for in a pool, entities still apply ASC 310-30 to the pool and do not apply TDR accounting to the individual loan. Under ASC 326-20-30-2 (added by ASU 2016-13), entities are required to reevaluate the characteristics of the assets in the pool and remove assets that no longer have similar characteristics. In other words, if an asset that was considered to be a PCI asset at transition no longer has characteristics that are similar to those of the rest of the assets in the pool, that asset should be removed and placed in a different pool containing loans with similar risk characteristics.

**Question**

Can an entity continue to apply ASC 310-30 to pools of PCI assets if it elects to maintain those pools when adopting ASU 2016-13?
Answer

Yes. At its June 2017 meeting, the TRG noted that while the transition guidance permits entities to elect to maintain pools of loans accounted for under ASC 310-30, ASU 2016-13 is unclear on the extent to which entities can continue to apply the guidance in ASC 310-30 to these pools. TRG members generally agreed that entities have the choice of maintaining their existing pools accounted for under ASC 310-30 either at adoption only or on an ongoing basis after adoption. Note that if an entity elects to maintain pools of loans accounted for under ASC 310-30, it would continue to estimate its expected credit losses by using a DCF approach, as it did when applying ASC 310-30 before the adoption of ASU 2016-13.

Furthermore, the FASB staff noted in TRG Memo 6 that an entity's approach to maintaining its existing pools should be determined on a pool-by-pool basis. The staff also stated:

[A]s part of complying with the disclosure requirements in paragraphs 326-20-50-10 through 50-11, any entity that [maintains its existing pools on an ongoing basis] should evaluate the need for disclosure of their election to maintain pools and any additional qualitative or quantitative information that may be necessary for a financial statement user to understand the size and nature of former Subtopic 310-30 pools. Additionally, an entity would need to consider disclosure of the accounting policies that are in place for these pools that are different from other assets held by the entity.

Q&A 9-2 Transition for PCD AFS Debt Securities

Entity ABC purchases a debt security with a par/UPB of $1,000 and a fair value of $600 (before the adoption of ASU 2016-13). Entity ABC classifies the debt security as AFS in accordance with ASC 320. The discount on the security is partially due to a deterioration in credit since its issuance and therefore is within the scope of ASC 310-30. At the time of purchase, the credit portion of the discount is $150 and the noncredit discount (also known as the “accretable yield”) is $250. Market interest rates have dropped since the debt security was acquired by ABC, but the expected cash flows are unchanged. As a result, immediately before the adoption of ASU 2016-13, the amortized cost basis has increased to $675 through accretion but the fair value is $700.

Question

How should an entity apply the transition provisions of ASU 2016-13 to an AFS debt security with an unrealized gain that was previously accounted for in accordance with ASC 310-30?

Answer

ASC 326-10-65-1(d) provides transition guidance related to purchased financial assets with credit deterioration and states:

An entity shall apply prospectively the pending content that links to this paragraph for purchased financial assets with credit deterioration to financial assets for which Subtopic 310-30 was previously applied. The prospective application will result in an adjustment to the amortized cost basis of the financial asset to reflect the addition of the allowance for credit losses at the date of adoption. An entity shall not reassess whether recognized financial assets meet the criteria of a purchased financial asset with credit deterioration as of the date of adoption. An entity may elect to maintain pools of loans accounted for under Subtopic 310-30 at adoption. An entity shall not reassess whether modifications to individual acquired financial assets accounted for in pools are troubled debt restructurings as of the date of adoption. The noncredit discount or premium, after the adjustment for the allowance for credit losses, shall be accreted to interest income using the interest method based on the effective interest rate determined after the adjustment for credit losses at the adoption date. The same transition requirements should be applied to beneficial interests for which Subtopic 310-30 was applied previously or for which there is a significant difference between the contractual cash flows and expected cash flows at the date of recognition.
Any debt security that was within the scope of ASC 310-30 before the adoption of ASU 2016-13 is automatically considered a PCD asset under ASU 2016-13. Under the transition provisions of ASU 2016-13, PCD assets are “grossed up” by any allowance for credit losses upon transition. In the example above, ABC might conclude that it should increase the amortized cost basis by $150, with an offsetting credit of $150 as an allowance for credit losses. However, ASC 326-30 governs the accounting for credit losses for AFS debt securities. Under ASC 326-30-35-1, “[a]n investment is impaired if the fair value of the investment is less than its amortized cost basis.” In addition, under ASC 326-30-35-2, if an investment in an AFS debt security is impaired, the allowance for credit losses is “limited by the amount that the fair value is less than the amortized cost basis.” If ABC were to gross up the debt security in such a way that the amortized cost basis is now $825 ($675 + $150), but the fair value is $700, ABC would be limited to having an allowance for credit losses of $125 ($825 – $700).

On the basis of discussions with the FASB staff, we understand that it would be appropriate for an entity to apply the guidance in ASC 326-30-35-1 in determining whether an allowance for credit losses is required upon the adoption of ASU 2016-13. In other words, if an AFS debt security has a fair value that is greater than its amortized cost as of the date of adoption, that AFS debt security is not impaired. Accordingly, the entity would not adjust the amortized cost basis of the AFS debt security upon adopting ASU 2016-13 and would not establish an allowance for credit losses. With respect to the entity in the example above, the AFS debt security would continue to have an amortized cost basis of $675 and no allowance for credit losses. In addition, the noncredit discount would remain at $175 ($250 at inception minus $75 of accretion before adoption).

If a PCD AFS debt security has an unrealized loss as of the date of adoption, the amortized cost basis of the security should be adjusted for the allowance for credit losses required by ASC 326-30 at transition (the full “gross up” model).

### 9.2.1 Transition Relief by Providing the Fair Value Option

<table>
<thead>
<tr>
<th>ASC 326-10</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>65-1</strong> The following represents the transition and effective date information related to Accounting Standards Updates No. 2016-13 . . .</td>
</tr>
<tr>
<td>i. An entity may irrevocably elect the fair value option in accordance with Subtopic 825-10 for financial instruments within the scope of Subtopic 326-20, except for those financial assets in paragraph 326-20-15-2(a)(2), that also are eligible items in Subtopic 825-10.</td>
</tr>
</tbody>
</table>

In May 2019, the FASB issued ASU 2019-05 to allow companies to irrevocably elect, upon adopting ASU 2016-13, the fair value option for financial instruments that were previously recorded at amortized cost and are within the scope of ASC 326-20 if the instruments are eligible for the fair value option under ASC 825-10. The entity would make this election on an instrument-by-instrument basis. For the effective date of ASU 2019-05, see Section 9.1.
9.2.2 Transition for Financial Guarantees Within the Scope of ASC 326-20

As discussed in Chapter 5, for guarantees within the scope of ASC 326-20, the guarantor is required to recognize (1) the fair value of the obligation related to the noncontingent portion of the guarantee and (2) an estimate of expected credit losses in accordance with ASC 326-20 on the contingent obligation related to the guarantee.

Before the adoption of ASU 2016-13, a guarantor was not required to bifurcate and separately account for the contingent and noncontingent aspects of a financial guarantee under ASC 460. Rather, the guarantor was required to initially recognize the guarantee liability at the greater of the following:

- The noncontingent liability stand-ready obligation of the guarantee measured at fair value in accordance with ASC 460-10-30-2.
- The contingent liability measured in accordance with ASC 450-20-30.

ASC 460 distinguishes between the noncontingent “stand ready” obligation associated with a guarantee (accounted for under ASC 460) and the contingent obligation associated with a guarantee (accounted for under ASC 450-20). The ASC 460 liability, established at the inception of a guarantee, generally represents unearned income related to the noncontingent liability (premium charged for standing ready) and, as noted in ASC 460-10-35-1 and 35-2, is typically reduced by a credit to earnings because the guarantor is released from risk under the guarantee. ASC 450-20, on the other hand, provides guidance on establishing a liability for a loss contingency, which represents an estimate of an entity’s probable future obligation related to an incurred loss. The ASC 450-20 liability is subsequently measured on the basis of facts and circumstances specific to the contingency, and the related loss is recorded apart from the credit to earnings recognized under ASC 460.

Neither ASC 460 nor ASC 450-20 provides explicit guidance on the interaction between ASC 460 and ASC 450-20 after initial recognition. Accordingly, entities generally established a systematic and rational method with a reasonable basis for supporting subsequent accounting. The following is a discussion of two different methods that entities have applied in practice to determine the amount of an ASC 450-20 liability to record:

- **Method 1: Incremental recognition of the ASC 450-20 contingent liability** — After initial recognition, an entity would record a separate ASC 450-20 liability only when the entire estimated ASC 450-20 amount exceeds the unamortized ASC 460 liability. The ASC 450-20 liability equals the excess of the entire estimated probable obligation over (1) the unamortized ASC 460 liability or (2) the expected unamortized ASC 460 liability at the time of the expected payment. In subsequent periods, the ASC 450-20 liability may need to be adjusted so that it continues to equal the excess of the entire estimated probable obligation over the unamortized ASC 460 liability.

- **Method 2: Gross recognition of the ASC 450-20 contingent liability** — Under this method, after the initial recognition and measurement of the guarantee, an entity would record a separate ASC 450-20 liability for the entire amount of the estimated probable obligation. The entity would continue to amortize the ASC 460 liability in accordance with its established policy until the entity is released from its obligation to stand ready.
ASU 2016-13 amended ASC 460-10-35-4 to require an entity to account for a guarantee that is within the scope of ASC 326-20 in a manner consistent with Method 2 discussed above (i.e., the contingent and noncontingent liabilities are recognized on a gross basis), although the measurement of that contingent liability should be calculated in accordance with ASC 326-20. Accordingly, the transition adjustments that an entity adopting ASU 2016-13 is required to make in connection with the contingent liability of a guarantee within the scope of ASC 326-20 will depend on the following factors:

- Whether a contingent liability was recognized before the adoption of ASU 2016-13.
- If a contingent liability was recognized before the adoption of ASU 2016-13, whether it was measured by using Method 1 or Method 2 above.
- Whether the contingent liability must now be measured on the basis of current expected credit losses in accordance with ASC 326-20 instead of by using the best estimate required under ASC 450-20.

Example 9-3

Transition Adjustments Upon Adoption of ASU 2016-13

Scenario 1 — Guarantor Recognized the Noncontingent Obligation in Accordance With ASC 460 Before Adoption of ASU 2016-13

Entity X is a guarantor of debt incurred by Entity Y. The guarantee arrangement stipulates that X must guarantee payment of 100 percent of Y’s debt obligations borrowed from a third-party debtor for a specified time frame. Entity X is not an insurance entity, and the guarantee is not within the scope of ASC 815.

On January 1, 20X9, Y borrows $1 million from a third-party debtor for which X is obligated to guarantee repayment under the guarantee arrangement. The debt matures in five years, and X’s guarantee arrangement covers the entire debt term. Entity X receives an up-front cash premium payment of $25,000 for the guarantee, and the cash premium is considered to be at arm’s length. Entity X measures and recognizes the fair value of its stand-ready obligation (i.e., the noncontingent obligation) to guarantee Y’s repayment under the debt arrangement to be $25,000 on the basis of the arm’s-length premium it received. That is, the cash premium that X received was greater than the contingent liability amount that needed to be recognized at the inception of the guarantee in accordance with ASC 450-20-30.

Entity X’s subsequent-measurement accounting policy for the guarantee liability is to amortize the obligation on a straight-line basis over the life of the guarantee, which is equal to the term of the debt (i.e., five years). As of December 31, 20X9, the unamortized guarantee obligation is $20,000.

Upon adoption of ASU 2016-13 on January 1, 20Y0, X determines that this guarantee is within the scope of ASC 326-20 and measures the contingent obligation to be $50,000 in accordance with the guidance in ASC 326-20. The table below summarizes the facts in Scenario 1.

<table>
<thead>
<tr>
<th>Guarantee Obligation Before Adoption of ASU 2016-13 as of December 31, 20X9</th>
<th>Guarantee Obligation After Adoption of ASU 2016-13 on January 1, 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Noncontingent component</td>
<td>$ 20,000</td>
</tr>
<tr>
<td>Contingent component</td>
<td>—</td>
</tr>
</tbody>
</table>
Example 9-3 (continued)

On January 1, 20Y0, X would record the following journal entry related to the contingent obligation associated with the guarantee:

**Journal Entry: January 1, 20Y0**

<table>
<thead>
<tr>
<th>Retained earnings</th>
<th>50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability for off-balance-sheet credit losses (contingent)</td>
<td>50,000</td>
</tr>
</tbody>
</table>

*Note: The contingent obligation is measured and recognized in accordance with ASC 326-20 upon adoption of ASU 2016-13. The noncontingent obligation that was recorded before the adoption of ASU 2016-13 is not adjusted upon adoption of ASU 2016-13.*

**Scenario 2 — Guarantor Recognized Both a Noncontingent and Contingent Obligation in Accordance With ASC 460 and ASC 450-20 Before Adoption of ASU 2016-13**

Assume the same facts as in Scenario 1 above, except that X recorded a contingent obligation amount after the inception of the guarantee under ASC 450-20 in accordance with ASC 460-10-35-4 (i.e., gross recognition of the ASC 450-20 liability). That is, after the initial recognition and measurement of the guarantee, X separately recorded an ASC 450-20 liability for the entire amount of the estimated contingent obligation and recognized the establishment of that liability in earnings.

