

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2019-05
May 2019

Financial Instruments—Credit Losses (Topic 326)

Targeted Transition Relief

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

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

In June 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 the expected credit losses methodology for the measurement of credit losses on financial assets measured at amortized cost basis, replacing the previous incurred loss methodology. The amendments in Update 2016-13 added Topic 326, Financial Instruments—Credit Losses, and made several consequential amendments to the Codification. Update 2016-13 also modified the accounting for available-for-sale 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, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities.

Since the issuance of Update 2016-13, the Board has assisted stakeholders in implementing the amendments formally through the activities of the Credit Losses Transition Resource Group (TRG) and informally through other implementation assistance activities. Through this assistance, the Board has identified certain areas that require clarification and improvement.

The FASB received several agenda request letters asking that the Board consider amending the transition guidance for Update 2016-13. The entities that submitted the agenda request letters noted that certain financial statement preparers have begun (or are planning) to elect the fair value option on newly originated or purchased financial assets, although those entities historically have measured similar financial assets at amortized cost basis. Without the targeted transition relief provided by the amendments in this Update, those entities noted that they would be required to maintain dual measurement methodologies for identical or similar financial instruments that are being managed in the same manner and that they would not provide financial statement users with decision-useful information because the financial statement information would not be comparable. That is, the portion of an entity's financial instruments measured at fair value may not be comparable to other identical, or similar, financial instruments measured at amortized cost basis that are owned by the same entity.

The amendments in this Update address those stakeholders' concerns by providing an option to irrevocably elect the fair value option for certain financial assets previously measured at amortized cost basis. For those entities, the targeted transition relief will increase comparability of financial statement information by providing an option to align measurement methodologies for similar financial assets. Furthermore, the targeted transition relief also may reduce the

costs for some entities to comply with the amendments in Update 2016-13 while still providing financial statement users with decision-useful information.

Who Is Affected by the Amendments in This Update?

The amendments in this Update provide targeted transition relief that is optional for, and will be available to, all reporting entities within the scope of Topic 326.

What Are the Main Provisions?

The amendments in this Update provide entities that have certain instruments within the scope of Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost, with an option to irrevocably elect the fair value option in Subtopic 825-10, Financial Instruments—Overall, applied on an instrument-by-instrument basis for eligible instruments, upon adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. An entity that elects the fair value option should subsequently apply the guidance in Subtopics 820-10, Fair Value Measurement—Overall, and 825-10.

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

The amendments in this Update provide entities with targeted transition relief that is intended to increase comparability of financial statement information for some entities that otherwise would have measured similar financial instruments using different measurement methodologies. The amendments also decrease costs for some financial statement preparers while providing financial statement users with decision-useful information.

The amendments accomplish those objectives by providing entities with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, that are within the scope of Subtopic 326-20, upon adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities.

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

For entities that have not yet adopted the amendments in Update 2016-13, the effective date and transition methodology for the amendments in this Update are the same as 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 the issuance of this Update as long as an entity has 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 balance of 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*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 3 and 4. 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 underlined, and deleted text is ~~struck out~~.

2. Since the issuance of Update 2016-13, the staff has been working with stakeholders by responding to inquiries and seeking feedback, both through the formal Credit Losses TRG and informally through other communications with stakeholders. In response to several agenda request letters submitted by various financial statement users and preparers, the following amendments in this section reflect the Board's decisions to provide targeted transition relief upon the adoption of the amendments in Update 2016-13. The amendments provide entities with the option to irrevocably elect the fair value option in accordance with Subtopic 825-10 for certain financial instruments that are within the scope of Subtopic 326-20, upon adopting Topic 326. The fair value option election does not apply to held-to-maturity debt securities.

Amendments to Subtopic 326-10

3. Amend paragraph 326-10-65-1 and its related heading by adding (i), with a link to transition paragraph 326-10-65-3, and add paragraph 326-10-65-3 and its related heading, 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*, and No. 2019-04, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging*, and Topic 825, *Financial Instruments*, and No. 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief*

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*, and No. 2019-04, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, and No. 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief*:

- i. An entity may irrevocably elect the fair value option in accordance with Subtopic 825-10 for financial instruments within the scope of Subtopic 326-20, except for those financial assets in paragraph 326-20-15-2(a)(2), that also are eligible items in Subtopic 825-10.

> Transition Related to Accounting Standards Update No. 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief*

326-10-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief*:

- 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.
- 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. For items measured at {add glossary link to 2nd definition}fair value{add glossary link to 2nd definition} in accordance with paragraph 326-10-65-1(i), the difference between the carrying amount and the fair value shall be recorded by means of a cumulative-effect adjustment to the opening retained earnings balance as of the beginning of the first reporting period that an entity has adopted the pending content that links to paragraph 326-10-65-1. Those differences may include, but are not limited to:
 - 1. Unamortized deferred costs, fees, premiums, and discounts
 - 2. Valuation allowances (for example, allowance for loan losses)
 - 3. Accrued interest.

