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TRG Snapshot
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June 2018 TRG Meeting on Credit Losses

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In June 2016, the FASB issued ASU 2016-13,[1] which adds to U.S. GAAP an impairment model — known as the current expected credit losses (CECL) model — that is based on expected losses rather than incurred losses. Once effective, the new guidance will significantly change the accounting for credit impairment under ASC 326.[2] See Deloitte's June 17, 2016, *Heads Up* for more information about the new guidance.

This *TRG Snapshot* summarizes the June 11, 2018, public meeting of the FASB's credit losses transition resource group (TRG). This credit losses TRG meeting was the second to be attended by the FASB since it issued the CECL guidance. See Deloitte's June 23, 2017, *TRG Snapshot* for a summary of the first public TRG meeting, held on June 12, 2017.

The purpose of the credit losses TRG is similar to that of the TRG that the FASB and the International Accounting Standards Board (IASB®) established to discuss their joint revenue recognition standard. That is, the TRG does not issue guidance but provides feedback on potential issues related to the implementation of the CECL model. By analyzing and discussing potential implementation issues, the TRG helps the FASB determine whether it needs to take action, such as providing clarification or issuing additional guidance. The TRG comprises

[1] FASB Accounting Standards Update (ASU) No. 2016-13, *Measurement of Credit Losses on Financial Instruments*.

[2] FASB Accounting Standards Codification (ASC) Topic 326, *Financial Instruments — Credit Losses*. ASC 326 represents a new section in the Codification that includes both legacy impairment guidance moved from other Codification sections as well as new credit losses guidance introduced by ASU 2016-13. Some of the guidance moved from other Codification sections was also amended by ASU 2016-13.

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financial statement preparers, auditors, and users. Board members of the FASB also attend the TRG's meetings. In addition, representatives from the SEC, PCAOB, Federal Reserve, Office of the Comptroller of the Currency, FDIC, National Credit Union Administration, and Federal Housing Finance Agency are invited to observe the meetings.

The following topics were discussed at the June 11, 2018, meeting:

- *Topic 1* — Consideration of capitalized interest by using a method other than a discounted cash flow method under the CECL model.
- *Topic 2* — Definition of "amortized cost basis" and the reversal of accrued interest on nonperforming financial assets.
- *Topic 3* — Transfer of loans from held for sale to held for investment and transfer of credit-impaired debt securities from available for sale to held to maturity.
- *Topic 4* — Accounting for recoveries under the CECL model.
- *Topic 5* — Refinancing and loan prepayments.

We have also included, as an appendix, discussion regarding (1) other submissions to the credit losses TRG and (2) recent technical inquiries submitted to the FASB staff related to ASU 2016-13.

Topic 1 — Consideration of Capitalized Interest by Using a Method Other Than a Discounted Cash Flow Method Under the CECL Model

Background: If an entity elects to use a method other than a discounted cash flow (DCF) method to estimate expected credit losses on financial assets carried at amortized cost, ASC 326-20-30-5 provides guidance on how the allowance may be calculated. ASC 326-20-30-5 does not require the entity to use a single method when calculating the allowance; however, the starting point when estimating the allowance under ASC 326-20-30-5 is the amortized cost basis of the financial asset(s) regardless of the method that is applied. The amortized cost basis is defined in ASU 2016-13 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."

Stakeholders have highlighted an apparent inconsistency in ASC 326-20-30-5 between the sentence containing the phrase "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**" (emphasis added) and the sentence containing the phrase "when an entity expects to accrete a discount into interest income, the discount **should not offset the entity's expectation of credit losses**" (emphasis added). Further, some stakeholders have interpreted this second phrase to mean that they must make an estimation of the loss's timing when applying the guidance in ASC 326-20-30-5 and must have analogized future capitalized interest to a discount on a discounted financial asset or a zero-coupon bond.

TRG Memo 8 discusses the implementation question raised by stakeholders on how future capitalized interest should be considered if a method other than a DCF method is used in the estimation of expected credit losses.

Summary: The Board analyzed the following views related to the question:

- *View A* — Consider expected future capitalized interest in the calculation of an allowance for credit losses and develop an allowance for credit losses associated with the principal amount of the financial asset(s) and the expected future capitalized interest.