The unamortized noncontingent obligation as of December 31, 20X9, is $20,000, and the contingent obligation recognized under ASC 450-20 is $30,000. Upon adopting ASU 2016-13 on January 1, 20Y0, X determines that this guarantee is within the scope of ASC 326-20 and measures the contingent obligation to be $50,000 in accordance with the guidance in ASC 326-20. The table below summarizes the facts in Scenario 2.

<table>
<thead>
<tr>
<th>Guarantee Obligation Before Adoption of ASU 2016-13 as of December 31, 20X9</th>
<th>Guarantee Obligation After Adoption of ASU 2016-13 on January 1, 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Noncontingent component</td>
<td>$ 20,000</td>
</tr>
<tr>
<td>Contingent component</td>
<td>$ 30,000</td>
</tr>
</tbody>
</table>

On January 1, 20Y0, X would record the following journal entry related to the contingent obligation associated with the guarantee:

**Journal Entry: January 1, 20Y0**

<table>
<thead>
<tr>
<th>Retained earnings</th>
<th>20,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability for off-balance-sheet credit losses (contingent)</td>
<td>20,000</td>
</tr>
</tbody>
</table>

*Note: The contingent obligation is remeasured and recognized in accordance with ASC 326-20 upon adoption of ASU 2016-13. The noncontingent obligation that was recorded before the adoption of ASU 2016-13 is not adjusted upon adoption of ASU 2016-13.*
9.2.3 Transition Disclosures

<table>
<thead>
<tr>
<th>ASC 326-10</th>
</tr>
</thead>
</table>

**65-1** The following represents the transition and effective date information related to Accounting Standards Updates No. 2016-13.

f. An entity shall disclose the following in the period that the entity adopts the pending content that links to this paragraph:

1. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle.
2. The method of applying the change.
3. The effect of the adoption on any line item in the statement of financial position, if material, as of the beginning of the first period for which the pending content that links to this paragraph is effective. Presentation of the effect on financial statement subtotals is not required.
4. The cumulative effect of the change on retained earnings or other components of equity in the statement of financial position as of the beginning of the first period for which the pending content that links to this paragraph is effective.

g. An entity that issues interim financial statements shall provide the disclosures in (f) in each interim financial statement of the year of change and the annual financial statement of the period of the change.

h. In the year of initial application of the pending content that links to this paragraph, a public business entity is not within the scope of paragraph 326-10-65-1(a)(1) may phase-in the disclosure of credit quality indicators by year of origination by only presenting the three most recent origination years (including the first year of adoption). In each subsequent fiscal year, the then-current origination year will be added in the periods after adoption until a total of five origination years are presented. Origination years before those that are presented separately shall be disclosed in the aggregate. For example, the phase-in approach would work as follows assuming a calendar year-end entity:

1. For the first annual reporting period ended December 31, 2X23, after the effective date of January 1, 2X23, an entity would disclose the end of period amortized cost basis of the current period originations within 2X23, as well as the two origination years of 2X22 and 2X21. The December 31, 2X23 end of period amortized cost balances for all prior originations would be presented separately in the aggregate.
2. For the second annual reporting period ended December 31, 2X24, after the effective date of January 1, 2X23, an entity would disclose the end of period amortized cost basis of the current period originations within 2X24, as well as the three origination years of 2X23, 2X22, and 2X21. The December 31, 2X24 ending amortized cost basis would be presented in the aggregate for all origination periods before the four years that are presented separately.
3. For the third annual reporting period ended December 31, 2X25, after the effective date of January 1, 2X23, an entity would disclose the end-of-period amortized cost basis of the current-period originations within 2X25, as well as the four origination years of 2X24, 2X23, 2X22, and 2X21. The December 31, 2X25 ending amortized cost basis would be presented in aggregate for all origination periods before the five years that are presented separately.
4. For interim-period disclosures within the years discussed above, the current year-to-date originations should be disclosed as the originations in the interim reporting period.

As discussed in Q&A 8-1, only PBEs are required to provide the vintage disclosures in ASC 326-20-50-6. That is, only PBEs are required to present the amortized cost basis “by year of origination (that is, vintage year)” for each credit quality indicator. However, the FASB decided to provide transition relief to PBEs that are not within the scope of ASC 326-10-65-1(a) to make it less burdensome for such entities to adopt these vintage disclosure requirements. Specifically, ASC 326-10-65-1(h) requires PBEs that are not within the scope of ASC 326-10-65-1(a) to only (1) disclose credit quality indicators disaggregated for the previous three years and (2) add another year of information until they have provided disclosures for the previous five years.
9.3 SAB Topic 11.M Disclosure Requirements

The SEC staff has continued to emphasize the importance of providing investors with disclosures that explain the impact that new accounting standards are expected to have on an entity’s financial statements (“transition disclosures”). Such disclosures include information that investors may need to determine the effects of adopting a new standard and how the adoption will affect comparability from period to period. Transition disclosures should include not only an explanation of the transition method elected but also information about the impact that the new credit losses standard is expected to have on an entity’s financial statements. The SEC staff has highlighted that, in the past, transparent disclosures about the anticipated effects of a new standard in multiple reporting periods preceding its adoption have prevented market participants from reacting adversely to significant accounting changes. In addition, the staff has indicated that it expects to see robust qualitative and quantitative disclosures about (1) the anticipated impact of new standards and (2) the status of management’s progress with implementation as the adoption date of the new standard approaches.

While much of the previous discussion of transition disclosures has focused on the adoption of the new revenue and leasing standards, the SEC staff has stated that similar considerations apply to the new credit losses standard as well as other significant new accounting standards.

The SEC staff has also reiterated that a registrant should provide transparent transition disclosures that comply with the requirements of SAB Topic 11.M and has indicated that a registrant that is unable to reasonably estimate the quantitative impact of adopting the new credit losses standard should consider providing additional qualitative disclosures about the significance of the impact on its financial statements.

Connecting the Dots — SAB 74 Disclosures — Footnotes or MD&A

Questions have arisen regarding whether an SEC registrant should provide SAB 74 disclosures in the financial statement footnotes or in its MD&A. On the basis of informal discussions with the SEC staff on this issue, we understand that the SEC would expect the following:

• If material, the SAB 74 disclosures should be included in the financial statement disclosures (in addition to MD&A).
• The determination of materiality would be based on specific facts and circumstances.
• The disclosures in MD&A could have additional information that is not included in the financial statement footnotes. For example, if there is significant uncertainty regarding the impact of a new accounting standard, the MD&A may provide additional forward-looking statements and ranges that may not be replicated in the footnotes.

These views are supported by other SEC staff announcements, including those in the following guidance:

• ASC 250-10-S99-6 states (emphasis added in bold):

The following is the text of SEC Staff Announcement: Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of a Registrant When Such Standards Are Adopted in a Future Period (in accordance with Staff Accounting Bulletin [SAB] Topic 11.M), [ASU 2017-03, paragraph 3]

This announcement applies to Accounting Standards Update (ASU) No. 2014-09, Revenue From Contracts With Customers (Topic 606); ASU No. 2016-02, Leases (Topic 842); and ASU No. 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments [ASU 2017-03, paragraph 3]

See SAB Topic 11.M.
SAB Topic 11.M provides the SEC staff view that a registrant should evaluate ASUs that have not yet been adopted to determine the appropriate financial statement disclosures concerning the potential material effects of those ASUs on the financial statements when adopted. Consistent with Topic 11.M, if a registrant does not know or cannot reasonably estimate the impact that adoption of the ASUs referenced in this announcement is expected to have on the financial statements, then in addition to making a statement to that effect, that registrant should consider additional qualitative financial statement disclosures to assist the reader in assessing the significance of the impact that the standard will have on the financial statements of the registrant when adopted. In this regard, the SEC staff expects the additional qualitative disclosures to include a description of the effect of the accounting policies that the registrant expects to apply, if determined, and a comparison to the registrant’s current accounting policies. Also, a registrant should describe the status of its process to implement the new standards and the significant implementation matters yet to be addressed. [ASU 2017-03, paragraph 3]

FN1 This announcement also applies to any subsequent amendments to guidance in the ASUs that are issued prior to a registrant’s adoption of the aforementioned ASUs. [ASU 2017-03, paragraph 3]

FN2 Topic 11.M provides SEC staff views on disclosures that registrants should consider in both Management’s Discussion & Analysis (MD&A) and the notes to the financial statements. MD&A may contain cross references to these disclosures that appear within the notes to the financial statements.

- SAB Topic 11.M, which states:

  **Facts:** An accounting standard has been issued that does not require adoption until some future date. A registrant is required to include financial statements in filings with the Commission after the issuance of the standard but before it is adopted by the registrant.

  **Question 1:** Does the staff believe that these filings should include disclosure of the impact that the recently issued accounting standard will have on the financial position and results of operations of the registrant when such standard is adopted in a future period?

  **Interpretive Response:** Yes. The Commission addressed a similar issue and concluded that registrants should discuss the potential effects of adoption of recently issued accounting standards in registration statements and reports filed with the Commission. The staff believes that this disclosure guidance applies to all accounting standards which have been issued but not yet adopted by the registrant unless the impact on its financial position and results of operations is not expected to be material. MD&A requires registrants to provide information with respect to liquidity, capital resources and results of operations and such other information that the registrant believes to be necessary to understand its financial condition and results of operations. In addition, MD&A requires disclosure of presently known material changes, trends and uncertainties that have had or that the registrant reasonably expects will have a material impact on future sales, revenues or income from continuing operations. The staff believes that disclosure of impending accounting changes is necessary to inform the reader about expected impacts on financial information to be reported in the future and, therefore, should be disclosed in accordance with the existing MD&A requirements. With respect to financial statement disclosure, GAAS specifically address the need for the auditor to consider the adequacy of the disclosure of impending changes in accounting principles if (a) the financial statements have been prepared on the basis of accounting principles that were acceptable at the financial statement date but that will not be acceptable in the future and (b) the financial statements will be retroactively adjusted in the future as a result of the change. The staff believes that recently issued accounting standards may constitute material matters and, therefore, disclosure in the financial statements should also be considered in situations where the change to the new accounting standard will be accounted for in financial statements of future periods, prospectively or with a cumulative catch-up adjustment.

5 Some registrants may want to disclose the potential effects of proposed accounting standards not yet issued, (e.g., exposure drafts). Such disclosures, which generally are not required because the final standard may differ from the exposure draft, are not addressed by this SAB. See also FRR 26.

6 FRR 6, Section 2.
In those instances where a recently issued standard will impact the preparation of, but not materially affect, the financial statements, the registrant is encouraged to disclose that a standard has been issued and that its adoption will not have a material effect on its financial position or results of operations.

Item 303 of Regulation S-K.

See AU 9410.13–18.
Chapter 10 — Stakeholder Activities

10.1 Overview

Since the issuance of ASU 2016-13, the FASB has released various additional final ASUs to (1) make certain technical corrections and improvements on the basis of technical inquiries and TRG recommendations, (2) delay the effective date for certain entities, and (3) provide transition relief through the use of a fair value option. In addition, the FASB staff has issued two Q&A documents (see Section 10.2.2) addressing various aspects of the CECL model.

The SEC and banking regulators — such as the Federal Reserve Board, the OCC, FDIC, National Credit Union Administration, and Federal Housing Finance Agency — have also been involved in the standard-setting process (e.g., through their involvement in TRG meetings). Given the impact that the CECL model will have on certain industries, the level of implementation activity is not surprising. Stakeholders should continue to monitor activity at the FASB, SEC, and other standard setters or regulators for any relevant developments or interpretations.

In addition, the AICPA’s Financial Reporting Executive Committee has reviewed various credit loss implementation issues identified by members of the AICPA’s Depository Institutions and Insurance Expert Panel and has posted them to its Web site. Many of those issues have been included in an AICPA Audit and Accounting Guide on credit losses (which includes relevant guidance issued through May 1, 2020).

Further, the COVID-19 pandemic has affected major economic and financial markets, and virtually all industries are facing challenges associated with the economic conditions resulting from efforts to address it. In response to the pandemic, governments and other regulatory bodies have taken certain actions to help alleviate the financial burden caused by COVID-19. See Section 10.3.5 for a summary of certain actions governments and other regulatory bodies have taken with respect to the application of ASC 326 and other relevant topics.

10.2 FASB Activities

This Roadmap discusses the FASB’s standard setting up through December 1, 2020, including the issuance of ASU 2020-03, which makes certain technical corrections and amendments to ASU 2016-13. Our interpretive guidance also reflects two FASB staff Q&A documents issued in January and July 2019 (see Section 10.2.2).

10.2.1 Final ASUs

As noted above, the FASB has released various final ASUs to amend and clarify the guidance in ASC 326. These standards, which were largely issued in response to TRG discussions, are discussed throughout this Roadmap, as applicable, and include the following:

• ASU 2018-19 on Codification improvements to ASC 326 (Section 10.2.1.1).
• ASU 2019-04 on Codification improvements to ASC 326, ASC 815, and ASC 825 (Section 10.2.1.2).
• ASU 2019-05 on transition relief related to the fair value option (Section 10.2.1.3).
• ASU 2019-10 on effective-date considerations for private companies, not-for-profit organizations, and smaller public companies (Section 10.2.1.4).
• ASU 2019-11 on Codification improvements to ASC 326 (Section 10.2.1.5).
• ASU 2020-02 on amendments to SEC paragraphs in accordance with SAB 119 (Section 10.2.1.6).
• ASU 2020-03 on Codification improvements to the guidance on financial instruments (Section 10.2.1.7).

10.2.1.1 ASU 2018-19 on Codification Improvements to ASC 326

In November 2018, the FASB issued ASU 2018-19 to address questions regarding (1) the transition and effective date for non-PBEs and (2) whether billed operating lease receivables are within the scope of ASC 326.