Amendments to Status Sections

4. 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	2019-05	05/15/2019
326-10-65-3	Added	2019-05	05/15/2019

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

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
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.

Background Information

BC2. On June 16, 2016, the Board issued Update 2016-13, which introduced the expected credit losses methodology for the measurement of credit losses on financial assets measured at amortized cost basis, replacing the previous incurred loss methodology. 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 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.

BC3. 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. The Board also has considered and responded to agenda request letters submitted by stakeholders, including those requesting targeted transition relief upon adopting the amendments in Update 2016-13.

BC4. The amendments in this Update address an issue brought to the Board's attention by stakeholders through their implementation efforts on Update 2016-13. The Board issued a proposed Accounting Standards Update, *Targeted Transition Relief for Topic 326, Financial Instruments—Credit Losses*, on February 6, 2019, with a 30-day comment period that ended on March 8, 2019. The Board received 27 comment letters representing 30 respondents on the proposed Update. Overall, respondents broadly supported the Board's proposed amendments to provide targeted transition relief upon adopting the amendments in Update 2016-13.

Benefits and Costs

BC5. The amendments in this Update provide entities with the option to irrevocably elect the fair value option, on an instrument-by-instrument basis in accordance with Subtopic 825-10, for certain financial instruments that are within

the scope of Subtopic 326-20, upon adopting Topic 326. The fair value option election does not apply to held-to-maturity debt securities.

BC6. Subtopic 825-10 provides entities with the option to elect the fair value option on certain election dates on an instrument-by-instrument basis, with certain exceptions in paragraph 825-10-25-7. Because the amendments in this Update will be applied in a consistent manner with Subtopic 825-10 on an instrument-by-instrument basis, the Board anticipates that entities will be able to utilize existing systems and processes to adopt the amendments without incurring significant operational costs. The amendments in this Update do not change any of the principles described in the amendments in Update 2016-13 or Subtopic 825-10 and provide entities with an additional election date upon adoption of Topic 326 to elect the fair value option in accordance with Subtopic 825-10. Furthermore, electing the fair value option is not required, and any additional costs apply only to those entities that elect to use the targeted transition relief.

BC7. The Board concluded that the amendments in this Update will benefit financial statement users by increasing comparability of financial statement information for entities that have begun (or are planning) to elect the fair value option for certain financial instruments that are newly purchased or originated before the adoption of Topic 326. As a result of their election of the fair value option, those entities will measure similar financial assets using different measurement methodologies. Absent these amendments, an entity would have been required to measure previously originated or purchased financial assets for which the fair value option was not elected within the scope of the amendments in Update 2016-13 at amortized cost basis. The amendments allow the use of fair value measurements for those previously originated or purchased financial assets, resulting in a consistent measurement methodology for those financial assets.

Basis for Conclusions

BC8. After the issuance of Update 2016-13, several stakeholders submitted agenda request letters asking that the Board consider providing targeted transition relief upon the adoption of the amendments in Update 2016-13. Those stakeholders requested an option to elect the fair value option in accordance with Subtopic 825-10 for certain financial instruments upon adoption of Topic 326.

BC9. Several of those stakeholders represent financial statement users and preparers in the auto-financing industry, including institutions that may extend credit to borrowers with limited or impaired credit histories. They noted that certain financial statement preparers have begun (or are planning) to elect the fair value option on newly originated or purchased financial assets, although those entities historically have measured their financial assets at amortized cost basis. Those entities noted that without the targeted transition relief provided through the amendments in this Update, their election of the fair value option would have resulted in the need to maintain dual measurement methodologies by measuring

previously originated or purchased financial assets at amortized cost basis in accordance with Topic 326, while measuring newly originated or purchased financial assets at fair value through net income in accordance with Subtopic 825-10. Furthermore, several investors noted that financial statements that have dual measurement methodologies for identical or similar financial instruments that are being managed in the same manner would not have provided financial statement users with decision-useful information because financial statement information would not have been comparable. That is, the portion of an entity's financial instruments measured at fair value may not be comparable to other identical, or similar, financial instruments measured at amortized cost basis that are owned by the same entity.

BC10. The Board also received an agenda request letter from an industry trade group that supported the targeted transition relief. Those stakeholders noted that the targeted transition relief will provide cost savings for some financial statement preparers by allowing them to utilize their existing systems and processes for measuring financial assets at fair value.

BC11. In response to stakeholders' requests, the Board decided to provide entities that have certain financial instruments within the scope of Subtopic 326-20 with an irrevocable option to elect the fair value option in accordance with Subtopic 825-10 for eligible instruments upon adoption of Topic 326. The Board also concluded that an entity should apply the fair value option on an instrument-by-instrument basis and that held-to-maturity debt securities should be excluded from the scope of financial instruments eligible for the fair value option transition relief.

