FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2019-11
November 2019

Codification Improvements to Topic 326, Financial Instruments—Credit Losses

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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FASB

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

On June 16, 2016, the FASB issued Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* which introduced an expected credit loss model for the impairment of financial assets measured at amortized cost basis. That model replaces the probable, incurred loss model for those assets. Through the amendments in that Update, the Board added Topic 326, Financial Instruments—Credit Losses, and made several consequential amendments to the Codification.

The Board has an ongoing project on its agenda for improving the Codification or correcting its unintended application. The items addressed in that project generally are not expected to have a significant effect on current accounting practice or create a significant administrative cost for most entities. The amendments in this Update are similar to those items. However, the Board decided to issue a separate Update for improvements to the amendments in Update 2016-13 to increase stakeholder awareness of those amendments and to expedite the improvement process. The amendments include items brought to the Board's attention by stakeholders.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect a variety of Topics in the Codification. The amendments apply to all reporting entities within the scope of the affected accounting guidance.

What Are the Main Provisions?

The amendments in this Update clarify or address stakeholders' specific issues about certain aspects of the amendments in Update 2016-13 as described in the table below:

Area of Improvement	Summary of Amendments
Issue 1: Expected Recoveries for Purchased Financial Assets with Credit Deterioration 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.	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.
Issue 2: Transition Relief for Troubled Debt Restructurings At the June 2017 Credit Losses Transition Resource Group (TRG) meeting, stakeholders noted the operational complexities of calculating a prepayment-adjusted	The amendments provide transition relief by permitting entities an accounting policy election to adjust the effective interest rate on existing TDRs

Area of Improvement	Summary of Amendments
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.	using prepayment assumptions on the date of adoption of Topic 326 rather than the prepayment assumptions in effect immediately before the restructuring.
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 amortized cost basis.

Area of Improvement	Summary of Amendments
Issue 4: Financial Assets Secured by Collateral Maintenance Provisions	
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.
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.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments in this Update represent changes to clarify, correct errors in, or improve the Codification. The amendments make the Codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications.

When Will the Amendments Be Effective and What Are the Transition Requirements?

For entities that have not yet adopted the amendments in Update 2016-13 as of the issuance date of this Update, the effective dates and transition requirements for the amendments are the same as the effective dates and transition requirements in Update 2016-13.

For entities that have adopted the amendments in Update 2016-13, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted in any interim period after issuance of this Update as long as an entity has adopted the amendments in Update 2016-13.

For entities that have adopted the amendments in Update 2016-13, the amendments in this Update 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 that an entity adopted the amendments in Update 2016-13.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Amendments to the Accounting Standards Codification

1. The following table provides a summary of the amendments to the Accounting Standards Codification.

Area of Improvement	Related Paragraphs
Issue 1: Expected Recoveries for Purchased Financial Assets with Credit Deterioration	3 and 4
Issue 2: Transition Relief for Troubled Debt Restructurings	5–7
Issue 3: Disclosures Related to Accrued Interest Receivables	8 and 9
Issue 4: Financial Assets Secured by Collateral Maintenance Provisions	10–12
Issue 5: Conforming Amendment to Subtopic 805-20	13–15

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–19. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Issue 1: Expected Recoveries for Purchased Financial Assets with Credit Deterioration

3. 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 Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* to 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 an entity. 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. The amendments in this Update extend that amendment to purchased financial assets with credit deterioration and clarify that an entity 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 the entity. In addition, the amendments clarify that when a method other than a discounted cash flow method is used to estimate credit losses, expected recoveries should not include any amounts that result in an acceleration of the noncredit discount; however, an entity may include increases in expected cash flows after acquisition.

Amendments to Subtopic 326-20

4. Amend paragraph 326-20-30-13 and add paragraphs 326-20-30-13A and 326-20-55-86 through 55-90 and their related headings, with a link to transition paragraph 326-10-65-4, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Initial Measurement

> Purchased Financial Assets with Credit Deterioration

326-20-30-13 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, ~~30-10 and~~ 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.

326-20-30-13A 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.

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.
b. The entity may include increases in expected cash flows after acquisition.

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

Implementation Guidance and Illustrations

> Illustrations

> > Example 18: Determining the Negative Allowance for Purchased Financial Assets with Credit Deterioration with No Change in Credit Conditions

326-20-55-86 The following Example illustrates the application of the guidance in paragraph 326-20-30-13A for purchased financial assets with credit deterioration. For purposes of this Example, the acquired portfolio of loans is assumed to share similar risk characteristics and is evaluated for credit losses on a collective basis.

