



In This Issue

- [Key Changes](#)
- [Effective Dates](#)
- [Appendix](#)

FASB Improves Guidance on Credit Losses

by Michelle Leon and Jon Howard, Deloitte & Touche LLP

On November 26, 2019, the FASB issued [ASU 2019-11](#),¹ which amends certain aspects of the Board's new credit losses standard, ASU 2016-13² (codified in ASC 326³).

Key Changes

ASU 2019-11 amends or clarifies the following aspects of the guidance in ASC 326 on credit losses:

- *Purchased credit-deteriorated (PCD) financial assets* — The ASU permits entities to record a negative allowance when measuring the expected credit losses for a PCD financial asset, not to exceed the total amount of the amortized cost basis previously written off and expected to be written off.

The Board notes in the ASU's Basis for Conclusions that negative allowances should be recognized only to the extent that they offset expected credit losses. ASC 326-20-30-13A specifies that an entity that estimates expected credit losses by using a method other than a discounted cash flow approach is permitted to include expected recoveries in the allowance for credit losses ("ALL"). However, those expected recoveries should not include "any amounts that result in an acceleration of the noncredit discount." As the Board explains in paragraph BC10, "[b]ecause 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."

¹ FASB Accounting Standards Update (ASU) No. 2019-11, *Codification Improvements to Topic 326, Financial Instruments — Credit Losses*.

² FASB Accounting Standards Update No. 2016-13, *Measurement of Credit Losses on Financial Instruments*.

³ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's ["Titles of Topics and Subtopics in the FASB Accounting Standards Codification."](#)

Examples from the ASU that illustrate the above concepts are reproduced in the [appendix](#) of this *Heads Up*.



Connecting the Dots

In ASU 2019-04,⁴ the FASB clarified that an entity must include expected recoveries of amounts previously written off and expected to be written off in determining the ALL for non-PCD assets. Accordingly, an entity may be required to include a negative allowance (or basis recovery) in the ALL for non-PCD assets that have been written off as long as the negative allowance does not exceed the aggregate amount of previous or expected write-offs of the non-PCD asset. ASU 2019-11 allows an entity to apply a similar approach when determining the ALL for PCD assets but does not permit the premature recognition (i.e., acceleration) of interest income (as discussed above).

- *Transition relief for troubled debt restructurings* — Entities may calculate the effective interest rate for existing troubled debt restructurings by using prepayment assumptions as of the date they adopt ASU 2016-13.
- *Disclosure relief for accrued interest receivable (AIR)* — ASU 2019-04 provides certain alternatives for the measurement of the ALL on AIR. Those include (1) measuring an ALL on AIR separately, (2) electing to provide separate disclosure of the AIR component of amortized cost as a practical expedient, and (3) making accounting policy elections to simplify certain aspects of the presentation and measurement of AIR. ASU 2019-11 amends ASC 320 to give entities that elect the separate measurement or disclosure alternative in (1) or (2) the same AIR disclosure relief they have under ASU 2019-04 when accounting for available-for-sale debt securities.
- *Financial assets secured by collateral maintenance provisions* — ASC 326-20-35-6 gives entities a practical expedient for financial assets secured by collateral maintenance provisions (e.g., the borrower is contractually required to adjust the amount of the collateral securing the financial asset). Under the practical expedient, entities can measure the expected credit losses of the financial asset as the difference between the amortized cost basis and the fair value of the collateral. If the fair value of the collateral equals or exceeds the amortized cost basis of the financial asset, an expected credit loss of zero may be appropriate.

ASU 2019-11 clarifies that to use the practical expedient, entities must reasonably expect the borrower “to continue to replenish the collateral to meet the requirements of the contract.” In addition, if entities have elected the practical expedient (i.e., they reasonably expect the borrower to continue to replenish the collateral to meet the requirements of the contract) and the fair value of the collateral is less than the amortized cost of the financial asset, they should estimate expected credit losses on the portion of the amortized cost basis that is unsecured (i.e., the amount by which the amortized cost basis of the financial asset exceeds the fair value of the collateral). The expected credit loss is limited to the difference between the amortized cost basis of the financial asset and the fair value of the collateral.

ASU 2019-11 also makes conforming amendments to ASC 805-20.

Effective Dates

For entities that have not yet adopted ASU 2016-13, the amendments in ASU 2019-11 are effective on the same date as those in ASU 2016-13. For entities that have adopted ASU 2016-13, the amendments in ASU 2019-11 are effective for fiscal years beginning after December 15, 2019, and interim periods therein.

⁴ FASB 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*.

Appendix — Implementation Examples

The following examples from the ASU illustrate how, for PCD financial assets, entities should include in the ALL expected recoveries of amounts previously written off and expected to be written off:

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.

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

***Dbriefs* for Financial Executives**

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy and tax.
- Financial reporting.
- Tax accounting and provisions.
- Controllership perspectives.
- Governance, risk, and compliance.
- Transactions and business events.
- Driving enterprise value.
- Innovation in risk and controls.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk.

Subscriptions

To subscribe to *Dbriefs*, or to receive accounting publications issued by Deloitte's Accounting Services Department, please register at [My.Deloitte.com](https://my.deloitte.com).

The Deloitte Accounting Research Tool

Put a wealth of information at your fingertips. The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosure literature. It contains material from the FASB, EITF, AICPA, PCAOB, and SEC, in addition to Deloitte's own accounting manuals and other interpretive guidance and publications.

Updated every business day, DART has an intuitive design and navigation system that, together with its powerful search and personalization features, enable users to quickly locate information anytime, from any device and any browser. While much of the content on DART is available at no cost, subscribers have access to premium content, such as Deloitte's *FASB Accounting Standards Codification Manual*. DART subscribers and others can also [subscribe](#) to *Weekly Accounting Roundup*, which provides links to recent news articles, publications, and other additions to DART. For more information, or to sign up for a free 30-day trial of premium DART content, visit dart.deloitte.com.

Heads Up is prepared by members of Deloitte's National Office as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.