10.2.1.1.1 Transition and Effective Date for Non-PBEs

The effective dates of ASU 2016-13 for financial statement preparers are staggered; however, the ASU is effective for fiscal years beginning after December 15, 2020, for both (1) PBEs that do not meet the U.S. GAAP definition of an SEC filer and (2) non-PBEs. Further, for most debt instruments, entities must record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is effective (modified retrospective approach).

Consequently, in submissions to the TRG, stakeholders raised concerns that for non-PBEs, the effective date and transition requirements related to ASU 2016-13 would, in essence, eliminate the benefit of receiving an additional year to implement the guidance, which is inconsistent with the FASB’s original intent.

As a result, the Board amended the effective date for non-PBEs to fiscal years beginning after December 15, 2021, including interim periods within those fiscal years.

See Chapter 9 for more information about effective date and transition.

Changing Lanes — Effective Dates Changing Yet Again

In November 2019, the FASB issued ASU 2019-10 on effective-date considerations for private companies, not-for-profit organizations, and smaller public companies. For more information, see Section 10.2.1.4.

10.2.1.1.2 Billed Operating Lease Receivables

In light of a stakeholder’s concerns, the TRG discussed at its June 2018 meeting “whether billed operating lease receivables are within the scope of the guidance in Subtopic 326-20.”

On the basis of the TRG’s recommendations, the FASB amended ASC 326-20 to clarify that operating lease receivables are not within its scope. Accordingly, an entity will assess the collectibility of such receivables in accordance with ASC 842.

For more information about billed operating lease receivables, see Section 2.2.

1 See TRG Memo 7.
10.2.1.2 ASU 2019-04 on Codification Improvements to ASC 326, ASC 815, and ASC 825

In April 2019, the FASB issued ASU 2019-04 to make certain technical corrections and amendments to the guidance on financial instruments in ASC 326, ASC 815, and ASC 825. The following tables, reproduced from ASU 2019-04, summarize the amendments that were made to ASC 326:

<table>
<thead>
<tr>
<th>Area for Improvement</th>
<th>Summary of Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issue 1A: Accrued Interest</strong></td>
<td>The amendments to Subtopic 326-20 allow an entity to:</td>
</tr>
<tr>
<td></td>
<td>a. Measure the allowance for credit losses on accrued interest receivable balances separately from other components of the amortized cost basis of associated financial assets.</td>
</tr>
<tr>
<td></td>
<td>b. Make an accounting policy election not to measure an allowance for credit losses on accrued interest receivable amounts if an entity writes off the uncollectible accrued interest receivable balance in a timely manner and makes certain disclosures.</td>
</tr>
<tr>
<td></td>
<td>c. Make an accounting policy election to write off accrued interest amounts by reversing interest income or recognizing credit loss expense, or a combination of both. The entity also is required to make certain disclosures.</td>
</tr>
<tr>
<td></td>
<td>d. Make an accounting policy election to present accrued interest receivable balances and the related allowance for credit losses for those accrued interest receivable balances separately from the associated financial assets on the balance sheet. If the accrued interest receivable balances and the related allowance for credit losses are not presented as a separate line item on the balance sheet, an entity should disclose the amount of accrued interest receivable balances and the related allowance for credit losses and where the balance is presented.</td>
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<tr>
<td></td>
<td>e. Elect a practical expedient to disclose separately the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements.</td>
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</table>

Certain amendments in (a) through (e) above are applicable to Subtopic 326-30.

[See Section 4.4.4.1 of this Roadmap.]
Issue 1B: Transfers Between Classifications or Categories for Loans and Debt Securities

Subtopics 310-10, Receivables — Overall, and 948-310, Financial Services — Mortgage Banking — Receivables, provide guidance on how an entity should account for loans with various classifications. While a significant portion of that guidance was superseded by Update 2016-13, stakeholders questioned how to account for the allowance for credit losses or valuation allowance when transferring nonmortgage loans between classifications (that is, not-held-for-sale and held-for-sale classifications) and mortgage loans between classifications (that is, held-for-long-term-investment and held-for-sale classifications).

Subtopic 320-10, Investments — Debt Securities — Overall, provides guidance on how an entity should account for transfers of debt securities between categories. Stakeholders questioned how to account for the allowance for credit losses when transferring debt securities between the available-for-sale category and the held-to-maturity category.

The amendments require that an entity reverse in earnings, any allowance for credit losses or valuation allowance previously measured on a loan or debt security, reclassify and transfer the loan or debt security to the new classification or category, and apply the applicable measurement guidance in accordance with the new classification or category.

[See Section 4.9 of this Roadmap.]

Issue 1C: Recoveries

The guidance in paragraph 326-20-35-8 states that recoveries of financial assets and trade receivables previously written off should be recorded when received. Without proper clarification, stakeholders noted that this guidance could be interpreted to prohibit the inclusion of recoveries in the estimation of expected credit losses on financial assets measured at amortized cost basis.

Furthermore, stakeholders questioned how an entity should account for an amount expected to be collected greater than the amortized cost basis.

The amendments clarify that an entity should include recoveries when estimating the allowance for credit losses.

The amendments clarify that expected recoveries of amounts previously written off and expected to be written off should be included in the valuation account and should not exceed the aggregate of amounts previously written off and expected to be written off by the entity. In addition, for collateral-dependent financial assets, the amendments clarify that an allowance for credit losses that is added to the amortized cost basis of the financial asset(s) should not exceed amounts previously written off.

[See Section 4.5.2 of this Roadmap.]
<table>
<thead>
<tr>
<th>Area for Improvement</th>
<th>Summary of Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issue 2A: Conforming Amendment to Subtopic 310-40</strong></td>
<td>The amendment clarifies the illustration by removing the incorrect cross-reference to paragraph 326-20-35-2 and replacing it with the correct cross-reference to paragraphs 326-20-35-4 through 35-5, which require that an entity use the fair value of collateral to determine expected credit losses when foreclosure is probable.</td>
</tr>
<tr>
<td>Stakeholders noted that the cross-reference to paragraph 326-20-35-2 in Example 2 in Subtopic 310-40, Receivables — Troubled Debt Restructurings by Creditors, is incorrect. The illustration describes an entity that determines that foreclosure is probable on a collateral-dependent loan. Therefore, stakeholders asked whether the cross-reference should instead link to paragraphs 326-20-35-4 through 35-5, which require that an entity use the fair value of collateral to determine expected credit losses when foreclosure is probable.</td>
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</tr>
<tr>
<td><strong>Issue 2B: Conforming Amendment to Subtopic 323-10</strong></td>
<td>The amendment clarifies the equity method losses allocation guidance in paragraphs 323-10-35-24 and 323-10-35-26 by adding cross-references to Subtopics 326-20 and 326-30 for the subsequent measurement of those loans and debt securities.</td>
</tr>
<tr>
<td>Stakeholders noted that the guidance on equity method losses in paragraphs 323-10-35-24 and 323-10-35-26 was not amended in Update 2016-13. Specifically, the guidance describes the allocation of equity method losses when an investor has other investments, such as loans and debt securities, in the equity method investee. Stakeholders asked whether the guidance should refer an entity to Topic 326 for the subsequent measurement of those loans and debt securities.</td>
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</tr>
<tr>
<td><strong>Issue 2C: Clarification That Reinsurance Recoverables Are Within the Scope of Subtopic 326-20</strong></td>
<td>The amendment clarifies the Board’s intent to include all reinsurance recoverables within the scope of Topic 944 within the scope of Subtopic 326-20, regardless of the measurement basis of those recoverables.</td>
</tr>
<tr>
<td>Stakeholders asked whether reinsurance recoverables measured on a net present value basis in accordance with Topic 944, Financial Services — Insurance, are within the scope of Subtopic 326-20. As written, the scope could be interpreted to exclude those recoverables because they are not measured at amortized cost basis.</td>
<td>[See Section 2.1 of this Roadmap.]</td>
</tr>
</tbody>
</table>
### Issue 2D: Projections of Interest Rate Environments for Variable-Rate Financial Instruments

Stakeholders asked whether the prohibition of using projections of future interest rate environments in estimating expected future cash flows and determining the effective interest rate to discount expected cash flow for variable-rate financial instruments was consistent with the Board's intent. As written, an entity that chooses to use a discounted cash flow method to determine expected credit losses on a variable-rate financial instrument is precluded from forecasting changes in the variable rate for the purposes of estimating expected cash flows and determining the effective interest rate with which to discount those cash flows.

Stakeholders also asked if an entity is required to use a prepayment-adjusted effective interest rate if it uses projections of interest rate environments for variable-rate financial instruments in estimating expected cash flows.

The amendments clarify the Board's intent to provide flexibility in determining the allowance for credit losses by removing the prohibition of using projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate financial instruments.

The amendments clarify that an entity that uses projections or expectations of future interest rate environments in estimating expected cash flows should use the same assumptions in determining the effective interest rate used to discount those expected cash flows.

The amendments also clarify that if an entity uses projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate financial instruments, it also should adjust the effective interest rate to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments.

[See Section 4.4.3.2 of this Roadmap.]

### Issue 2E: Consideration of Prepayments in Determining the Effective Interest Rate

Stakeholders asked whether an entity may adjust the effective interest rate used to discount expected cash flows in a discounted cash flow method for the entity's expectations of prepayments on financial assets. Stakeholders noted that expected prepayments are required to be considered in estimating expected cash flows. However, they noted that without incorporating those expected prepayments into determining the effective interest rate, the discounted cash flow calculation fails to appropriately isolate credit risk in the determination of an allowance for credit losses.

The amendments permit an entity to make an accounting policy election to adjust the effective interest rate used to discount expected future cash flows for expected prepayments on financial assets within the scope of Subtopic 326-20 and on available-for-sale debt securities within the scope of Subtopic 326-30 to appropriately isolate credit risk in determining the allowance for credit losses.

The amendments also clarify that an entity should not adjust the effective interest rate used to discount expected cash flows for subsequent changes in expected prepayments if the financial asset is restructured in a troubled debt restructuring.

[See Section 4.4.3.1 of this Roadmap.]
(Table continued)

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<thead>
<tr>
<th>Area for Improvement</th>
<th>Summary of Amendments</th>
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<tbody>
<tr>
<td><strong>Issue 2F: Consideration of Estimated Costs to Sell When Foreclosure Is Probable</strong></td>
<td>Stakeholders asked whether an entity is required to consider estimated costs to sell the collateral when using the fair value of [the] collateral to estimate expected credit losses on a financial asset because foreclosure is probable in accordance with paragraph 326-20-35-4. Stakeholders noted that the collateral-dependent financial asset practical expedient in paragraph 326-20-35-5 requires that an entity consider estimated costs to sell if repayment or satisfaction of the asset depends on the sale of the collateral. Stakeholders also noted that paragraphs 326-20-35-4 through 35-5 require that an entity adjust the fair value of collateral for the estimated costs to sell on a discounted basis if it intends to sell rather than operate the collateral. Stakeholders asked why an entity is required to estimate the costs to sell on a discounted basis if the fair value of collateral should be based on amounts as of the reporting date.</td>
</tr>
<tr>
<td>The amendments clarify the guidance in paragraph 326-20-35-4 by specifically requiring that an entity consider the estimated costs to sell if it intends to sell rather than operate the collateral when the entity determines that foreclosure on a financial asset is probable. Additionally, the amendments clarify the guidance that when an entity adjusts the fair value of collateral for the estimated costs to sell, the estimated costs to sell should be undiscounted if the entity intends to sell rather than operate the collateral. [See Q&amp;A 4-22 of this Roadmap.]</td>
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<tr>
<th>Area for Improvement</th>
<th>Summary of Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issue 5A: Vintage Disclosures — Line-of-Credit Arrangements Converted to Term Loans</strong></td>
<td>Stakeholders asked how an entity should disclose line-of-credit arrangements that convert to term loans within the vintage disclosure table.</td>
</tr>
<tr>
<td>The amendments require that an entity present the amortized cost basis of line-of-credit arrangements that are converted to term loans in a separate column as illustrated in Example 15. [See Q&amp;A 8-2 of this Roadmap.]</td>
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| Issue 5B: Contractual Extensions and Renewals                                          | Stakeholders asked whether an entity should consider contractual extension or renewal options in determining the contractual term of a financial asset. Stakeholders stated that the guidance in paragraph 326-20-30-6 appears to preclude an entity from considering those contractual extension or renewal options. |
| The amendments clarify that an entity should consider extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity. [See Q&A 4-22 of this Roadmap.] |

**10.2.1.3 ASU 2019-05 on Transition Relief by Providing the Fair Value Option**

In May 2019, the FASB issued ASU 2019-05 to allow entities to irrevocably elect, upon adoption of ASU 2016-13, the fair value option for financial instruments that (1) were previously recorded at amortized cost and (2) are within the scope of ASC 326-20 if the instruments are eligible for the fair value option under ASC 825-10. This election would be made on an instrument-by-instrument basis.
First-time adopters of ASU 2016-13 would elect the fair value option upon adoption, and entities would apply a modified retrospective approach in which the cumulative effect of the election would be recorded in beginning retained earnings in the period of adoption. An entity that has already adopted the amendments in ASU 2016-13 should apply them for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The entity should apply the amendments on a modified retrospective basis by making a cumulative-effect adjustment to the balance of opening retained earnings as of the beginning of the first reporting period in which ASU 2016-13 was adopted. Early adoption will be permitted in any interim period within fiscal years beginning after December 15, 2018, provided that the entity has adopted ASU 2016-13.