- *View B* — Do not consider expected future capitalized interest in the calculation of an allowance for credit losses and develop an allowance for credit losses associated with the principal amount of the financial asset(s).
- *View C* — Treat expected future capitalized interest as an unfunded loan commitment. Develop an allowance for credit losses associated with the principal amount of the financial asset(s) and an additional liability to reflect expected credit losses on the expected future capitalized interest.

Regarding the question of whether the allowance for credit losses should consider future capitalized interest, the FASB staff recommended that it would be inappropriate to calculate an allowance for a nonexistent asset (i.e., future capitalized interest) and stated that it believed that it would be inappropriate to analogize a loan with future capitalized interest to a debt security purchased at a discount. The staff expressed concerns that under View A, the allowance for credit losses would be overstated since an entity has not yet earned expected accrued interest. In addition, the staff believes that the issuing entity of a debt security purchased at a discount is obligated to repay the stated face value of the instrument at any point from issuance to maturity, whereas a borrower is not obligated to repay a lender an amount greater than the outstanding principal balance plus any accrued interest to date. Therefore, the staff recommended that it would be inappropriate to analogize a loan with future capitalized interest to a debt security purchased at a discount under View A.

The FASB staff also expressed concerns with View C since unearned accrued interest cannot be considered a loan commitment because a loan commitment represents a legally binding agreement to extend credit. By contrast, unearned accrued interest represents costs to borrow money that has already been disbursed from a lender.

Accordingly, the staff recommended View B because it would be an incorrect application of the guidance in ASC 326-20-30-5 to calculate an allowance for credit losses on a nonexistent asset. The staff provided the following example illustrating the application of View B: "[T]he numerator would consider expected credit losses of the amortized cost basis of the financial asset and the denominator could be set equal to the amortized cost basis, and the basis of the financial asset to which the loss rate is applied are the same."

The TRG generally agreed with the FASB staff on how future capitalized interest should be considered if a method other than a DCF method is used in the estimation of expected credit losses. That is, the TRG generally supported View B as proposed by the FASB staff; however, many TRG members disagreed with the staff's conclusion that future accrued interest is conceptually different from a debt discount, especially for a zero-coupon bond for which there are no payment obligations until maturity. The views expressed by TRG members highlighted the fact that the guidance for the treatment of premiums and discounts in the estimation of expected credit losses is not clear. The FASB staff was asked to further articulate the conceptual difference between future capitalized interest and a debt discount and how the staff ultimately determined that View B was the most appropriate treatment in the summarization of the discussion. Further, the FASB staff was asked to consider providing additional examples of the treatment of a premium or a discount when an entity uses a method other than a DCF method in estimating expected credit losses.

Topic 2 — Definition of "Amortized Cost Basis" and the Reversal of Accrued Interest on Nonperforming Financial Assets

Background: "Amortized cost basis" is defined in ASU 2016-13 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 inclusion of accrued interest in the definition has three significant financial statement implications on the measurement, presentation, and disclosure of the

amortized cost basis and allowance for credit losses of financial asset(s): (1) the measurement of an allowance for credit losses on the amortized cost basis of that asset under ASU 2016-13 requires entities to include an allowance for the applicable accrued interest of the financial asset, (2) ASU 2016-13 requires entities to present the accrued interest amount in the amortized cost basis of the financial asset(s) in the same line item on the balance sheet, and (3) the disclosures of amortized cost basis by class of financing receivable and vintage as required by ASC 326-20-50-5 and 50-6, respectively, would require the inclusion of accrued interest.

Further, the inclusion of accrued interest in the definition requires that the reversal of the accrued interest be written off in the same manner as the principal or other components of amortized cost basis. 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), meaning all components of the amortized cost basis, including the accrued interest, must be written off through the allowance for credit losses.

"Stakeholders have indicated . . . that the inclusion of accrued interest in the definition of amortized cost basis will be operationally burdensome" because many loan systems do not have the capability to track accrued interest on an individual loan level. Stakeholders have also raised concerns over 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, stated 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. Further, those stakeholders stated 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.