326-20-55-87 Bank Q purchases a portfolio of loans with a par amount of $10 million for $2 million. At acquisition, Bank Q expects to collect $2.5 million on the loan portfolio. Bank Q estimates expected credit losses using a method other than a discounted cash flow method in accordance with paragraph 326-20-30-4. The acquisition-date journal entry is as follows.

[For ease of readability, the new journal entries in Examples 18 and 19 are not underlined.]

Loan—par amount	$ 10,000,000	
Loan—noncredit discount		$ 500,000
Allowance for credit losses		7,500,000
Cash		2,000,000

326-20-55-88 After acquisition, Bank Q determines that each loan is deemed uncollectible on an individual unit-of-account basis and, therefore, writes off the loan portfolio. The following journal entries are recorded.

Provision expense	$ 2,000,000	
Allowance for credit losses		$ 2,000,000

Allowance for credit losses	$ 9,500,000	
Loan—noncredit discount	500,000	
Loan—par amount		$ 10,000,000

326-20-55-89 Although deemed uncollectible on an individual basis, when grouped together, the group of loans is expected to have some recoveries on an aggregate basis. Therefore, Bank Q records a negative allowance in accordance with paragraph 326-20-30-13A. Because Bank Q's expectation of credit conditions has not changed since acquisition, the expected recoveries of $2.5 million must not result in the acceleration of the noncredit discount that existed immediately before being written off. Therefore, the following journal entry is recorded.

Allowance for credit losses	$ 2,000,000	
Provision expense		$ 2,000,000

> > Example 19: Determining the Negative Allowance for Purchased Financial Assets with Credit Deterioration after a Change in Credit Conditions

326-20-55-90 Assume the same facts from Example 18. Bank Q subsequently determines that a change in credit conditions has occurred and expects to collect an additional $600,000 (for a total of $3.1 million) on the group of loans. Because Bank Q's expectation of credit conditions has changed and it is determining the amount that it expects to collect using a method other than a discounted cash flow method, the expected recoveries of $3.1 million would be reduced by the noncredit discount of $0.5 million (that has not been accreted). This would result in Bank Q having an overall negative allowance of $2.6 million. Therefore, the following journal entry is recorded.

Allowance for credit losses	$	600,000		
Provision expense			$	600,000

Issue 2: Transition Relief for Troubled Debt Restructurings

5. At the June 2017 Credit Losses Transition Resource Group meeting, stakeholders noted that if entities chose to adjust the effective interest rate for prepayments upon the adoption of the amendments in Update 2016-13, those entities using a discounted cash flow method to estimate expected credit losses on a preexisting troubled debt restructuring would be required to use the prepayment assumptions in effect immediately before the restructuring date. Stakeholders noted that, to adopt Update 2016-13, identifying the restructuring date for each troubled debt restructuring and recreating the appropriate economic assumptions that existed immediately before those dates would be operationally complex and time consuming. Stakeholders requested transition relief that would reduce the operational burden associated with adjusting the effective interest rate on preexisting troubled debt restructurings upon the adoption of the amendments in Update 2016-13.

6. The Board did not intend to introduce significant operational complexities when measuring expected credit losses on preexisting troubled debt restructurings. Therefore, at its December 13, 2017 meeting, the Board decided to allow entities an accounting policy election to calculate the prepayment-adjusted effective interest rate on preexisting troubled debt restructurings using the prepayment assumptions that exist as of the date that an entity adopts the amendments in Update 2016-13, instead of the prepayment-adjusted effective interest rate immediately before the restructuring date.

Amendments to Subtopic 326-10

7. Amend paragraph 326-10-65-1 and its related heading by adding item j, with a link to transition paragraph 326-10-65-4, as follows:

Financial Instruments—Credit Losses—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Updates No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* No. 2018-19, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* No. 2019-04*, Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments,* No. 2019-05*, Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief,* ~~and~~ No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, and No. 2019-11, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*

326-10-65-1 The following represents the transition and effective date information related to Accounting Standards Updates No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* No. 2018-19, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, No. 2019-04, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, No. 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief*, ~~and~~ No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, and No. 2019-11, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses:*

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.