For more information, see Chapter 9 on effective date and transition.

### 10.2.1.4 ASU 2019-10 on Effective-Date Consideration for Private Companies, Not-for-Profit Organizations, and Small Public Companies

In November 2019, the FASB issued ASU 2019-10, which grants private companies, not-for-profit organizations, and certain small public companies additional time to implement the Board’s standards on CECL, leases, and hedging. Specifically, the ASU defers the effective dates for (1) smaller reporting companies (SRCs) by three years, (2) PBEs that are not SEC filers by two years, and (3) non-PBEs by one year.

In summary, the amendments change the effective dates as follows (for more information, see Section 9.1.1):

<table>
<thead>
<tr>
<th>PBEs That Are SEC Filers</th>
<th>PBEs That Are Not SEC Filers</th>
<th>All Other Entities</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>SEC Filers Excluding SRCs</th>
<th>All Other Entities</th>
</tr>
</thead>
</table>

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2 SEC Regulation S-K, Item 10(f)(1), defines an SRC, in part, as:

[A]n issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that:

(i) Had a public float of less than $250 million; or

(ii) Had annual revenues of less than $100 million and either:

(A) No public float; or

(B) A public float of less than $700 million.

3 Under U.S. GAAP, an SEC filer is defined as follows:

An entity that is required to file or furnish its financial statements with either of the following:

a. The Securities and Exchange Commission (SEC)

b. With respect to an entity subject to Section 12(b) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.
10.2.1.5 **ASU 2019-11 on Codification Improvements to ASC 326**

In November 2019, the FASB issued **ASU 2019-11** to make certain technical corrections and amendments to ASC 326. The following table, reproduced from ASU 2019-11, summarizes these amendments:

<table>
<thead>
<tr>
<th>Area of Improvement</th>
<th>Summary of Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issue 1: Expected Recoveries for Purchased Financial Assets With Credit Deterioration</strong></td>
<td>The amendments clarify that the allowance for credit losses for PCD assets should include in the allowance for credit losses expected recoveries of amounts previously written off and expected to be written off by the entity and should not exceed the aggregate of amounts of the amortized cost basis previously written off and expected to be written off by an entity. In addition, the amendments clarify that when a method other than a discounted cash flow method is used to estimate expected credit losses, expected recoveries should not include any amounts that result in an acceleration of the noncredit discount. An entity may include increases in expected cash flows after acquisition. [See Section 6.3.3.1 of this Roadmap.]</td>
</tr>
<tr>
<td><strong>Issue 2: Transition Relief for Troubled Debt Restructurings</strong></td>
<td>The amendments provide transition relief by permitting entities an accounting policy election to adjust the effective interest rate on existing TDRs using prepayment assumptions on the date of adoption of Topic 326 rather than the prepayment assumptions in effect immediately before the restructuring. [See Section 9.2 of this Roadmap.]</td>
</tr>
</tbody>
</table>

The guidance in paragraph 326-20-30-1 states that expected recoveries of amounts previously written off or expected to be written off should be included in the allowance for credit losses valuation account. Stakeholders questioned whether this guidance applies to purchased financial assets with credit deterioration (PCD assets) measured at amortized cost basis in Subtopic 326-20, Financial Instruments — Credit Losses — Measured at Amortized Cost.

Specifically, stakeholders questioned whether negative allowances were permitted on PCD assets. The phrase *negative allowance* is used to describe situations for which an entity determines that it will recover the amortized cost basis, or a portion of that basis, after a writeoff and that “basis recovery” is included in the allowance for credit losses through a negative allowance. Those situations often are a result of an entity applying regulatory charge-off policies that are generally based on delinquency status.

At the June 2017 Credit Losses Transition Resource Group (TRG) meeting, stakeholders noted the operational complexities of calculating a prepayment-adjusted effective interest rate on troubled debt restructurings (TDRs) that exist as of the adoption date by using the prepayment assumptions in effect immediately before the restructuring. They requested transition relief when adjusting the effective interest rate for those arrangements.
### Issue 3: Disclosures Related to Accrued Interest Receivables

Accounting Standards Update No. 2019-04, Codification Improvements to Topic 326, Financial Instruments — Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments, amended the guidance in Subtopics 326-20 and 326-30, Financial Instruments — Credit Losses — Available-for-Sale Debt Securities, to allow an entity to elect a practical expedient to disclose separately the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements.

Stakeholders noted that an entity would still be required to include accrued interest in other disclosure requirements of its amortized cost basis for financial assets under other Topics. Stakeholders requested that the disclosure relief for accrued interest receivable balances be extended to all relevant disclosures involving amortized cost basis.

The amendments extend the disclosure relief for accrued interest receivable balances to additional relevant disclosures involving the amortized cost basis.


The guidance in paragraph 326-20-35-6 for financial assets secured by collateral maintenance provisions provides a practical expedient to measure the estimate of expected credit losses by comparing the amortized cost basis of a financial asset and the fair value of collateral securing the financial asset as of the reporting date. Stakeholders questioned whether an entity is required to evaluate whether a borrower has the ability to continually replenish collateral securing the financial asset to apply the practical expedient. Additionally, stakeholders questioned how an entity should determine its estimate of expected credit losses if the fair value of the collateral securing the financial asset is less than its amortized cost basis.

The amendments clarify that an entity should assess whether it reasonably expects the borrower will be able to continually replenish collateral securing the financial asset to apply the practical expedient. The amendments clarify that an entity applying the practical expedient should estimate expected credit losses for any difference between the amount of the amortized cost basis that is greater than the fair value of the collateral securing the financial asset (that is, the unsecured portion of the amortized cost basis). An entity may determine that the expectation of nonpayment for the amount of the amortized cost basis equal to the fair value of the collateral securing the financial asset is zero.

[See Section 4.4.6.2 of this Roadmap.]

### Issue 5: Conforming Amendment to Subtopic 805-20

Stakeholders noted that paragraph 805-20-50-1 references Subtopic 310-30, Receivables — Loans and Debt Securities Acquired with Deteriorated Credit Quality, which was superseded by the amendments in Update 2016-13.

The amendment to Subtopic 805-20, Business Combinations — Identifiable Assets and Liabilities, and Any Noncontrolling Interest, clarifies the guidance by removing the cross-reference to Subtopic 310-30 in paragraph 805-20-50-1 and replacing it with a cross-reference to the guidance on PCD assets in Subtopic 326-20.
10.2.1.6 **ASU 2020-02 on Amendments to SEC Paragraphs in Accordance With SAB 119**

In February 2020, the FASB issued **ASU 2020-02** to make certain amendments to SEC paragraphs in accordance with SAB 119, which adds the text from SAB Topic 6.M to ASC 326-20-S99-1.

10.2.1.7 **ASU 2020-03 on Codification Improvements to Financial Instruments**

In March 2020, the FASB issued **ASU 2020-03** to address various issues associated with financial instruments. The following table, reproduced, in part, from ASU 2020-03, summarizes the amendments related to ASC 326:

<table>
<thead>
<tr>
<th>Area of Improvement</th>
<th>Summary of Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issue 6: Interaction of Topic 842 and Topic 326</strong></td>
<td>The amendments clarify that the contractual term of a net investment in a lease determined in accordance with Topic 842 should be the contractual term used to measure expected credit losses under Topic 326.</td>
</tr>
<tr>
<td>Stakeholders requested clarification on determining the contractual term of a net investment in a lease for the purposes of measuring expected credit losses. Specifically, stakeholders noted that the contractual term of the net investment in a lease determined in accordance with Topic 842, Leases, may not align with the contractual term determined in accordance with Topic 326, Financial Instruments — Credit Losses.</td>
<td></td>
</tr>
<tr>
<td><strong>Issue 7: Interaction of Topic 326 and Subtopic 860-20</strong></td>
<td>The amendments to Subtopic 860-20, Transfers and Servicing — Sales of Financial Assets, clarify that when an entity regains control of financial assets sold, an allowance for credit losses should be recorded in accordance with Topic 326.</td>
</tr>
<tr>
<td>Stakeholders noted that paragraph 860-20-25-13, which relates to a transferor regaining control of certain financial assets after a transfer that was previously accounted for as a sale is inconsistent with the requirements in Topic 326.</td>
<td>Specifically, stakeholders noted that paragraph 860-20-25-13 precludes an entity from recognizing a loan loss allowance for loans that do not meet the definition of a security when they are rerecognized.</td>
</tr>
</tbody>
</table>

10.2.2 **FASB Staff Q&A Documents**

The FASB staff issued two Q&A documents in January and July 2019:

- **Topic 326, No. 1: Whether the Weighted-Average Remaining Maturity Method Is an Acceptable Method to Estimate Expected Credit Losses (January 2019)** — This Q&A discusses the FASB staff's views that (1) the WARM method is one of many methods that an entity can use to estimate an allowance for credit losses, particularly on less complex financial asset pools, and (2) an entity needs to consider whether qualitative adjustments should be made. In addition, the Q&A provides examples illustrating how an entity would estimate the allowance for credit losses by using the WARM method. For more information about the WARM method, see Section 4.4.5.

- **Topic 326, No. 2: Developing an Estimate of Expected Credit Losses on Financial Assets (July 2019)** — This Q&A discusses the FASB staff's views on acceptable approaches for “determining reasonable and supportable forecasts and techniques for reverting to historical loss information when developing an estimate of expected credit losses on financial assets.”
10.2.3 TRG Activity

As discussed in Chapter 1, shortly before issuing ASU 2016-13, the FASB formed a credit losses TRG. Although the TRG does not issue guidance, it provides feedback on potential issues related to the implementation of the CECL model. By analyzing and discussing such issues, the TRG helps the Board determine whether it needs to take action, such as providing clarification or issuing additional guidance. Since the issuance of ASU 2016-13, the TRG has met three times, discussing the following issues:

**June 2017**

- Determining the EIR under the CECL model (see Section 4.4.3.1).
- The scope of the guidance on purchased financial assets with credit deterioration with respect to BIs accounted for under ASC 325-40 (see Section 6.2).
- Applying the transition guidance to pools of PCI assets under ASC 310-30 (see Q&A 9-1).
- Accounting for TDRs under the CECL model (see Section 4.7).
- Estimating the life of a credit card receivable under the CECL model (see Section 4.2.3).

**June 2018**

- Considering capitalized interest by using a method other than a DCF method under the CECL model (see Q&A 4-18).
- Definition of “amortized cost basis” and the reversal of accrued interest on nonperforming financial assets (see Section 4.4.4.1).
- Transfer of loans from HFS to HFI and transfer of credit-impaired debt securities from AFS to HTM (see Section 4.10).
- Accounting for recoveries under the CECL model (see Section 4.5.2).
- Refinancing and loan prepayments (see Section 4.2.1).

**November 2018**

- Contractual term: extensions and measurement inputs (see Q&A 4-2).
- Vintage disclosures for revolving loans (see Q&A 8-2).
- Recoveries (see Section 4.5.2).
10.3 **Regulator Activities**

10.3.1 **Interagency FAQs**

In April 2019, the federal financial institution regulatory agencies issued updated FAQs to help institutions and examiners with the implementation of the new accounting standard on credit losses. The updates can be summarized as follows:

- The updated FAQs combined recent Q&As (FAQs 38 through 46) as well as those previously issued in 2017 and 2016.
- Recent FAQs address collateral-dependent loans; reasonable and supportable forecasts; internal control considerations related to data; and the continued relevance of concepts, processes, and practices in existing supervisory guidance on the allowance for loan and lease losses.
- Certain previously issued FAQs have been updated in response to recent developments, including the amendment to the effective date for non-PBEs.
- The appendix to the FAQs includes links to relevant resources that are available to institutions to assist with the implementation of CECL.

10.3.2 **Interagency Policy Statement**

In May 2020, the federal financial institution regulatory agencies issued an interagency policy statement on allowances for credit losses. The proposal is intended to promote consistency in the interpretation and application of ASC 326 and updates concepts and practices detailed in existing supervisory guidance that remain applicable.

10.3.3 **Bank Accounting Advisory Series**

In August 2019, the OCC released the annual update to its Bank Accounting Advisory Series, which "expresses the OCA's interpretations of accounting topics relevant to national banks and federal savings associations." The latest edition includes Topic 12, "Credit Losses," which addresses various questions related to ASU 2016-13 (e.g., credit losses on AFS and HTM debt securities, TDRs, acquired loans, and allowances for credit losses).

10.3.4 **SAB 119**

In November 2019, the SEC staff issued SAB 119 to update the staff's guidance in light of the FASB's issuance of ASU 2016-13. The SAB addresses the staff's expectation for management's policies, procedures, internal controls, and documentation of judgments related to ASC 326. An SEC registrant must apply the guidance in SAB 119 when it adopts ASU 2016-13.

10.3.5 **The CARES Act and Interim Final Rule**

On March 27, 2020, President Trump signed into law the CARES Act, which provides relief from certain accounting and financial reporting requirements under U.S. GAAP. The CARES Act, in part, provides certain qualifying entities with optional temporary relief from the application of ASC 326. In addition, the Board of Governors of the Federal Reserve System, the FDIC, and the OCC issued an interim final rule (IFR) that, as of its effective date of March 31, 2020, gives certain qualifying entities the option of delaying the estimated impact on regulatory capital stemming from the implementation of ASC 326 for two years, followed by a three-year transition period. The IFR applies to banking organizations that implement the new CECL standard (ASU 2016-13) before the end of 2020.
10.3.5.1 Deferral of the New CECL Standard

Section 4014 of the CARES Act offers optional temporary relief from the application of ASC 326 for the following qualifying entities:

- Insured depository institutions,4 as defined in Section 3 of the Federal Deposit Insurance Act.
- Credit unions regulated by the National Credit Union Administration.