TRG Memo 9 discusses the implementation questions raised by stakeholders related to the inclusion of accrued interest in the definition of "amortized cost basis" and the reversal of recognized but uncollected interest on nonperforming financial assets.

Summary: The Board analyzed the following three alternatives related to the inclusion of accrued interest in the definition of "amortized cost basis":

- *Alternative 1* — "Maintain the definition of amortized cost basis."
- *Alternative 2* — "Maintain the definition of amortized cost basis. However, the Board could provide a practical expedient that would allow entities to:
    - (a) Perform a CECL evaluation for the accrued interest amounts separately from their associated loan balances
    - (b) Continue their current practices for the presentation of accrued interest (such as, in 'other assets' on the balance sheet)
    - (c) Disclose the accrued interest amounts included in amortized cost for the vintage disclosure table by either (i) including the amounts in the vintage year and class of financing receivable amounts, (ii) including the amounts in the class of financing receivable amounts only, or (iii) not including them in any amounts and adding a footnote to the table that states the total amount."
- *Alternative 3* — "Remove accrued interest from the definition of amortized cost basis."

The FASB staff agreed with the Board's intent to include accrued interest as part of the amortized cost basis of an asset; however, the staff recognized that the Board did not intend to impose on entities the significant operational costs required to overhaul systems and processes for accrued interest. Accordingly, the staff recommended Alternative 2, which would maintain the definition of "amortized cost basis" and allow certain practical expedients to alleviate the significant system costs entities would otherwise be required to bear to comply with the disclosure guidance.

The Board analyzed the following two views related to the reversal of recognized but uncollected interest on nonperforming financial assets:

- *View A* — "Interest income. The reversal of accrued interest applicable to a loan placed in nonaccrual status should be accomplished through a debit to interest income and a credit to the amortized cost basis of the loan. The reversal would include a reduction to the allowance against the credit loss expense that will reverse any amount of allowance previously established for outstanding amounts of accrued interest."
- *View B* — "Credit loss writeoff. For all entities, regardless of whether they adhere to nonaccrual policies, the reversal of accrued interest applicable to loans placed in nonaccrual status or otherwise deemed uncollectible should be accomplished through a debit to the allowance for credit losses and a credit to the amortized cost basis of the loan, identical to [the procedure for] a partial writeoff of a portion of the principal balance of the loan. There should be no effect on the interest income line item for the reversal of accrued interest applicable to loans placed in nonaccrual status or otherwise deemed uncollectible because the loss would be reflected entirely in the credit loss expense line item."

The FASB staff acknowledged that the recognized cost basis of the loan and allowance for credit losses that would be recorded on the balance sheet would be the same under both View A and View B after the reversal of accrued interest. Further, under View A and View B, the net effect to net income would be the same; however, under View B, higher interest income and credit loss expense would be recognized than would be under View A as a result of the differing treatments of the reversal of accrued interest. The staff also agreed with the Board's intent not to broadly change nonaccrual practices. The decision to maintain nonaccrual practices is most consistent with View A for entities required to follow regulatory nonaccrual guidance in the regulatory instructions; however, the staff raised the concern that ASU 2016-13 applies to both regulated and nonregulated entities and that many nonregulated entities may not have a sufficient nonaccrual policy. The staff believes that if a nonregulated entity has a nonaccrual policy that sufficiently limits interest accrual and prescribes the timely reversal or write-off of accrued interest, that entity should be allowed to maintain its nonaccrual practices. Accordingly, the staff recommended the following alternative view as a practical solution since it incorporates elements of both views:

- *View C* — "Interest income, if the entity follows a nonaccrual policy. If not, credit loss writeoff. For entities that abide by nonaccrual policies, the reversal of accrued interest applicable to a loan placed in nonaccrual status may be accomplished through a debit to interest income and a credit to the amortized cost basis of the loan. . . . For entities that do not follow a nonaccrual policy, the reversal of accrued interest should be accomplished through a partial writeoff of the amortized cost basis, that is, by debiting the allowance and crediting the amortized cost basis."