Issue 3: Disclosures Related to Accrued Interest Receivables

8. Update 2019-04 amended the guidance in Topic 326 to provide a practical expedient that allows an entity to exclude accrued interest receivable balances from the disclosure requirements in paragraphs 326-20-50-4 through 50-22 and 326-30-50-4 through 50-10. The amendments in this Update extend the disclosure relief for accrued interest receivable balances as permitted in Update 2019-04 to certain other Topics in the Codification.

Amendments to Subtopic 320-10

9. Add paragraphs 320-10-50-2A and 320-10-50-5C, with a link to transition paragraph 326-10-65-4, as follows:

Investments—Debt and Equity Securities—Overall

Disclosure

> Securities Classified as Available for Sale

320-10-50-2 For securities classified as available for sale, all reporting entities shall disclose all of the following by major security type as of each date for which a statement of financial position is presented:

a. Amortized cost basis
aa. Aggregate **fair value**
aaa. Total allowance for credit losses
b. Total unrealized gains for securities with net gains in accumulated other comprehensive income
c. Total unrealized losses for securities with net losses in accumulated other comprehensive income
d. Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented.

<u>**320-10-50-2A** If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the fair value and 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 paragraph 320-10-50-2. 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.</u>

> Securities Classified as Held to Maturity

320-10-50-5 All reporting entities shall disclose the following for securities classified as held to maturity by major security type as of each date for which a statement of financial position is presented:

a. Amortized cost basis
aa. Subparagraph superseded by Accounting Standards Update No. 2019-04.
aaa. Total allowance for credit losses

b. Subparagraph superseded by Accounting Standards Update No. 2019-04.
c. Subparagraph superseded by Accounting Standards Update No. 2019-04.
d. Net carrying amount
dd. Subparagraph superseded by Accounting Standards Update No. 2016-13.
e. Gross gains and losses in accumulated other comprehensive income for any derivatives that hedged the forecasted acquisition of the held-to-maturity securities
f. Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented. (Maturity information may be combined in appropriate groupings. In complying with this requirement, financial institutions [see paragraph 942-320-50-1] shall disclose the net carrying amount of debt securities on the basis of at least the following four maturity groupings:
    1. Within one year
    2. After one year through five years
    3. After 5 years through 10 years
    4. After 10 years.

    Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately rather than allocated over several maturity groupings; if allocated, the basis for allocation also shall be disclosed.)

320-10-50-5C If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from the amortized cost basis of held-to-maturity securities, an entity may, as a practical expedient, exclude the accrued interest receivable balance that is included in the amortized cost basis of the held-to-maturity securities for the purposes of the disclosure requirements in paragraph 320-10-50-5. If an entity applies 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.

Issue 4: Financial Assets Secured by Collateral Maintenance Provisions

10. Stakeholders questioned whether an entity is required to determine that a borrower will be able to continually replenish collateral in accordance with the contractual terms of the financial asset(s) to apply the collateral maintenance practical expedient in accordance with paragraph 326-20-35-6. The amendments in this Update that relate to estimating credit losses for financial asset(s) secured by collateral maintenance provisions clarify that an entity should reasonably expect the borrower to continually replenish collateral securing the financial asset(s) in accordance with the contractual terms of the financial asset to apply the practical

expedient. An entity is not required to consider remote scenarios in making this determination.

11. 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(s) is less than its amortized cost basis. The amendments in this Update clarify that an entity should estimate expected credit losses related to the amount of the amortized cost basis that is greater than the fair value of the collateral. However, the allowance for credit losses would be limited to the difference between the amortized cost basis and the fair value of the collateral.

Amendments to Subtopic 326-20

12. Amend paragraph 326-20-35-6, with a link to transition paragraph 326-10-65-4, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Subsequent Measurement

> Financial Assets Secured by Collateral

> > Financial Assets Secured by Collateral Maintenance Provisions

326-20-35-6 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 borrower continually replenishes the collateral securing the financial asset such that~~ 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, ~~an~~ the entity shall ~~limit the~~ 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.

Issue 5: Conforming Amendment to Subtopic 805-20

13. The amendment clarifies paragraph 805-20-50-1 by removing the cross-reference to Subtopic 310-30, Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality, which was superseded by Update 2016-13. The amendment instead correctly cross-references the guidance for purchased financial assets with credit deterioration in Subtopic 326-20.