Qualifying entities are not required to comply with the requirements of ASC 326 during the period beginning on the date of enactment and ending on the earlier of the following:

- The termination date of the national emergency declared by President Trump under the National Emergencies Act on March 13, 2020, related to the outbreak of COVID-19.

10.3.5.2 Delay of the Impact of the New CECL Standard on Regulatory Capital

As noted above, the IFR gives banking organizations that implement ASC 326 before the end of 2020 the option of delaying the estimated impact on regulatory capital stemming from the implementation of the ASC 326 for two years, followed by a three-year transition period.

10.3.5.3 Relief From Troubled Debt Restructurings

Section 4013 of the CARES Act provides temporary relief from the accounting and reporting requirements for TDRs with respect to certain loan modifications related to COVID-19 that are offered by insured depository institutions and credit unions (i.e., the same entities that qualify for the optional deferral of ASC 326 described above). Specifically, under the CARES Act, a qualifying financial institution may elect to suspend (1) the U.S. GAAP requirements for certain loan modifications that would otherwise be categorized as a TDR and (2) any determination that such loan modifications would be considered a TDR, including the related impairment for accounting purposes.

In addition, on April 7, 2020, a group of banking agencies (the “Agencies”)
5 issued an interagency statement that offers some practical expedients for evaluating whether loan modifications that occur in response to COVID-19 are TDRs. The interagency statement was originally issued on March 22, 2020, but the Agencies revised it to address the relationship between their TDR accounting and disclosure guidance and the TDR guidance in Section 4013 of the CARES Act.

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4 The CARES Act states that the relief applies to an insured depository institution, bank holding company, or any affiliate thereof.
5 The Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, the OCC, the Consumer Financial Protection Bureau, and the State Banking Regulators.
Appendix A — Comparison of U.S. GAAP and IFRS Standards

A.1 Receivables Measured at Amortized Cost

Under U.S. GAAP, ASC 310 and ASC 326 are the primary sources of guidance on receivables measured at amortized cost.

Under IFRS® Standards, IFRS 9 is the primary source of guidance on recognition and measurement, as well as income recognition, of receivables measured at amortized cost.

This section focuses on differences between the accounting for receivables measured at amortized cost under U.S. GAAP and that under IFRS Standards, specifically discussing the recognition and measurement of (1) credit losses and (2) interest income. Note, however, that it does not address differences in the accounting for investments in debt securities classified as HTM under U.S. GAAP. See Section A.2 for guidance on U.S. GAAP–IFRS differences related to investments in debt securities, including those classified as HTM and AFS.

<table>
<thead>
<tr>
<th>Subject</th>
<th>U.S. GAAP</th>
<th>IFRS Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognition of credit losses</td>
<td>Expected loss approach in which an entity recognizes expected (rather than incurred) credit losses.</td>
<td>Expected loss approach in which an impairment loss on a financial asset accounted for at amortized cost or fair value through other comprehensive income (FVTOCI) is recognized immediately on the basis of expected credit losses.</td>
</tr>
</tbody>
</table>
### (Table continued)

<table>
<thead>
<tr>
<th>Subject</th>
<th>U.S. GAAP</th>
<th>IFRS Standards</th>
</tr>
</thead>
</table>
| **Measurement of impairment losses** | Entities have flexibility in measuring expected credit losses as long as the measurement results in an allowance that:  
• Reflects a risk of loss, even if remote.  
• Reflects losses that are expected over the contractual life of the asset.  
• Takes into account historical loss experience, current conditions, and reasonable and supportable forecasts.  
The entity must evaluate financial assets on a collective (i.e., pool) basis if they share similar risk characteristics. If an asset’s risk characteristics are not similar to those of any of the entity’s other assets, the entity would evaluate the asset individually.  
Depending on the financial asset’s credit risk at inception and changes in credit risk from inception, as well as the applicability of certain practical expedients, the measurement of the impairment loss will differ. The impairment loss would be measured as either (1) the 12-month credit loss or (2) the lifetime expected credit loss. Further, for financial assets that are credit-impaired at the time of recognition, the impairment loss will be based on the cumulative changes in the lifetime expected credit losses since initial recognition. |                                                                                                                                                                                                              |
| **Interest method — computation of the EIR** | The EIR is computed on the basis of the **contractual cash flows** over the **contractual term** of the loan, except for (1) certain loans that are part of a group of prepayable loans and (2) purchased loans that are accounted for as PCD loans. Therefore, loan origination fees, direct loan origination costs, premiums, and discounts typically are amortized over the **contractual term** of the loan. | The EIR is computed on the basis of the **estimated cash flows** that are expected to be received over the **expected life** of a loan by considering all of the loan’s contractual terms (e.g., prepayment, call, and similar options), excluding expected credit losses. Therefore, fees, points paid or received, transaction costs, and other premiums or discounts are deferred and amortized as part of the calculation of the EIR over the **expected life** of the instrument. |
| **Interest method — revisions in estimates** | “Retrospective” approach — If estimated payments for certain groups of prepayable loans are revised, an entity may adjust the net investment in the group of loans — on the basis of a recalculation of the effective yield to reflect actual payments to date and anticipated future payments — to the amount that would have existed if the new effective yield had been applied since the loans’ origination/acquisition, with a corresponding charge or credit to interest income. | “Cumulative catch-up” approach — If estimated receipts are revised, the carrying amount is adjusted to the present value of the future estimated cash flows, discounted at the financial asset’s original EIR (or credit-adjusted EIR for purchased or originated credit-impaired financial assets). The resulting adjustment is recognized within profit or loss. This treatment applies not only to groups of prepayable loans but also to all financial assets that are subject to the effective interest method. |
(Table continued)

<table>
<thead>
<tr>
<th>Subject</th>
<th>U.S. GAAP</th>
<th>IFRS Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest recognition on PCD loans</td>
<td>Interest income is recognized on the basis of the purchase price plus the initial allowance accreting to the contractual cash flows by using the effective interest method.</td>
<td>Interest income is calculated on the basis of the gross carrying amount (i.e., the amortized cost before adjusting for any loss allowance), unless the loan (1) is purchased or originated credit-impaired or (2) subsequently became credit-impaired. In those cases, interest revenue is calculated on the basis of amortized cost (i.e., net of the loss allowance).</td>
</tr>
<tr>
<td>Nonaccrual of interest</td>
<td>There is no explicit requirement in U.S. GAAP for when an entity should cease the recognition of interest income on a receivable measured at amortized cost. However, the practice of placing financial assets on nonaccrual status is acknowledged by U.S. GAAP.</td>
<td>IFRS Standards do not permit nonaccrual of interest. However, for assets that have become credit-impaired, interest income is based on the net carrying amount of the credit-impaired financial asset.</td>
</tr>
</tbody>
</table>

**A.1.1 Recognition of Credit Losses**

Under U.S. GAAP, ASC 326-20 does not specify a threshold for recognizing an impairment allowance. Rather, an entity will recognize its estimate of expected credit losses for financial assets as of the end of the reporting period. Credit impairment will be recognized as an allowance — or contra-asset — rather than as a direct write-down of the amortized cost basis of a financial asset.

Under IFRS Standards, an impairment loss on a financial asset accounted for at amortized cost or FVTOCI is recognized immediately on the basis of expected credit losses.

**A.1.2 Measurement of Credit Losses**

ASC 326-20 describes the impairment allowance as a “valuation account that is deducted from, or added to, the amortized cost basis of the financial asset(s) to present the net amount expected to be collected on the financial asset.” An entity can use a number of measurement approaches to determine the impairment allowance. Regardless of the measurement method used, an entity’s estimate of expected credit losses should reflect those losses occurring over the contractual life of the financial asset and should incorporate all available relevant information, including details about past events, current conditions, and reasonable and supportable forecasts and their implications for expected credit losses.

ASC 326-20 does not prescribe a unit of account (e.g., an individual asset or a group of financial assets) for measuring expected credit losses. However, an entity is required to evaluate financial assets within the scope of the model on a collective (i.e., pool) basis when assets share similar risk characteristics. If a financial asset’s risk characteristics are not similar to the risk characteristics of any of the entity’s other financial assets, the entity would evaluate the financial asset individually.
For PCD assets, ASC 326-20 requires that an entity’s method for measuring expected credit losses be consistent with its method for measuring expected credit losses for originated and purchased non-credit-deteriorated assets. However, upon acquiring a PCD asset, the entity would recognize its allowance for expected credit losses as an adjustment that increases the cost basis of the asset (the “gross-up” approach). After initial recognition of the PCD asset and its related allowance, the entity would continue to apply the CECL model to the asset — that is, any changes in the entity’s estimate of cash flows that it expects to collect (favorable or unfavorable) would be recognized immediately in the income statement through an adjustment to the allowance for credit losses.

Under IFRS Standards, IFRS 9’s dual-measurement approach requires an entity to measure the loss allowance for an asset accounted for at amortized cost or FVTOCI (other than one that is purchased or originated credit-impaired) at an amount equal to either (1) the 12-month expected credit losses or (2) lifetime expected credit losses.

The measurement of 12-month expected credit losses, which reflects the expected credit losses arising from default events possible within 12 months of the reporting date, is required if the asset’s credit risk is (1) low as of the reporting date or (2) has not increased significantly since initial recognition. As noted in paragraph B5.5.22 of IFRS 9, the credit risk is considered low if (1) there is “a low risk of default,” (2) “the borrower has a strong capacity to meet its contractual cash flow obligations in the near term,” and (3) “adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.” Paragraph B5.5.23 of IFRS 9 suggests that an “investment grade” rating might be an indicator of low credit risk.

Paragraph 5.5.9 of IFRS 9 states that in assessing whether a financial asset’s credit risk has significantly increased, an entity is required to consider “the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses” since initial recognition. Paragraph B5.5.17 of IFRS 9 provides a nonexhaustive list of factors that an entity may consider in determining whether there has been a significant increase in credit risk. For financial instruments for which credit risk has significantly increased since initial recognition, the allowance is measured as the lifetime credit losses, which IFRS 9 defines as the “expected credit losses that result from all possible default events over the expected life of a financial instrument,” unless the credit risk is low as of the reporting date. This measurement is also required for certain contract assets and trade receivables that do not contain a significant financing component in accordance with IFRS 15, and it is available as an accounting policy option for certain trade receivables that contain significant financing components in accordance with IFRS 15 and for certain lease receivables (see paragraph 5.5.15 of IFRS 9).

Purchased or originated credit-impaired financial assets (e.g., distressed debt) are treated differently under IFRS 9. As stated in paragraph 5.5.13 of IFRS 9, for these assets, an entity recognizes only “the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance.” Changes in lifetime expected losses since initial recognition are recognized in profit or loss. Thus, any favorable change in lifetime expected credit losses since initial recognition of a purchased or originated credit-impaired financial asset is recognized as an impairment gain in profit or loss regardless of whether a corresponding impairment loss was recorded for the asset in previous periods.
A.1.3 Interest Method — Computation of the EIR

Under U.S. GAAP on non-PCD loans, the EIR used to recognize interest income on loan receivables generally is computed in accordance with ASC 310-20-35-26 on the basis of the contractual cash flows over the contractual term of the loan. Prepayments of principal are not anticipated. As a result, loan origination fees, direct loan origination costs, premiums, and discounts are typically amortized over the contractual term of the loan. However, ASC 310-20-35-26 indicates that if an entity “holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, the entity may consider estimates of future principal prepayments” in calculating the EIR.

Under IFRS 9, an entity recognizes interest income by applying the EIR. IFRS 9 defines the EIR of a financial asset or liability as the “rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset . . . to the gross carrying amount of a financial asset” (emphasis added). Therefore, the effective interest method in IFRS 9, unlike that in ASC 310-20, requires an entity to compute the EIR on the basis of the estimated cash flows over the expected life of the instrument in considering all contractual terms (e.g., prepayment, extension, call, and similar options) but not expected credit losses. As a result, fees, points paid or received, transaction costs, and other premiums or discounts are deferred and amortized as part of the calculation of the EIR over the expected life of the instrument. Further, in its definition of an EIR, IFRS 9 states that in “rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument [an] entity shall use the contractual cash flows over the full contractual term.”

A.1.4 Interest Method — Revisions in Estimates

Under U.S. GAAP, whether and, if so, how an entity recognizes a change in expected future cash flows of a receivable depends on the instrument’s characteristics and which effective interest method the entity is applying. ASC 310-20-35-26 indicates that in applying the interest method to non-PCD loans, an entity should use the payment terms of the loan contract without considering the anticipated prepayment of principal to shorten the loan term. However, if the entity can reasonably estimate probable prepayments for a large number of similar loans, it may include an estimate of future prepayments in the calculation of the constant effective yield under the interest method. If prepayments are anticipated and considered in the determination of the effective yield, and there is a difference between the anticipated prepayments and the actual prepayments received, the effective yield should be recalculated to reflect actual payments received to date and anticipated future payments. The net investment in the loans should be adjusted to reflect the amount that would have existed if the revised effective yield had been applied since the acquisition or origination of the group of loans, with a corresponding charge or credit to interest income. In other words, under U.S. GAAP, entities may use a “retrospective” approach in accounting for revisions in estimates related to such groups of loans.