The TRG generally agreed with the FASB staff on the retention of accrued interest in the definition of "amortized cost basis" and the provision of a practical expedient to present accrued interest separately. The TRG also agreed with the FASB staff on the reversal of recognized but uncollected interest on nonperforming financial assets. That is, the TRG agreed with Alternative 2 related to the inclusion of accrued interest in the definition of "amortized cost basis" and with View C related to the reversal of recognized but uncollected

interest on nonperforming financial assets. TRG members raised concerns that without further clarification of what the FASB would consider a nonaccrual policy for a nonregulated entity that is "sufficient to limit the accrual of interest that is ultimately deemed uncollectible," the implementation of View C would be difficult. Further, the TRG highlighted the unique characteristics of credit card portfolios and the diversity in practice for (1) placement of a credit card in nonaccrual status and (2) the reversal of accrued but uncollected interest on credit cards. The FASB staff intends to make improvements to ASC 360-20 and ASC 360-30 to address the concerns raised by the TRG.

Topic 3 — Transfer of Loans From Held for Sale to Held for Investment and Transfer of Credit-Impaired Debt Securities From Available for Sale to Held to Maturity

Background: ASC 326-20 includes within its scope financial assets reported at amortized cost. By comparison, loans held for sale (HFS) and available-for-sale (AFS) debt securities are not within the scope of the expected credit loss guidance of ASC 326-20 since (1) loans HFS 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 a loan HFS to a loan held for investment (HFI) or (2) the transfer of an AFS debt security to a held-to-maturity (HTM) debt security, the transferred loan (i.e., loan HFI or HTM debt security) then becomes subject to ASC 326-20. TRG Memo 10 discusses the following implementation questions stakeholders have raised:

- How should the expected credit loss guidance be applied upon the transfer of loans classified as HFS to loans classified as HFI?
- How should the expected credit loss guidance be applied upon the transfer of credit-impaired AFS debt securities to HTM debt securities?

On the basis of these implementation questions, the FASB staff performed outreach with a number of organizations, including auditors and financial statement preparers. Stakeholders generally stated that the issues of transfers of loans HFS to loans HFI and of AFS debt securities to HTM debt securities are not pervasive but may become so in certain economic cycles. The staff considered multiple views shared by stakeholders and ultimately recommended the following approaches to the TRG in response to the implementation questions:

- The FASB staff believes that upon transfer of an AFS debt security to a HTM debt security, an entity should:
    1. Reclassify any allowance for credit losses that was previously recorded through the income statement for the AFS debt security.
    2. Continue to report any unrealized gain (loss) at the time of transfer as a separate component of shareholders' equity (i.e., accumulated other comprehensive income) but amortize it over the remaining life of the transferred debt security as an adjustment of yield in a manner consistent with the amortization of any discount or premium.
    3. Transfer the debt security from AFS to HTM at the debt security's amortized cost, adjusted for any remaining unrealized gain (loss) at the transfer date.
    4. Evaluate the HTM debt security for any expected credit loss in accordance with ASC 326-20. That is, the entity should evaluate whether the "reclassified" credit loss is an appropriate estimate of expected credit losses upon applying ASC 326-20 to the debt security. To the extent the expected credit loss amount varies from the previously reclassified credit loss (i.e., either greater than or less than), the difference represents an adjustment to the income statement recognized upon transfer from AFS debt security to HTM.

- The FASB staff believes that upon the transfer of a loan HFS to a loan HFI, an entity should:
  1. Reverse any previous valuation allowance that was recorded through the income statement for the loan HFS.
  2. Transfer the loan HFS to HFI at the lower of the loan's amortized cost or fair value at the time of transfer.
  3. Evaluate the loan HFI for an expected credit loss in accordance with ASC 326-20.

The FASB staff's recommended approaches described above are illustrated in Appendix A of TRG Memo 10.

In addition, in its discussions with stakeholders, the FASB staff asked their views on how an entity should present the effect of transferring loans from HFS to HFI and the effect of transferring debt securities from AFS to HTM. Most stakeholders supported a net approach. But the FASB staff "dismissed the net basis approach because the presentation guidance and the disclosure guidance required in existing GAAP were intended to increase transparency for financial statement users, while also providing entities with some latitude in determining how the transparent information should be provided on the face of the financial statements or in the notes to the financial statements."