Amendments to Subtopic 805-20

14. Amend paragraph 805-20-50-1, with a link to transition paragraph 326-10-65-4, as follows:

Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest

Disclosure

> Business Combinations Occurring during a Current Reporting Period or after the Reporting Date but before the Financial Statements Are Issued

805-20-50-1 Paragraph 805-10-50-1 identifies one of the objectives of disclosures about a **business combination**. To meet that objective, the **acquirer** shall disclose all of the following information for each business combination that occurs during the reporting period:

- a. For indemnification assets, all of the following:
  1. The amount recognized as of the **acquisition date**
  2. A description of the arrangement and the basis for determining the amount of the payment
  3. An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.
- b. For acquired receivables not subject to the requirements of Subtopic ~~310-30~~ <u>326-20 relating to purchased financial assets with credit deterioration</u>, all of the following:
  1. The **fair value** of the receivables (unless those receivables arise from **sales-type leases** or **direct financing leases** by the lessor for

which the acquirer shall disclose the amounts recognized as of the acquisition date)
2. The gross contractual amounts receivable
3. The best estimate at the acquisition date of the contractual cash flows not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, net investment in sales-type or direct financing leases in accordance with Subtopic 842-30 on leases—lessor, and any other class of receivables.

c. The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed (see Example 5 [paragraph 805-10-55-37]).
d. For contingencies, the following disclosures shall be included in the note that describes the business combination:
   1. For assets and liabilities arising from contingencies recognized at the acquisition date:
      i. The amounts recognized at the acquisition date and the measurement basis applied (that is, at fair value or at an amount recognized in accordance with Topic 450 and Section 450-20-25)
      ii. The nature of the contingencies.

   An acquirer may aggregate disclosures for assets or liabilities arising from contingencies that are similar in nature.
   2. For contingencies that are not recognized at the acquisition date, the disclosures required by Topic 450 if the criteria for disclosures in that Topic are met.

An acquirer may aggregate disclosures for assets and liabilities arising from contingencies that are similar in nature.

e. For each business combination in which the acquirer holds less than 100 percent of the equity interests in the **acquiree** at the acquisition date, both of the following:
   1. The fair value of the noncontrolling interest in the acquiree at the acquisition date
   2. The valuation technique(s) and significant inputs used to measure the fair value of the noncontrolling interest.

Amendments to Subtopic 326-10

15. Add paragraph 326-10-65-4 and its related heading as follows:

Financial Instruments—Credit Losses—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2019-11, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*

326-10-65-4 The following represents the transition and effective date information related to Accounting Standards Update No. 2019-11, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses:*

- a. An entity that has not yet adopted the pending content that links to paragraph 326-10-65-1 shall apply the pending content that links to this paragraph when the entity first applies the pending content that links to paragraph 326-10-65-1 and shall apply the same transition requirements for the pending content that links to paragraph 326-10-65-1.
- b. An entity that has adopted the pending content that links to paragraph 326-10-65-1 shall apply the pending content that links to this paragraph for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.
- c. Early adoption, including adoption in any interim period, is permitted provided that an entity has adopted the pending content that links to paragraph 326-10-65-1.
- d. An entity that adopts the pending content that links to this paragraph in accordance with (b) or (c) shall apply the pending content that links to this paragraph by means of a cumulative-effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the pending content that links to paragraph 326-10-65-1 is effective.
- e. An entity that adopts the pending content that links to this paragraph in accordance with (b) or (c) 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 applied.

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 applied.
5. An entity that issues interim financial statements shall provide the disclosures in (1) through (4) in each interim financial statement of the fiscal year of change and the annual financial statement of the fiscal year of change.

Amendments to Status Sections

16. Amend paragraph 320-10-00-1, by adding the following items to the table, as follows:

320-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
320-10-50-2A	Added	2019-11	11/26/2019
320-10-50-5C	Added	2019-11	11/26/2019

17. Amend paragraph 326-10-00-1, by adding the following items to the table, as follows:

326-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
326-10-65-1	Amended	2019-11	11/26/2019
326-10-65-4	Added	2019-11	11/26/2019

18. Amend paragraph 326-20-00-1, by adding the following items to the table, as follows:

326-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
326-20-30-13	Amended	2019-11	11/26/2019
326-20-30-13A	Added	2019-11	11/26/2019
326-20-35-6	Amended	2019-11	11/26/2019
326-20-55-86 through 55-90	Added	2019-11	11/26/2019

19. Amend paragraph 805-20-00-1, by adding the following item to the table, as follows:

805-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
805-20-50-1	Amended	2019-11	11/26/2019

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Susan M. Cosper
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The following paragraphs are organized by issue, mirroring the organization in the amendments to the Codification section.