Under IFRS Standards, the original EIR must be used throughout the life of the instrument for financial assets and liabilities, except for certain reclassified financial assets and floating-rate instruments that reset to reflect movements in market interest rates. Upon a change in estimates, IFRS 9 generally requires entities to use a “cumulative catch-up” approach when changes in estimated cash flows occur. Specifically, paragraph B5.4.6 of IFRS 9 states, in part:

If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 5.4.3 and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset . . . to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset . . . as the present value of the estimated future contractual cash flows that are discounted at the financial instrument’s original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). . . . The adjustment is recognised in profit or loss as income or expense.
A.1.5 Interest Recognition on PCD Loans

Regarding an entity's acquisition of a loan that it determines to be PCD, ASC 326-20 states that in the calculation of the EIR for purchased financial assets with credit deterioration, "the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to the acquirer's assessment of credit losses at the date of acquisition.” For PCD loans, ASC 326-20 requires an entity to use the original EIR throughout the life of the loan and to record all subsequent changes to its estimate of expected credit losses — whether unfavorable or favorable — as impairment expense (or a reduction of expense) during the period of change.

Under IFRS Standards, the application of the effective interest method depends on whether the financial asset is purchased or originated credit-impaired or on whether it became credit-impaired after initial recognition.

When recognizing interest revenue related to purchased or originated credit-impaired financial assets under IFRS 9, an entity applies a credit-adjusted EIR to the amortized cost carrying amount. The calculation of the credit-adjusted EIR is consistent with the calculation of the EIR, except that it takes into account expected credit losses within the expected cash flows.

For a financial asset that is not purchased or originated credit-impaired, paragraph 5.4.1 of IFRS 9 requires an entity to calculate interest revenue as follows:

- **Gross method** — If the financial asset has not become credit-impaired since initial recognition, the entity applies the EIR method to the gross carrying amount. IFRS 9 defines the gross carrying amount as “the amortised cost of a financial asset, before adjusting for any loss allowance.”

- **Net method** — If the financial asset has subsequently become credit-impaired, the entity applies the EIR to the amortized cost balance, which is the gross carrying amount adjusted for any loss allowance.

An entity that uses the net method is required to revert to the gross method if (1) the credit risk of the financial instrument subsequently improves to the extent that the financial asset is no longer credit-impaired and (2) the improvement is objectively related to an event that occurred after the net method was applied (see paragraph 5.4.2 of IFRS 9).

IFRS 9 defines a credit-impaired financial asset as follows:

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include[s] observable data about the following events:

a. significant financial difficulty of the issuer or the borrower;

b. a breach of contract, such as a default or past due event;

c. the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;

d. it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

e. the disappearance of an active market for that financial asset because of financial difficulties; or

f. the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event — instead, the combined effect of several events may have caused financial assets to become credit-impaired.
A.1.6 Nonaccrual of Interest

There is no explicit U.S. GAAP requirement for when an entity should cease recognizing interest income on receivables measured at amortized cost. However, an entity is permitted to cease such recognition as an accounting policy. In addition, U.S. financial institutions subject to banking regulations look to regulatory reporting instructions for guidance on placing financial assets on nonaccrual status and follow these regulatory instructions for U.S. GAAP financial reporting purposes.¹

Under IFRS 9, an entity is not allowed to cease the accrual of interest. Rather, interest income recognition is determined on the basis of whether the asset is considered to be credit-impaired. That is, if the financial asset has not become credit-impaired since initial recognition, the entity applies the EIR method to the gross carrying amount (“gross method”). If the financial asset has subsequently become credit-impaired, the entity applies the EIR to the amortized cost balance, which is the gross carrying amount adjusted for any loss allowance (“net method”). An entity using the net method should revert to the gross method if (1) the credit risk of the financial instrument subsequently improves to the extent that the financial asset is no longer credit-impaired and (2) the improvement is objectively related to an event that occurred after the net method was applied.

A.2 Investments in Debt Securities

Under U.S. GAAP, ASC 320, ASC 326-20, and ASC 326-30 are the primary sources of guidance on the accounting for investments in debt securities.

Under IFRS Standards, IFRS 9 is the primary source of guidance on the accounting for financial assets and financial liabilities, including investments in debt securities.

This section focuses on differences between U.S. GAAP and IFRS Standards in the accounting for investments in debt securities, specifically discussing the recognition and measurement of (1) credit losses and (2) interest income. It does not address differences in the accounting for financial assets measured at amortized cost except for investments in debt securities classified as HTM under U.S. GAAP. See Section A.1 for guidance on differences between U.S. GAAP and IFRS Standards related to financial assets measured at amortized cost.

<table>
<thead>
<tr>
<th>Subject</th>
<th>U.S. GAAP</th>
<th>IFRS Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit losses — recognition</td>
<td>An entity recognizes and measures expected credit losses on an investment in a debt security classified as HTM by using the same model as it does for loans in accordance with ASC 326-20 (see Section A.1 for more information).</td>
<td>An impairment loss on a financial asset accounted for at amortized cost or FVTOCI is recognized immediately on the basis of expected credit losses.</td>
</tr>
</tbody>
</table>

¹ Federal Financial Institutions Examination Council, FFIEC 031 and 041, “Call Report Instructions.”
## Appendix A — Comparison of U.S. GAAP and IFRS Standards

### (Table continued)

<table>
<thead>
<tr>
<th>Subject</th>
<th>U.S. GAAP</th>
<th>IFRS Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Credit losses — measurement</strong></td>
<td>Under ASC 326-30, the recognition of an impairment loss depends on whether the entity “intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis” less any current-period credit loss. If the entity “intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis” less any current-period credit loss, the impairment loss is equal to the difference between the amortized cost basis and fair value. Any change in the impairment loss is recognized through earnings. If neither condition is met, the impairment loss is separated into the credit loss component (through earnings) and all other factors (through OCI). The credit loss component for an impaired AFS debt security is the excess of (1) the security’s amortized cost basis over (2) the present value of the investor’s best estimate of the cash flows expected to be collected from the security.</td>
<td>Under IFRS 9, the measurement of the impairment loss will differ depending on the financial asset’s credit risk at inception and changes in credit risk from inception, as well as the applicability of certain practical expedients. The impairment loss is measured as either (1) the 12-month expected credit loss or (2) the lifetime expected credit loss. Further, for financial assets that are credit-impaired at the time of recognition, the impairment loss will be based on the cumulative changes in the lifetime expected credit losses since initial recognition.</td>
</tr>
<tr>
<td><strong>Credit losses — reversal of recognized losses</strong></td>
<td>Under ASC 326-30, an entity must use an allowance when recognizing expected credit losses on an AFS debt security. Any changes in the allowance for expected credit losses on an AFS debt security would be recognized as an adjustment to the entity’s credit loss expense.</td>
<td>Under IFRS 9, previously recognized expected credit losses are reversed through profit or loss (as an impairment gain) if expected credit losses decrease.</td>
</tr>
<tr>
<td><strong>Subsequent measurement — interest method: interest income recognition</strong></td>
<td>The EIR is computed on the basis of contractual cash flows over the contractual term of the loan, with certain exceptions depending on the specific characteristics of a debt security, such as whether the debt security is (1) part of a group of prepayable debt securities, (2) a BI in securitized financial assets, (3) a callable bond purchased at a premium, (4) considered a PCD asset, or (5) prepayable by the issuer and has a stated interest rate that increases over time.</td>
<td>Under IFRS 9, the EIR is computed on the basis of estimated cash flows that the entity expects to receive over the expected life of the financial asset. The method used to calculate interest revenue depends on whether the financial asset (1) is purchased or originated credit-impaired or (2) has subsequently become credit-impaired.</td>
</tr>
</tbody>
</table>
A.2.1 Expected Credit Losses

A.2.1.1 Recognition

Under U.S. GAAP, expected credit losses on HTM debt securities are accounted for in a manner consistent with loans receivable. See Section A.1 for more information.

For AFS debt securities, ASC 326-30 states that an impairment loss is recognized when the security’s fair value is less than its amortized cost. This evaluation must be performed on an individual security level.

Under IFRS Standards, an impairment loss on a financial asset accounted for at amortized cost or FVTOCI is recognized immediately on the basis of expected credit losses.

A.2.1.2 Measurement

Under U.S. GAAP, expected credit losses on HTM debt securities are accounted for in a manner consistent with loans receivable. See Section A.1 for more information.

ASC 326-30 states that for AFS debt securities, the recognition of an impairment loss depends on whether the entity “intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis” less any current-period credit loss.

If the entity “intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis” less any current-period credit loss, the impairment is equal to the difference between the amortized cost basis and fair value. Changes in the impairment are recognized through earnings. If neither condition is met, the impairment loss is separated into the credit loss component (through earnings) and all other factors (through OCI). Under ASC 326-30-35-6, “[i]f the present value of cash flows expected to be collected is less than the amortized cost basis of the security” when the credit loss component of the total impairment is measured, “a credit loss exists and an
allowance for credit losses shall be recorded for the credit loss, limited by the amount that the fair value is less than amortized cost basis.” Therefore, the amount of credit loss for an impaired AFS debt security is the excess of (1) the security’s amortized cost basis over (2) the present value of the investor’s best estimate of the cash flows expected to be collected from the security.

Under IFRS Standards, IFRS 9 employs a dual-measurement approach that requires an entity to measure the loss allowance for an asset accounted for at amortized cost or FVTOCI (other than one that is purchased or originated credit-impaired) at an amount equal to either (1) the 12-month expected credit losses or (2) lifetime expected credit losses.

The measurement of 12-month expected credit losses, which reflects the expected credit losses arising from default events possible within 12 months of the reporting date, is required if the asset’s credit risk has not increased significantly since initial recognition. Further, an entity is permitted to apply a 12-month expected credit loss measurement if the credit risk, in absolute terms, is low as of the reporting date. As noted in paragraph B5.5.22 of IFRS 9, the credit risk is considered low if (1) there is a “low risk of default,” (2) “the borrower has a strong capacity to meet its contractual cash flow obligations in the near term,” and (3) “adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfill its contractual cash flow obligations.” Paragraph B5.5.23 of IFRS 9 suggests that an “investment grade” rating might be an indicator of low credit risk.

Paragraph 5.5.9 of IFRS 9 states that in assessing whether there has been a significant increase in a financial asset’s credit risk, an entity is required to consider “the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses” since initial recognition. Paragraph B5.5.17 of IFRS 9 provides a nonexhaustive list of factors that an entity may consider in determining whether there has been a significant increase in credit risk. For financial instruments for which credit risk has significantly increased since initial recognition, the allowance is measured as full lifetime expected credit losses, which IFRS 9 defines as the “expected credit losses that result from all possible default events over the expected life of a financial instrument,” unless the credit risk is low as of the reporting date.

Purchased or originated credit-impaired financial assets (e.g., distressed debt) are treated differently under IFRS 9. As stated in paragraph 5.5.13 of IFRS 9, for these assets, an entity recognizes only “the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance.” Changes in lifetime expected losses since initial recognition are recognized in profit or loss. Thus, any favorable change in lifetime expected credit losses since initial recognition of a purchased or originated credit-impaired financial asset is recognized as an impairment gain in profit or loss regardless of whether a corresponding impairment loss was recorded for the asset in previous periods.

**A.2.1.3 Reversal of Recognized Losses**

Under ASC 326-30, an entity must use an allowance when recognizing expected credit losses on an AFS debt security. Any changes in the allowance for expected credit losses on an AFS debt security would be recognized as an adjustment to the entity’s credit loss expense.

Under IFRS Standards, previously recognized expected credit losses are reversed through profit or loss if the expected credit losses decrease. Paragraph 5.5.8 of IFRS 9 states that an “entity shall recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognized in accordance with this Standard [IFRS 9].”
A.2.2 Subsequent Measurement

A.2.2.1 Interest Method: Interest Income Recognition and Revisions in Estimates (Not From a Modification)

Under U.S. GAAP, an entity typically recognizes interest income on investments in debt securities accounted for at amortized cost or FVTOCI in accordance with ASC 310-20-35-18 and ASC 310-20-35-26 by applying the effective interest method on the basis of the contractual cash flows of the security. An entity should not anticipate prepayments of principal. However, the following are exceptions to this method of recognizing interest income:

- If a debt security is part of a pool of prepayable financial assets and the timing and amount of prepayments are reasonably estimable, an entity is allowed to anticipate future principal prepayments when determining the appropriate EIR to apply to the debt security under ASC 310-20-35-26. If an entity anticipates estimated prepayments when measuring interest income of an investment in a debt security that is part of a pool of prepayable financial assets in accordance with ASC 310-20-35-26, the entity must continually recalculate the appropriate effective yield as prepayment assumptions change. That is, if the estimated future cash flows of a debt security change, the effective yield of the debt security must be recalculated to take into account the new prepayment assumptions. The adjustment to the interest method under ASC 310-20 must be retroactively applied to the debt security. That is, the amortized cost of the debt security is adjusted to reflect what it would have been if the new effective yield had been used since the acquisition of the debt security, with a corresponding charge or credit to current-period earnings.

- If an investment in a debt security meets the definition of a PCD asset, an entity must not recognize as interest income the discount embedded in the purchase price that is attributable to the acquirer's assessment of expected credit losses as of the acquisition date. The entity must accrete or amortize as interest income the non-credit-related discount or premium of a purchased financial asset with credit deterioration in accordance with the existing applicable guidance in ASC 310-20-35 or ASC 325-40-35.