Summary: TRG members generally supported the "reversal" approaches described above for both transfers of (1) loans HFS to loans HFI and (2) credit-impaired AFS debt securities to HTM debt securities. In addition, TRG members generally supported a gross presentation to present the effect of transferring loans from HFS to HFI and the effect of transferring securities from AFS to HTM.

Topic 4 — Accounting for Recoveries Under the CECL Model

Background: Stakeholders have raised questions regarding the accounting for recoveries of financial assets an entity has written off in connection with estimating expected credit losses under ASC 326. ASC 326-20-30-1 requires entities to estimate the allowance for credit losses and present the "net amount expected to be collected" on a financial asset. ASC 326-20-35-8 describes the accounting for write-offs and subsequent recoveries of financial assets and states:

> Writeoffs of financial assets, which may be full or partial writeoffs, shall be deducted from the allowance. The writeoffs shall be recorded in the period in which the financial asset(s) are deemed uncollectible. Recoveries of financial assets and trade receivables previously written off shall be recorded when received.

Given this guidance, stakeholders have asked questions regarding the timing of an entity's recognition of expected recoveries of financial assets. Although ASC 326-20-30-1 requires entities to present the net amount expected to be collected on a financial asset, some stakeholders believe that ASC 326-20-35-8 conflicts with that guidance because it requires an entity to reflect recoveries in the carrying amount of the financial asset only when the entity receives the recovered amounts. TRG Memo 11 discusses the following implementation questions:

- Can entities include all expected recoveries on financial assets in the estimate of expected credit losses when assessing pools of financial assets?
- Can entities include all expected recoveries on financial assets in the estimate of expected credit losses when assessing individual financial assets?

TRG Memo 11 indicates that a stakeholder submission to the FASB staff provided the following two views regarding the accounting for recoveries:

- *View A* — "The amortized cost basis of a financial asset is the starting point to estimate the allowance for credit losses. Therefore, any cash flows related to loans that have been fully or partially charged off must be excluded from the pool level expected cash flows."
- *View B* — "The measurement of the allowance for credit losses for a pool of loans (which includes individual loans that have been charged off or down) should be based on a collective assessment of the cash flows expected to be collected from the pool, regardless of the charge-off status of each loan in the pool."

The FASB staff acknowledged that regulatory policies frequently drive industry practice regarding the timing of write-offs of financial assets. The staff believes that the Board's intent when developing the CECL model was that companies should estimate and include expected recoveries on financial assets in the calculation of the CECL because expected recoveries represent "amount[s] expected to be collected." Therefore, the staff believes that View B would appropriately achieve the Board's intent. The staff proposed to amend the guidance in ASC 326-20-35-8 to clarify that the measurement of the allowance for credit losses should be based on a collective assessment of the cash flows expected to be collected, regardless of the charge-off status of financial assets. The staff also proposed that entities should include expected recoveries in the estimate of expected credit losses when assessing both pools of financial assets and individual financial assets.

In addition to considering whether expected recoveries should be included in the estimate of expected credit losses, the FASB staff discussed the following two questions:

- After charge-off, should an entity include expected recoveries in the calculation of the allowance, or should it directly write up the financial asset at an individual asset level?
- Can the estimate of expected recoveries on financial assets exceed their amortized cost?

The FASB staff indicated that it believes that entities should include estimates of expected recoveries within the allowance account and should not directly write up the related assets. Regarding estimated expected recoveries that exceed the amortized cost of financial assets, the staff did not prescribe how entities should handle such situations.

Summary: TRG members generally supported entities' estimating and including expected recoveries on financial assets in the calculation of the CECL allowance for both pools of financial assets and individual financial assets. However, some TRG members stated that they do not believe that entities should be *required* to include expected recoveries in the CECL allowance. They noted that some entities, including community banks, may not track loans after they write off the loans as uncollectible, and forecasting future recoveries on these loans would be complex. Therefore, TRG members proposed that the FASB staff amend ASC 326 to indicate that entities "may" or "could" include estimated recoveries in the CECL allowance. When drafting proposed amendments to ASC 326, the FASB staff indicated that it would propose to allow, but not require, entities to include estimated future recoveries in the CECL allowance.