Background Information

BC3. On June 16, 2016, the Board issued Update 2016-13, which introduced the expected credit losses model for the measurement of credit losses on financial assets measured at amortized cost basis, replacing the previous incurred loss model. The amendments in that Update added Topic 326 and made several consequential amendments to the Codification. That Update also modified the accounting for available-for-sale (AFS) debt securities, which must be individually assessed for credit losses when fair value is less than the amortized cost basis in accordance with Subtopic 326-30.

BC4. Since the issuance of Update 2016-13, the Board has assisted stakeholders in implementing the amendments in that Update. Through this assistance, the Board has identified certain areas that require clarification and correction.

BC5. The amendments in this Update include items brought to the Board's attention by stakeholders through their implementation efforts on Update 2016-13. The Board issued a proposed Accounting Standards Update, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* on June 27, 2019, with a 30-day comment period that ended on July 29, 2019. The Board received 19 comment letters on the proposed Update. Overall, respondents broadly supported the Board's proposed amendments to provide Codification improvements to Topic 326.

Benefits and Costs

BC6. The amendments clarify, correct, and improve the guidance related to the amendments in Update 2016-13. Therefore, the Board does not anticipate that entities will incur significant costs as a result of these amendments. The amendments provide the benefit of improving the consistent application of GAAP by clarifying guidance that already exists within GAAP.

Basis for Conclusions

Issue 1: Expected Recoveries for PCD Assets

BC7. The amendments in Update 2016-13 require that writeoffs of financial assets, which may be full or partial writeoffs, be deducted from the allowance. The writeoffs should be recorded in the period in which the financial asset or assets are deemed uncollectible. The amendments further state that recoveries of financial assets and trade receivables previously written off should be recorded when received. Stakeholders questioned whether expected recoveries could be included when estimating expected credit losses for non-PCD assets.

BC8. Update 2019-04 amended the guidance in Update 2016-13 to clarify that an entity is required to include expected recoveries of amounts previously written off and expected to be written off in determining the allowance for credit losses and should not exceed the aggregate of amounts previously written off and expected to be written off by the entity. As a result, an entity may be required to include an expected recovery (that is, a *negative allowance*) in the allowance for credit losses on financial assets that have been written off as long as the amount does not exceed the aggregate amount of previous or expected writeoffs of the financial assets. The phrase negative allowance is used to describe situations in 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.

BC9. As part of the feedback received through the comment letter process of Update 2019-04, several stakeholders suggested that the Board extend the recoveries and expected recoveries decision to PCD assets.

BC10. The Board decided to extend its decision on recoveries and expected recoveries to PCD assets for similar reasons as noted in the basis for conclusions in Update 2019-04. In addition, the Board decided that additional guidance was needed to limit entities from prematurely recognizing (that is, accelerating) interest income when writing off PCD assets. Therefore, the Board added language to 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. The Board also added this clarifying language for the following reasons:

a. Because the valuation allowance represents expected credit losses, a negative valuation allowance can represent only the reversal or offset of expected credit losses. Reversals or offsets of expected credit losses can occur when reversing or offsetting future expected defaults (that is, an entity expects a loan to default and it considers the value of the collateral in determining its net charge-off amount) or reversing amounts previously written off (that is, an entity was required to write off a loan due to regulatory requirements, but the entity expects to recover some or all of the unpaid principle balance). Because a valuation allowance is intended to capture only losses related to credit, an entity cannot record a negative allowance for noncredit related amounts because the noncredit amounts are independent from the valuation allowance.
b. Not limiting negative allowances to the amortized cost basis would have resulted in the Board inadvertently creating new guidance for financial assets that were placed on nonaccrual status and subsequently return to accrual status. Creating new guidance on interest income recognition for financial assets that return to accrual status is beyond the scope of this Codification improvement, and the Board did not intend to change existing charge-off practices.

BC11. The Board also considered capping expected recoveries to the purchase price of PCD assets. The purchase price represents the economic exposure on a PCD asset, which is akin to an originated financial asset's unpaid principal balance. However, the Board concluded that this alternative would create different pre-writeoff and post-writeoff models for PCD assets because the allowance for credit loss is a valuation account that can be recognized in income before a writeoff but would be unable to be recovered after a writeoff.

