

To the Point

FASB – final guidance

FASB issues narrow-scope amendments to credit losses standard

The amendments require entities to include certain expected recoveries in the credit loss estimate for PCD assets.

What you need to know

- ▶ The FASB amended the new credit losses standard to require entities to include certain expected recoveries of the amortized cost basis previously written off, or expected to be written off, in the allowance for credit losses for PCD assets.
- ▶ The amendments also provide transition relief related to TDRs, allow entities to exclude accrued interest amounts from certain required disclosures and clarify the requirements for applying the collateral maintenance practical expedient.
- ▶ The amendments have the same effective dates as the credit losses standard for entities that have not adopted that standard. For entities that adopted the credit losses standard, the amendments are effective for fiscal years beginning after 15 December 2019 and interim periods therein. These entities may also early adopt the amendments.

Overview

The Financial Accounting Standards Board (FASB or Board) issued narrow-scope amendments¹ to the new credit losses standard in response to questions raised by stakeholders.

Key considerations

Expected recoveries for PCD assets

The amendments require entities to include in the allowance for credit losses for purchased credit deteriorated (PCD) assets expected recoveries of amounts they previously wrote off and expect to write off even if the recognition of these recoveries results in a negative allowance. However, if an entity estimates expected credit losses using a method other than a discounted cash flow (DCF) method, expected recoveries can't include any amounts that result in the accelerated recognition of the non-credit discount. The entity may include increases in expected cash flows after acquisition of the asset in the credit loss estimate.

How we see it

To give entities flexibility, the FASB did not provide guidance on how an entity should determine its estimate of expected recoveries. This may result in diversity in the approaches entities use to make their estimates.

Transition relief related to TDRs

The amendments provide transition relief for entities that use a DCF method to measure the allowance for credit losses and elect to use a prepayment-adjusted effective interest rate (EIR) on existing troubled debt restructurings (TDRs). It allows them to make an accounting policy election to use a prepayment-adjusted EIR based on the original contractual terms of the asset and prepayment assumptions as of the date they adopt the credit losses standard, rather than prepayment assumptions as of the date preceding the restructuring of the asset.

Disclosures related to accrued interest

The amendments expand the scope of the practical expedient that allows entities to exclude the accrued interest component of amortized cost from various disclosures required by Accounting Standards Codification (ASC) 326² to certain disclosures required by ASC 320.³ Entities that elect to apply the practical expedient must disclose the total amount of accrued interest that they exclude from their disclosures of amortized cost.

Collateral maintenance practical expedient

The amendments clarify that to apply the collateral maintenance practical expedient, an entity must reasonably expect the borrower will be able to continue to replenish collateral securing the financial asset in accordance with the contract. The amendments also clarify that if the fair value of the collateral at the measurement date is less than the amortized cost basis of the financial asset, the allowance for credit losses is limited to the difference between the fair value of the collateral and the amortized cost basis of the financial asset.

How we see it

We believe the FASB provided this practical expedient for "standard" reverse repurchase agreements. We believe that certain lending arrangements with provisions that require daily adjustments of collateral would qualify for this practical expedient. The less frequently the collateral is adjusted, the more challenging it will be for an entity to assert that it reasonably expects the borrower to continue to be able to replenish the collateral as necessary. In any case, an entity will need to consider factors such as the liquidity of the collateral and the frequency of collateral posting to determine whether it can apply this practical expedient.

Effective date and transition

The amendments have the same effective dates and transition requirements as the credit losses standard for entities that have not yet adopted that standard. For entities that early adopted the credit losses standard, the amendments are effective for fiscal years beginning after 15 December 2019 and interim periods therein (i.e., 1 January 2020 for calendar-year entities) and are to be applied using a modified retrospective approach by recording a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which they applied that standard. Entities that early adopted the credit losses standard may early adopt the amendments.

Endnotes:

- ¹ Accounting Standards Update (ASU) 2019-11, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses*.
- ² ASC 326, *Financial Instruments – Credit Losses*.
- ³ ASC 320, *Investments – Debt and Equity Securities*.

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