TRG members also discussed whether entities should record estimated future recoveries as an increase to a financial asset's amortized cost, as a separate asset, or within the CECL allowance. Although the recording of estimated future recoveries as part of the CECL allowance could result in a negative allowance on individual financial assets after those assets are charged off, most TRG members believe that entities should record recoveries as part of the CECL allowance. The FASB staff indicated that it will propose including estimated recoveries in the CECL allowance. However, the staff indicated that it does not intend to

prescribe how entities should handle situations in which entities estimate that recoveries will exceed a financial asset's amortized cost.

One TRG member also stated that when amending the guidance in ASC 326-20 related to the accounting for recoveries, the FASB staff should make consistent amendments to the guidance in ASC 326-30 for the accounting of AFS debt securities.

Topic 5 — Refinancing and Loan Prepayments

Background: ASC 326-20 requires entities to consider the effect of estimated prepayments on the measurement of expected credit losses. Under current U.S. GAAP's incurred loss model, expected prepayments have not been a significant input into allowance calculations. Accordingly, practice has not been established regarding what constitutes a "prepayment" for the measurement of expected credit losses. The lack of a unified "prepayment" definition has led to a diversity in views about how to consider certain transactions or events for the estimation of prepayments under ASC 326-20.

TRG Memo 12 describes the following two views submitted by stakeholders to the FASB staff for the consideration of how to define prepayments for the estimation of prepayments under ASC 326-20:

- *View A* — "To apply the expected prepayment guidance in [ASC 326-20] to an expected refinancing with the same lender prior to contractual maturity, assuming the refinancing is not a troubled debt restructuring, an entity must first apply the [loan refinancing and restructuring] guidance in [ASC] 310-20-35-9 through 35-12 . . . . If the refinancing is expected to be a modification," it is not considered a prepayment. "Conversely, if the refinancing is expected to be an extinguishment of the original loan," it is "considered in the same manner as an expected prepayment with cash settlement."
- *View B* — "[ASC 326-20] does not define a specific framework for the consideration of prepayments and, consistent with other elements of [the] CECL [model], whether a transaction or amendment should be considered to be a prepayment" in the measurement of expected credit losses in accordance with ASC 326-20 "is a matter of professional judgment." That is, the loan refinancing and restructuring guidance in ASC 310-20-35-9 through 35-12 may provide one approach to the consideration of prepayments, but it is not the only approach.

The FASB staff's interpretation is that "entities should not be required to use the loan modification guidance in [ASC] 310-20-35-9 through 35-12 to determine what constitutes a prepayment. However, the staff believes that an entity should not be precluded from using the guidance if the entity determines the guidance provides an appropriate basis for determining prepayments given its specific portfolios and facts and circumstances." In reaching this interpretation, the staff placed more weight on the following factors:

- The Board's overall intent with regard to ASC 326-20 is to provide flexibility.
- The primary purpose of the modification guidance in ASC 310-20-35-9 through 35-12 is loan fee recognition as opposed to the assessment of credit risk or exposure.
- ASC 326-20, in general, does not define specific inputs to the calculation of expected credit losses.
- The significant costs noted by stakeholders to adjust market prepayment data if the View A scenario were required to be applied.
- The term "prepayment" should not be defined for ASC 326-20 application purposes because of the potential cross-cutting issues that would result throughout U.S. GAAP.

Although the FASB staff considered “the desire of some stakeholders to [(1)] create consistency across entities or [(2)] ensure that the prepayment definition aspect of credit loss modeling is consistent with how an entity determines new loans” to meet the vintage disclosure requirements under ASC 326-20, it placed less weight on these factors.

Finally, the staff recommends no further work on this issue.

Summary: TRG members generally supported View B. That is, the TRG believes that the loan refinancing and restructuring guidance in ASC 310-20-35-9 through 35-12 may provide one approach to the consideration of prepayments, but it is not the only approach since the intent of ASC 326-20 is to provide flexibility. TRG members also discussed whether entities should be able to make a policy choice at the portfolio level for determining whether refinances should be treated as prepayments in the measurement of expected credit losses. However, the TRG ultimately did not make a final recommendation.

Next Steps: For the five topics of discussion summarized above, the FASB staff acknowledges that certain of its recommendations may require amendments to the Codification. The staff’s plan is to begin addressing such changes during the third quarter of 2018. In addition, the staff also plans to distribute summary memos for each of the five topics in the coming weeks.