BC12. The Board acknowledges that certain situations may result in negative allowances being capped at the purchase price of PCD assets. Stakeholders who responded to the proposed Update described situations in which a PCD asset is written off shortly after the acquisition date because individual financial assets within the PCD pool have been deemed uncollectible. A negative allowance is recorded immediately following the writeoff because, when grouped with similar financial assets that also have been written off, the group of financial assets is expected to have recoveries on an aggregate basis.

BC13. The Board concluded that the negative allowance, in this instance, should then represent the purchaser's original expectation of credit (that is, the purchase price) because credit conditions have not changed following the writeoff. At acquisition of a PCD asset, the purchaser's original expectation of credit is the purchase price (the maximum economic exposure on the asset), and any incremental amounts expected to be collected would be classified as noncredit discount. Therefore, if the asset is written off immediately after acquisition and the purchaser's expectation of credit conditions does not change, the negative allowance would be limited to the purchase price.

Negative Allowances on AFS Debt Securities

BC14. Update 2016-13 also amended the impairment guidance for AFS debt securities, including the requirement to present credit losses as an allowance rather than as a write-down to the amortized cost basis of an AFS debt security. Additionally, the amendments in Update 2016-13 prohibit an entity from recording an allowance for credit losses that is below zero. Stakeholders asked that the Board consider permitting an entity to record a negative allowance for AFS debt securities in a manner similar to held-to-maturity debt securities in accordance with paragraph 326-20-30-1.

BC15. As part of the proposed Update, the Board asked stakeholders whether the recognition of a negative allowance (basis recovery) should be extended to AFS debt securities. Generally, stakeholders who provided feedback stated that the Board should extend the decision on negative allowances to AFS debt securities. Stakeholders noted that there was no conceptual difference between debt securities classified as held to maturity, which is permitted to apply a negative allowance, and AFS debt securities.

BC16. The Board decided to retain the guidance in the amendments in Update 2016-13 that prohibits an entity from adjusting an allowance for credit losses to an amount below zero. In its deliberations, the Board considered that the amendments in Update 2016-13 made targeted improvements, rather than significantly amending, the impairment guidance for AFS debt securities. Therefore, the Board decided that a significant amendment to the impairment guidance would be outside the scope of a Codification improvements project. Furthermore, the Board decided that writeoffs of an AFS debt security should occur infrequently upon adopting the amendments in Update 2016-13 because credit losses will be presented as an allowance, rather than as a writeoff under the existing other-than-temporary impairment guidance.

BC17. Additionally, the Board noted that the impairment methodologies for amortized cost basis financial assets and AFS debt securities are not aligned and that amendments to the current expected credit losses methodology may not necessarily warrant similar amendments to the AFS impairment methodology. The Board concluded that its decision to permit a negative allowance on PCD assets within the scope of Subtopic 326-20 does not warrant corresponding amendments to the AFS debt security impairment methodology for those reasons noted above.

Issue 2: Transition Relief for Troubled Debt Restructurings

BC18. At the June 2017 Credit Losses TRG meeting, stakeholders noted that to adjust the effective interest rate for prepayments upon the adoption of the amendments in Update 2016-13, entities using a discounted cash flow method to estimate expected credit losses on a preexisting TDR would be required to use the prepayment assumptions in effect immediately before the restructuring date.

Stakeholders noted that identifying the restructuring date for each TDR and recreating the appropriate economic assumptions that existed immediately before those dates would be operationally complex and time consuming. Stakeholders requested transition relief that would reduce the operational burden associated with adjusting the effective interest rate on preexisting TDRs upon the adoption of the amendments in Update 2016-13.

BC19. The Board did not intend to introduce significant operational complexities when measuring expected credit losses on preexisting TDRs. Therefore, at its December 13, 2017 meeting, the Board decided to allow an entity, as an accounting policy election, to calculate the prepayment-adjusted effective interest rate on preexisting TDRs using the prepayment assumptions that exist as of the date that the entity adopts the amendments in Update 2016-13, instead of the prepayment-adjusted effective interest rate immediately before the restructuring date.