- If the investment is a BI in a securitized financial asset, an entity would apply one of the following income recognition models:
  - Non-PCD BI not accounted for under ASC 325-40 — Apply the effective interest method on the basis of the contractual cash flows of the security in accordance with ASC 310-20.
  - Non-PCD BI accounted for under ASC 325-40 and classified as HTM:
    - Under ASC 325-40 (as amended by ASU 2016-13), entities must initially estimate the timing and amount of all future cash inflows from a BI within the scope of ASC 325-40 by employing assumptions used in the determination of fair value at recognition. The excess of those expected future cash flows over the initial investment is the accretable yield. Entities recognize this excess as interest income over the life of the investment by using the effective interest method.
    - A subsequent adjustment to expected cash flows is recognized as a yield adjustment affecting interest income or, if related to credit, may be recognized through earnings by means of an allowance for credit losses. In other words, a cumulative adverse change in expected cash flows would be recognized as an allowance, and a cumulative favorable change in expected cash flows would be recognized as a prospective yield adjustment.
Non-PCD BI accounted for under ASC 325-40 and classified as AFS:

- Under ASC 325-40 (as amended by ASU 2016-13), entities must initially estimate the timing and amount of all future cash inflows from a BI within the scope of ASC 325-40 by employing assumptions used in the determination of fair value at recognition. The excess of those expected future cash flows over the initial investment is the accretable yield. Entities recognize this excess as interest income over the life of the investment by using the effective interest method.

- A subsequent adjustment to expected cash flows is recognized as a yield adjustment affecting interest income or, if related to credit, may be recognized through earnings by means of an allowance for credit losses. In other words, a cumulative adverse change in expected cash flows would be recognized as an allowance, and a cumulative favorable change in expected cash flows would be recognized as a prospective yield adjustment.

If there has not been an adverse change in the cash flows expected to be collected but the BI's fair value is significantly below its amortized cost basis, the entity is required to assess whether it intends to sell the BI or it is more likely than not that it will be required to sell the interest before recovery of the entire amortized cost basis. If so, the entity would be required to write down the BI to its fair value in accordance with ASC 326-30-35-10.

PCD BI classified as HTM:

- Under the PCD accounting model in ASC 326-20, entities are required to gross up the cost basis of a PCD asset by the estimated credit losses as of the date of acquisition and establish a corresponding allowance for credit losses. The initial allowance is based on the difference between expected cash flows and contractual cash flows (adjusted for prepayments).

- For PCD assets within the scope of ASC 325-40 that are classified as HTM debt securities, cumulative adverse changes in expected cash flows would be recognized currently as an increase to the allowance for credit losses (in a manner similar to recognition under the normal ASC 325-40 model, as amended by ASU 2016-13). However, favorable changes in expected cash flows would first be recognized as a decrease to the allowance for credit losses (recognized currently in earnings). Favorable changes in expected cash flows would be recognized as a prospective yield adjustment only when the allowance for credit losses is reduced to zero.

PCD BI classified as AFS:

- Under the PCD accounting model in ASC 326-20, entities are required to gross up the cost basis of a PCD asset by the estimated credit losses as of the acquisition date and establish a corresponding allowance for credit losses. The initial allowance is based on the difference between expected cash flows and contractual cash flows (adjusted for prepayments).
For a PCD asset within the scope of ASC 325-40 that is classified as an AFS debt security, cumulative adverse changes in expected cash flows would be recognized currently as an increase to the allowance for credit losses (in a manner similar to the accounting under the normal ASC 325-40 model, as amended by ASU 2016-13). However, the allowance is limited to the difference between the AFS debt security’s fair value and its amortized cost. Favorable changes in expected cash flows would first be recognized as a decrease to the allowance for credit losses (recognized currently in earnings). Such changes would be recognized as a prospective yield adjustment only when the allowance for credit losses is reduced to zero. A change in expected cash flows that is attributable solely to a change in a variable interest rate on a plain-vanilla debt instrument does not result in a credit loss and would be accounted for as a prospective yield adjustment.

• If an investment in a callable bond is purchased at a premium, the premium must be amortized to the first call date in accordance with ASC 310-20-35-33.

• If an investment in a debt security is considered a structured note but does not contain an embedded derivative that must be separated under ASC 815, the interest method articulated in ASC 320-10-35-40, which is based on estimated rather than contractual cash flows, must be applied.

• If an investment in a debt security to which the interest method in ASC 310-20-35-18(a) applies has a stated interest rate that increases during the term in such a way that “interest accrued under the interest method in early periods would exceed interest at the stated rate . . . , interest income shall not be recognized to the extent that the net investment . . . would increase to an amount greater than the amount at which the borrower could settle the obligation.” Thus, a limit on the accrual of interest income applies to certain investments in debt securities that have a stepped interest rate and contain a borrower prepayment option or issuer call option.

Under IFRS 9, an entity calculates interest revenue on financial assets accounted for at amortized cost or FVTOCI by applying the effective interest method. Appendix A of IFRS 9 defines the EIR of a financial asset or liability as the “rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset . . . to the gross carrying amount of a financial asset” (emphasis added). Therefore, the effective interest method in IFRS 9, unlike that in ASC 310-20, requires an entity to compute the EIR on the basis of the estimated cash flows over the expected life of the instrument by considering all contractual terms (e.g., prepayment, extension, call, and similar options) but not expected credit losses. Under IFRS Standards, there is no limit on the accrual of interest income for investments in debt securities that have a stepped interest rate and contain a borrower prepayment option or issuer call option. Further, in its definition of an EIR, IFRS 9 states that in rare cases in which it is not possible to reliably estimate the cash flows or the expected life of the financial instrument, an entity should “use the contractual cash flows over the full contractual term.”

The application of the effective interest method depends on whether the financial asset is purchased or originated credit-impaired or on whether it became credit-impaired after initial recognition. When recognizing interest revenue related to purchased or originated credit-impaired financial assets under IFRS 9, an entity applies a credit-adjusted EIR to the amortized cost carrying amount. The calculation of the credit-adjusted interest rate is consistent with that of the EIR, except that the calculation of the credit-adjusted interest rate takes into account expected credit losses within the expected cash flows.
For a financial asset that is not purchased or originated credit-impaired, paragraph 5.4.1 of IFRS 9 requires an entity to calculate interest revenue as follows:

- **Gross method** — If the financial asset has not become credit-impaired since initial recognition, the entity applies the EIR to the gross carrying amount. Appendix A of IFRS 9 defines the gross carrying amount as the “amortised cost of a financial asset, before adjusting for any loss allowance.”

- **Net method** — If the financial asset has subsequently become credit-impaired, the entity applies the EIR to the amortized cost balance, which is the gross carrying amount adjusted for any loss allowance.

An entity that uses the net method is required to revert to the gross method if (1) the credit risk of the financial instrument subsequently improves to the extent that the financial asset is no longer credit-impaired and (2) the improvement is objectively related to an event that occurred after the net method was applied (see paragraph 5.4.2 of IFRS 9).

Under IFRS Standards, paragraphs B5.4.5 and B5.4.6 of IFRS 9 provide guidance on when an entity should recalculate the EIR:

- For floating-rate instruments that pay a market rate of interest, paragraph B5.4.5 of IFRS 9 specifies that the “periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate.” However, paragraph B5.4.5 of IFRS 9 further notes that for such floating-rate financial instruments, “re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or the liability” if the asset or liability was initially recognized at an amount that equals the principal receivable.

- For other instruments and for revisions of estimates, paragraph B5.4.6 of IFRS 9 usually requires an entity to recalculate the gross carrying amount of the financial asset “as the present value of the estimated future contractual cash flows that are discounted at the financial instrument’s original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).” The resulting “catch-up” adjustment to the carrying amount of the financial asset is recognized immediately in profit or loss. This catch-up approach of recognizing changes in estimated cash flows differs from both the prospective and retrospective approaches used under U.S. GAAP.

### A.2.2.2 Nonaccrual of Interest

Under U.S. GAAP, there is no explicit requirement for when an entity should cease recognizing interest income on investments in debt securities. However, an entity is permitted to cease such recognition as an accounting policy. In addition, while there is no indication in U.S. GAAP on when the accrual of interest should cease, ASC 325-40 requires that an entity use the cost recovery method when it cannot reliably estimate cash flows on a BI within its scope. That is, once the decision is made to put a BI within the scope of ASC 325-40 on nonaccrual status, the cost recovery method should be applied (i.e., all cash receipts are applied to the asset’s amortized cost basis). Other methods of nonaccrual (e.g., recognition of interest income on a cash basis) are not appropriate.

Under IFRS 9, an entity is not allowed to cease the accrual of interest. Rather, interest income recognition is determined on the basis of whether the asset is considered credit-impaired. That is, if the financial asset has not become credit-impaired since initial recognition, the entity applies the EIR method to the gross carrying amount (the “gross method”). If the financial asset has subsequently become credit-impaired, the entity applies the EIR to the amortized cost balance, which is the gross carrying amount adjusted for any loss allowance (“net method”). An entity using the net method should revert to the gross method if (1) the credit risk of the financial instrument subsequently improves to the extent that
the financial asset is no longer credit-impaired and (2) the improvement is objectively related to an event that occurred after the net method was applied.

### A.2.2.3 Foreign Exchange Gains and Losses on AFS/FVTOCI Debt Securities

Under U.S. GAAP, unrealized changes in the value of an investment in a foreign-currency-denominated security classified as AFS that are attributable to changes in foreign exchange rates are recognized in OCI. ASC 320-10-35-36 states that the entire “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.” An entity must report credit losses on AFS debt securities as credit losses in the income statement.

Under IFRS Standards, unrealized changes in the value of a foreign-currency-denominated debt instrument accounted for at FVTOCI that are attributable to changes in the foreign exchange rates are recognized in profit or loss. In accordance with paragraphs 5.7.10 and 5.7.11 of IFRS 9, the amount recognized in profit or loss for debt instruments accounted for at FVTOCI is the same as the amount that would be recognized in profit or loss for instruments accounted for at amortized cost. Paragraph B5.7.2A of IFRS 9 further clarifies this guidance:

> For the purpose of recognising foreign exchange gains and losses under IAS 21, a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A is treated as a monetary item. Accordingly, such a financial asset is treated as an asset measured at amortised cost in the foreign currency. Exchange differences on the amortised cost are recognised in profit or loss and other changes in the carrying amount are recognised in accordance with paragraph 5.7.10.

Note that under IFRS 9, the treatment discussed above does not apply to investments in equity securities that an entity irrevocably elected to account for at FVTOCI. An investment in such securities is accounted for in a manner consistent with the guidance in paragraph B5.7.3 of IFRS 9, which states that “[s]uch an investment is not a monetary item. Accordingly, the gain or loss that is presented in other comprehensive income . . . includes any related foreign exchange component.”
Appendix B — Titles of Standards and Other Literature

AICPA Literature

Audit and Accounting Guide
Credit Losses

FASB Literature

ASC Topics
ASC 250, Accounting Changes and Error Corrections
ASC 310, Receivables
ASC 320, Investments — Debt and Equity Securities
ASC 323, Investments — Equity Method and Joint Ventures
ASC 325, Investments — Other
ASC 326, Financial Instruments — Credit Losses
ASC 360, Property, Plant, and Equipment
ASC 405, Liabilities
ASC 450, Contingencies
ASC 460, Guarantees
ASC 605, Revenue Recognition
ASC 606, Revenue From Contracts With Customers
ASC 610, Other Income
ASC 805, Business Combinations
ASC 815, Derivatives and Hedging
ASC 825, Financial Instruments
ASC 840, Leases
ASC 842, Leases
ASC 855, Subsequent Events
ASC 860, Transfers and Servicing
ASC 944, Financial Services — Insurance
ASC 948, Financial Services — Mortgage Banking
ASC 958, Not-for-Profit Entities
ASC 960, Plan Accounting — Defined Benefit Pension Plans
ASC 962, Plan Accounting — Defined Contribution Pension Plans
ASC 965, Plan Accounting — Health and Welfare Benefit Plans

**ASUs**

ASU 2014-09, Revenue From Contracts With Customers (Topic 606)
ASU 2016-02, Leases (Topic 842)
ASU 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments
ASU 2017-03, Accounting Changes and Error Corrections (Topic 250) and Investments — Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings (SEC Update)
ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments — Credit Losses
ASU 2019-04, Codification Improvements to Topic 326, Financial Instruments — Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments
ASU 2019-05, Financial Instruments — Credit Losses (Topic 326): Targeted Transition Relief
ASU 2019-10, Financial Instruments — Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates
ASU 2019-11, Codification Improvements to Topic 326, Financial Instruments — Credit Losses
ASU 2020-02, Financial Instruments — Credit Losses (Topic 326) and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842)
ASU 2020-03, Codification Improvements to Financial Instruments

**Proposed ASUs**

No. 1810-100, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)
No. 2012-260, Financial Instruments — Credit Losses (Subtopic 825-15)
No. 2018-300, Codification Improvements — Financial Instruments
No. 2019-800, Codification Improvements
**IFRS Literature**

IFRS 9, *Financial Instruments*

IFRS 15, *Revenue From Contracts With Customers*

IAS 21, *The Effects of Changes in Foreign Currency Rates*

**IASB Exposure Drafts**

ED/2009/12, *Financial Instruments: Amortised Cost and Impairment*

ED/2013/3, *Financial Instruments: Expected Credit Losses*

**SEC Literature**

**Financial Reporting Manual**

Topic 4, “Independent Accountants’ Involvement”

Topic 10, “Emerging Growth Companies”

**Regulation S-K**

Item 10(f), “General: Smaller Reporting Companies”

Item 302(a), “Supplementary Financial Information: Selected Quarterly Financial Data”