Appendix

Other Credit Losses TRG Submissions

In addition to the five topics discussed herein, the FASB staff received two other submissions from stakeholders for the credit losses TRG. These submissions are discussed in TRG Memo 7 as follows:

Fair Value Option

This submission consisted of a "request for the FASB to allow a one-time election to apply the fair value option (FVO) [in ASC 825] to existing financial instruments upon adoption of [the CECL model]. This request would allow entities who choose to elect the FVO for instruments going forward to avoid having two different accounting models for their portfolios (that is, CECL and fair value). In addition to the TRG submission, the FASB has received multiple agenda requests for applying the FVO at transition."

Nonpublic Business Entity Transition

This submission consisted of a "request for the FASB to consider clarifying the effective date and transition methodology language" so that nonpublic business entities have "an additional year [over] public SEC filers to adopt the amendments" under the CECL model. "Stakeholders have indicated that as written, nonpublic business entities with calendar year-ends would have to calculate their allowance for credit losses under the new amendments on January 1, 2021 to comply with the guidance. Therefore, if the FASB intended to provide additional time for nonpublic business entities to implement the amendments, stakeholders have indicated that the Board should clarify the guidance. In addition to the TRG submission, the FASB has received an agenda request for this issue."

For both submissions, the FASB staff acknowledged that "there does not appear to be disagreement among stakeholders about (a) what the guidance requires or (b) the potential solutions. Rather, these submissions are requests for additional transition relief and require the Board's action." Accordingly, the FASB staff will bring these issues before the Board for discussion in the near term.

Recent Technical Inquires (Related to ASU 2016-13)

The following recent technical inquiries (and outcomes) related to ASU 2016-13 are included in TRG Memo 7:

Loans and Receivables Between Entities Under Common Control

"[ASU 2016-13] indicates that loans and receivables between entities under common control are not within the scope of the guidance in [ASC] 326-20." A stakeholder asked the FASB staff "at which reporting level this scope exception should be applied" (i.e., parent or subsidiary). In response, the FASB staff informed the inquirer that the Board intended to provide this scope exception to all common-control arrangements at all stand-alone reporting levels (i.e., parent and subsidiaries). The staff plans no further work on this issue.

Gains and Losses on Subsequent Disposition of Leased Assets

ASC 326-20 includes within its scope "net investments in leases recognized by a lessor in accordance with [ASC] 842." Several stakeholders have asked the FASB staff "how expected gains and losses on the subsequent disposition of leased assets should be treated when measuring expected credit losses under [ASC] 326-20 on a portfolio of net investments in leases" (i.e., specifically "whether expected gains on the disposition should be considered in the calculation of the allowance").

In response to these inquiries, the FASB staff stated its belief 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 [ASC] 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 to preclude 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." The staff plans no further work on this issue.

Billed Operating Lease Receivables

A stakeholder asked the FASB staff "whether billed operating lease receivables are within the scope of [ASC] 326-20." The stakeholder noted conflicting views, including the following:

- "[ASC] 842 has specific guidance . . . indicating that if the assessment of collectibility of an operating lease changes, any amount of lease income recognized that has not been collected should be reversed through a current-period adjustment to lease income."
- "[T]he scope of [ASC] 326-20 includes financing receivables and billed operating lease receivables appear to meet that definition."

In response to this inquiry, the FASB staff stated its belief that "operating lease receivables are not within the scope of [ASC] 326-20" and that "it was never the Board's intent to include operating leases within the scope." Therefore, an entity would apply ASC 842 rather than ASC 326-20 to account for changes in the collectibility assessment for operating leases. When applying ASC 842, an entity would recognize changes in the collectibility assessment for an operating lease as an adjustment to lease income.

However, at the TRG meeting, the FASB staff stated that it is reconsidering its response to the inquiry discussed above and asked for feedback from TRG members, who generally supported that response; that is, that operating leases should be excluded from the scope of ASC 326-20. Further, TRG members encouraged the FASB staff to amend ASC 326-20 to clarify whether operating lease receivables are included within or excluded from its scope.

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