Issue 3: Disclosures Related to Accrued Interest Receivables

BC20. Update 2019-04 amended the guidance in Topic 326 to provide a practical expedient that allows an entity to exclude accrued interest receivable balances from the disclosure requirements in paragraphs 326-20-50-4 through 50-22 and 326-30-50-4 through 50-10 for entities presenting accrued interest receivable balances net of allowance for credit losses (if applicable) separately or within another line item in the statement of financial position. Stakeholders asked that disclosure relief for accrued interest receivable balances be extended to all relevant disclosures involving amortized cost basis to be consistent within all related areas of the Codification.

BC21. The amendments in this Update provide entities with relief from including accrued interest receivable balances in amortized cost basis disclosures for certain Topics in the Codification.

Issue 4: Financial Assets Secured by Collateral Maintenance Provisions

BC22. 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. An entity may determine that the expectation of nonpayment of the amortized cost basis is zero if the borrower continually replenishes the collateral securing the financial asset such that the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset and the entity expects that the borrower will continue to replenish collateral as necessary. If the fair value of the collateral at the reporting date is less than the amortized cost basis of the financial asset, an entity should limit the allowance for credit losses on the financial asset to the difference between the fair value of the collateral at the reporting date and the amortized cost basis of the financial asset.

BC23. Stakeholders questioned whether an entity is required to determine that a borrower will be able to continually replenish collateral in accordance with the contractual terms of the financial asset. The amendments in this Update clarify that an entity should determine that it reasonably expects that the borrower will be able to continually replenish collateral securing the financial asset in order to apply the practical expedient. In making this determination, the Board decided that an entity need not consider remote scenarios or determine that it is probable that the borrower will be able to continually replenish the collateral.

BC24. Additionally, stakeholders questioned in applying the practical expedient how an entity should determine its estimate of expected credit losses when the fair value of the collateral securing the financial asset is less than its amortized cost basis. The amendments in this Update clarify that an entity should estimate expected credit losses in accordance with paragraphs 326-20-30-4 through 30-5 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). However, the allowance for credit losses should be limited to the difference between the amortized cost basis and the fair value of the collateral. 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.

Issue 5: Conforming Amendment to Subtopic 805-20

BC25. Issue 5 represents a conforming amendment to the guidance related to amendments in Update 2016-13. The reasons for making this conforming amendment are sufficiently explained in the summary and amendments to the Codification. Therefore, there is no formal basis for conclusions for this issue.

Effective Date and Transition

BC26. As part of the feedback received on the proposed Update, some stakeholders asked that the Board delay the implementation of Topic 326 for U.S. Securities and Exchange Commission filers that are required to adopt the amendments in Topic 326 during 2020. Those stakeholders suggested that the amendments in this Update, in particular the Board’s decision on negative allowances for PCD assets, would require additional implementation time. The Board decided to affirm the effective date requirements in the amendments in the proposed Update because the amendments in this Update clarify the Board’s intent that entities should consider recoveries and expected recoveries in determining the allowance for credit losses, which is consistent with the approach used by entities today. That is, entities generally track their net charge-off information and use that information to determine the allowance for loan losses under existing GAAP. Therefore, the Board's decision to expand the use of recoveries and expected recoveries conforms practice with Topic 326.

BC27. The Board decided that if an entity has not yet adopted the amendments in Update 2016-13, the effective dates and transition requirements for the amendments in this Update should be the same as the effective dates and transition requirements in Update 2016-13. For entities that have adopted the amendments in Update 2016-13, the Board decided that the amendments in this Update should be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Board also decided that an entity that has adopted the amendments in Update 2016-13 is permitted to early adopt this guidance in any interim period within the fiscal years beginning after December 15, 2018.

BC28. For entities that have adopted the amendments in Update 2016-13, the Board decided that the amendments in this Update should be applied on a modified retrospective transition basis by means of a cumulative-effect adjustment to the opening retained earnings in the statement of financial position as of the date that an entity adopted the amendments in Update 2016-13. The Board determined that this transition approach will provide users with comparable information because the measurement of financial assets measured at amortized cost basis will be consistent for the applicable periods.

BC29. The Board also decided that entities that have adopted the amendments in Update 2016-13 should disclose the following in the period in which they adopt the amendments in this Update:

a. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle.
b. The method of applying the change.
c. 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 during which the amendments are adopted. Presentation of the effect on financial statement subtotals is not required.
d. 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 during which the amendments are adopted.
e. For entities that issue interim financial statements, the disclosures in (a) through (d) in each interim financial statement of the fiscal year of change and the annual financial statement of the fiscal year of change.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those improvements, which will be incorporated into the proposed 2020 Taxonomy, are available through Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.