Item 303, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”

**SAB Topics**


**Superseded Literature**

**FASB Statements**

No. 5, *Accounting for Contingencies*

No. 114, *Accounting by Creditors for Impairment of a Loan*

**FASB Staff Position (FSP)**

FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*
## Appendix C — Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>AFS</td>
<td>available for sale</td>
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<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
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<tr>
<td>ARS</td>
<td>auction rate security</td>
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<tr>
<td>ASC</td>
<td>FASB Accounting Standards Codification</td>
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<tr>
<td>ASU</td>
<td>FASB Accounting Standards Update</td>
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<tr>
<td>BI</td>
<td>beneficial interest</td>
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<tr>
<td>CECL</td>
<td>current expected credit loss</td>
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<td>CUSIP</td>
<td>Committee on Uniform Security Identification Procedures</td>
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<tr>
<td>DCF</td>
<td>discounted cash flow</td>
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<td>ED</td>
<td>exposure draft</td>
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<td>EIR</td>
<td>effective interest rate</td>
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<td>Financial Accounting Standards Board</td>
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<td>Financial Crisis Advisory Group</td>
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<td>FDIC</td>
<td>Federal Deposit Insurance Corporation</td>
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<td>FFIEC</td>
<td>Federal Financial Institutions Examination Council</td>
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<tr>
<td>FSP</td>
<td>FASB Staff Position</td>
</tr>
<tr>
<td>FVTOCI</td>
<td>fair value through other comprehensive income</td>
</tr>
<tr>
<td>GAAP</td>
<td>generally accepted accounting principles</td>
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<td>GAAS</td>
<td>generally accepted auditing standard</td>
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<td>HFI</td>
<td>held for investment</td>
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<td>HFS</td>
<td>held for sale</td>
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<td>HTM</td>
<td>held to maturity</td>
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<tr>
<td>IASB</td>
<td>International Accounting Standards Board</td>
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<tr>
<td>IFR</td>
<td>interim final rule</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standard</td>
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<tr>
<td>LIBOR</td>
<td>London Interbank Offered Rate</td>
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<tr>
<td>MD&amp;A</td>
<td>Management’s Discussion and Analysis</td>
</tr>
<tr>
<td>MLTN</td>
<td>more likely than not</td>
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<tr>
<td>OCA</td>
<td>SEC Office of the Chief Accountant</td>
</tr>
<tr>
<td>OCC</td>
<td>Office of the Comptroller of the Currency</td>
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<tr>
<td>OCI</td>
<td>other comprehensive income</td>
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<tr>
<td>OTTI</td>
<td>other-than-temporary impairment</td>
</tr>
<tr>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
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<tr>
<td>PCD</td>
<td>purchased credit-deteriorated</td>
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<tr>
<td>PCI</td>
<td>purchased credit-impaired</td>
</tr>
<tr>
<td>PCS</td>
<td>postcontract customer support</td>
</tr>
<tr>
<td>Q&amp;A</td>
<td>question and answer</td>
</tr>
<tr>
<td>SAB</td>
<td>SEC Staff Accounting Bulletin</td>
</tr>
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<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<tr>
<td>SRC</td>
<td>smaller reporting company</td>
</tr>
<tr>
<td>TDR</td>
<td>troubled debt restructuring</td>
</tr>
<tr>
<td>TRG</td>
<td>transition resource group</td>
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<tr>
<td>WARM</td>
<td>weighted-average remaining maturity</td>
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</table>
Appendix D — Changes Made in the 2020 Edition of This Publication

The tables below summarize the substantive changes made since the issuance of the 2019 edition of this Roadmap.

**New Q&As**

<table>
<thead>
<tr>
<th>Q&amp;A Reference</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q&amp;A 2-1</td>
<td>Forward Commitments to Purchase Loans</td>
</tr>
<tr>
<td>Q&amp;A 2-2</td>
<td>Indemnification Assets Recognized in a Business Combination</td>
</tr>
<tr>
<td>Q&amp;A 2-3</td>
<td>Perpetual Preferred Securities</td>
</tr>
<tr>
<td>Q&amp;A 4-9</td>
<td>Multiple Economic Scenarios</td>
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<tr>
<td>Q&amp;A 4-14</td>
<td>Applying Different Measurement Methods to Similar Pools of Assets</td>
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<tr>
<td>Q&amp;A 4-16</td>
<td>Nonaccrual Loans</td>
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<td>Q&amp;A 4-20</td>
<td>Determining Whether Repayment Is Expected to Be Provided Solely by Collateral</td>
</tr>
<tr>
<td>Q&amp;A 4-24</td>
<td>Expected Recoveries and Contractual Interest</td>
</tr>
<tr>
<td>Q&amp;A 4-25</td>
<td>Considering Recoveries When Foreclosure Is Probable</td>
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<tr>
<td>Q&amp;A 4-27</td>
<td>Measurement Approaches for TDRs</td>
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<tr>
<td>Q&amp;A 4-29</td>
<td>Reasonable Expectation of Executing a TDR</td>
</tr>
<tr>
<td>Q&amp;A 5-3</td>
<td>Recognition of the Allowance for Credit Losses Related to Unfunded Loan Commitments Assumed in a Business Combination</td>
</tr>
<tr>
<td>Q&amp;A 5-4</td>
<td>Accounting for the Off-Balance-Sheet Credit Exposure Related to a Forward Commitment to Purchase Loans</td>
</tr>
<tr>
<td>Q&amp;A 5-5</td>
<td>Credit Guarantee Between Entities Under Common Control</td>
</tr>
<tr>
<td>Q&amp;A 5-6</td>
<td>Measuring Expected Credit Losses on Trade Receivables When the Corresponding Revenue Has Not Been Recognized</td>
</tr>
<tr>
<td>Q&amp;A 5-7</td>
<td>Recognition of Expected Credit Losses on Sales Tax Receivables From Customers</td>
</tr>
<tr>
<td>Q&amp;A 6-3</td>
<td>Partially Funded Lines of Credit That Are PCD</td>
</tr>
<tr>
<td>Q&amp;A 6-4</td>
<td>Whether Pushdown Accounting Results in Applying PCD Accounting at the Subsidiary Level</td>
</tr>
<tr>
<td>Q&amp;A 6-6</td>
<td>Modification of a PCD Asset</td>
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<tr>
<td>Q&amp;A 9-2</td>
<td>Transition for PCD AFS Debt Securities</td>
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## Other Content (Excluding Q&As)

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
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<tbody>
<tr>
<td>2.1.2</td>
<td>Guarantees Between Entities Under Common Control</td>
<td>Added section on scope guidance related to financial guarantees between entities under common control.</td>
</tr>
<tr>
<td>2.1.3</td>
<td>Guarantees of Lease Payments</td>
<td>Added section on scope guidance related to guarantees of lease payments.</td>
</tr>
<tr>
<td>2.1.4</td>
<td>Refundable Lease Security Deposits</td>
<td>Added section on scope guidance on refundable security deposits under a lease arrangement.</td>
</tr>
<tr>
<td>2.1.5</td>
<td>Indemnification Assets</td>
<td>Added section on scope guidance on indemnifications assets acquired as part of a business combination.</td>
</tr>
<tr>
<td>2.1.6</td>
<td>Cash Equivalents</td>
<td>Added section on scope guidance related to cash equivalents.</td>
</tr>
<tr>
<td>2.1.7</td>
<td>Preferred Stock</td>
<td>Added section on scope guidance related to preferred stock.</td>
</tr>
<tr>
<td>2.2</td>
<td>Scope Exclusions</td>
<td>Renumbered Q&amp;A 2-1 to Q&amp;A 2-4.</td>
</tr>
<tr>
<td>4.3.3</td>
<td>Current Conditions and Reasonable and Supportable Forecasts</td>
<td>Renumbered Q&amp;As 4-9 and 4-10 to Q&amp;As 4-10 and 4-11, respectively.</td>
</tr>
<tr>
<td>4.3.4</td>
<td>Reversion to Historical Loss Information</td>
<td>Renumbered Q&amp;A 4-11 to Q&amp;A 4-12.</td>
</tr>
<tr>
<td>4.4</td>
<td>Measurement Methods and Techniques</td>
<td>Renumbered Q&amp;A 4-12 to Q&amp;A 4-13.</td>
</tr>
<tr>
<td>4.4.3.2</td>
<td>Variable-Rate Instruments</td>
<td>Expanded to include Connecting the Dots — Measuring Expected Credit Losses When an Effective Interest Rate on a Fixed-Rate Loan Is Lower Than a Current Market Rate.</td>
</tr>
<tr>
<td>4.4.4</td>
<td>Estimating Credit Losses by Using Methods Other Than a DCF Method</td>
<td>Renumbered Q&amp;As 4-13, 4-14, and 4-15 to Q&amp;As 4-15, 4-17, and 4-18, respectively.</td>
</tr>
<tr>
<td>4.4.4.1</td>
<td>Accrued Interest</td>
<td>Renumbered Q&amp;A 4-16 to Q&amp;A 4-19.</td>
</tr>
<tr>
<td>4.4.6.1</td>
<td>Collateral-Dependent Financial Assets</td>
<td>Expanded to clarify that the applicability of the practical expedient must be reassessed in every reporting period. Renumbered Q&amp;As 4-17 and 4-18 to Q&amp;As 4-21 and 4-22, respectively.</td>
</tr>
<tr>
<td>4.4.6.2</td>
<td>Collateral Maintenance Provisions</td>
<td>Renumbered Q&amp;A 4-19 to Q&amp;A 4-23.</td>
</tr>
<tr>
<td>4.6.1</td>
<td>Freestanding Credit Insurance and Other Credit Risk Mitigation Contracts</td>
<td>Added section to address how an entity could account for freestanding contracts that mitigate credit risk on financial assets.</td>
</tr>
<tr>
<td>4.7</td>
<td>Considerations Related to TDRs Under ASC 326</td>
<td>Expanded footnote to indicate that Section 4013 of the CARES Act provides certain entities with temporary relief related to applying U.S. GAAP on TDR. Renumbered Q&amp;As 4-20 and 4-21 to Q&amp;As 4-26 and 4-28, respectively.</td>
</tr>
<tr>
<td>4.8</td>
<td>Considerations Related to Postacquisition Accounting for Acquired Loans</td>
<td>Added section to discuss postacquisition accounting (via business combination or asset acquisition) for loans classified as held for investment and held for sale. Renumbered Section 4.8 to Section 4.9.</td>
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</tbody>
</table>
## Changes Made in the 2020 Edition of This Publication

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
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<tr>
<td>4.10</td>
<td>Transfers Between Classification Categories</td>
<td>Renumbered from Section 4.9. Added Examples 4-1 and 4-2 to illustrate a transfer of an investment in a debt security classified as HTM to AFS and vice versa.</td>
</tr>
<tr>
<td>5.1.1</td>
<td>Guarantees</td>
<td>Added section to discuss accounting for financial guarantees within the scope of ASC 326-20.</td>
</tr>
<tr>
<td>5.1.1.2</td>
<td>Initial Recognition and Measurement</td>
<td>Added Examples 5-1 and 5-2.</td>
</tr>
<tr>
<td>5.2.1</td>
<td>Trade Receivables</td>
<td>Expanded discussion to include more background on intersection of ASC 606 and ASC 326, including thoughts on price concessions versus credit risk.</td>
</tr>
<tr>
<td>5.2.2</td>
<td>Contract Assets</td>
<td>Renumbered Example 5-1 to Example 5-3.</td>
</tr>
<tr>
<td>5.3</td>
<td>Lease Receivables</td>
<td>Renumbered Q&amp;As 5-3 and 5-4 to Q&amp;As 5-8 and 5-9, respectively.</td>
</tr>
<tr>
<td>6.2</td>
<td>Scope of the PCD Model</td>
<td>Expanded Q&amp;A 6-2 to discuss whether the PCD model applies to acquired assets in a business combination that were previously written off by the seller. Renumbered Q&amp;A 6-3 to Q&amp;A 6-5.</td>
</tr>
<tr>
<td>6.2.1</td>
<td>Unit of Account for PCD Assets</td>
<td>Expanded to include Connecting the Dots — Maintaining Integrity of Pool No Longer Required.</td>
</tr>
<tr>
<td>6.3.3.1</td>
<td>Expected Recoveries</td>
<td>Expanded to include discussion of how an entity could determine its negative allowance for a previously written-off PCD asset when a non-DCF method is applied.</td>
</tr>
<tr>
<td>9.1.3</td>
<td>Emerging Growth Companies</td>
<td>Added section to include interpretive transition guidance and an illustrative example related to the adoption of ASC 326 for EGCs.</td>
</tr>
<tr>
<td>9.2.2</td>
<td>Transition for Financial Guarantees Within the Scope of ASC 326-20</td>
<td>Expanded section to add interpretive transition guidance and an illustrative example related to financial guarantees within the scope of ASC 326-20.</td>
</tr>
<tr>
<td>10.3.5</td>
<td>The CARES Act and Interim Final Rule</td>
<td>Added section to include a discussion and overview of the impact the CARES Act and an SEC interim final rule have on the CECL standard/TDR accounting for certain entities.</td>
</tr>
<tr>
<td>Appendix A</td>
<td>Comparison of U.S. GAAP and IFRS Standards</td>
<td>Added appendix to compare (1) the accounting for receivables measured at amortized cost under U.S. GAAP with that under IFRS Standards (see Section A.1) and (2) investments in debt securities under U.S. GAAP with that under IFRS Standards (see Section A.2).</td>
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</table>