BC12. The Board concluded that the amendments in this Update will provide certain financial statement preparers with targeted transition relief upon adopting the amendments in Update 2016-13 while providing financial statement users with decision-useful information. The Board observed that the amendments in this Update allow some entities to elect the fair value option to achieve a single measurement methodology for similar types of financial assets. As a result, the amendments will provide increased comparability for financial statement users who may have had difficulty analyzing financial statement information that includes dual measurement methodologies for similar types of assets. The Board also concluded that the amendments will lessen the costs associated with adopting Topic 326 for some entities.

BC13. During deliberations, the Board considered whether entities should be required to apply the transition relief on an instrument-by-instrument basis or at another unit of account, such as the class of financing receivable as defined in the Master Glossary. The Board decided to provide the election on an instrument-by-instrument basis because this unit of account is more operable and understandable for entities electing the targeted transition relief. The Board noted that an instrument-by-instrument election aligns with the current requirements in Subtopic 825-10. Furthermore, an instrument-by-instrument election provides

entities with flexibility to more precisely align their risk management strategies with their measurement methodologies.

BC14. The Board understands some stakeholders' concerns about potential selection bias that would result from the fair value option being applied on an instrument-by-instrument basis. However, any potential selection bias will be limited by the transition requirements of the amendments in this Update, which require that any fair value adjustments be recorded as a cumulative-effect adjustment to opening retained earnings. Potential selection bias also will be curtailed by the irrevocable nature of the fair value option, which prohibits entities from subsequently discontinuing fair value measurement for financial instruments that had previously elected the fair value option.

BC15. The Board also understands that an election on an instrument-by-instrument basis may result in similar financial assets having different measurement methodologies, potentially resulting in noncomparability. However, existing guidance in Subtopic 825-10 currently allows for similar outcomes because entities can measure similar financial instruments using different measurement methodologies by electing to use the fair value option (at certain election dates) for certain assets and not others. The Board believes that this concern is mitigated by the disclosure objectives in Subtopic 825-10, which require entities to disclose information to allow for comparisons when an entity selects different measurement methodologies for similar assets.

Scope

BC16. In the proposed Update, the Board decided that the amendments would apply to financial assets within the scope of Subtopic 326-20 that also are eligible items for the fair value option election in accordance with Subtopic 825-10, excluding held-to-maturity debt securities.

BC17. Respondents requested that the Board extend the transition relief to debt securities classified as held to maturity. Those stakeholders noted that the Board could provide transition relief upon adoption of Topic 326 by either (a) including held-to-maturity debt securities within the scope of financial instruments eligible for the fair value option or (b) allowing held-to-maturity debt securities to be transferred to the available-for-sale category without calling into question an entity's intent to hold other held-to-maturity debt securities to maturity.

BC18. In determining the scope of financial instruments eligible for the fair value option election, the Board considered the nature of the narrow-scope targeted transition relief project and the specific request from stakeholders in the auto-financing industry to address comparability concerns about an entity's loan portfolio upon transition to Topic 326. The Board also considered the potential transition complexities and subsequent questions that could arise from broadening

the scope of the targeted transition relief to include held-to-maturity debt securities. On the basis of those factors, the Board decided to exclude held-to-maturity debt securities from the scope of eligible instruments for the fair value option.

BC19. During its deliberations, the Board considered whether to provide an option to transfer held-to-maturity debt securities to the available-for-sale category without calling into question an entity's intent to hold other held-to-maturity debt securities to maturity. The Board noted that an allowance for credit losses is recorded for credit impaired available-for-sale debt securities and, therefore, an option to transfer a debt security from the held-to-maturity category to the available-for-sale category would not provide relief for those stakeholders that noted complexities in applying the credit loss methodology. The Board also noted that adopting a new accounting standard should not change an entity's intent of realizing the total value of a debt security through the collection of contractual cash flows (that is, holding a debt security to maturity). Furthermore, the Board considered the nature of the narrow-scope targeted transition relief project and concluded that the amendments in this Update address those stakeholders' concerns. The Board also noted that an entity had (or will have) the ability to transfer certain held-to-maturity debt securities to the available-for-sale category upon adoption of Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. On the basis of those factors, the Board decided not to provide an option to transfer held-to-maturity debt securities to the available-for-sale category without calling into question an entity's intent to hold other held-to-maturity debt securities to maturity.

BC20. The Board decided to limit the scope to financial assets that are eligible for the fair value option in Subtopic 825-10. For example, an entity cannot elect the fair value option for a net investment in a lease because this type of financial asset is not an eligible item for the fair value option in accordance with paragraph 825-10-15-5.

BC21. The industry trade group also requested that the Board consider expanding the scope of the transition relief by providing an option to discontinue fair value measurements for financial assets measured at fair value in accordance with Subtopic 825-10 that otherwise would be within the scope of Subtopic 326-20. The trade group noted that because of significant system redesigns, some of its members would prefer to apply the expected credit losses methodology in Topic 326 for certain financial instruments measured at fair value.

BC22. The Board decided not to provide entities with the option to discontinue fair value measurements upon the adoption of Topic 326 because of the irrevocable nature of the fair value option election and the potential selection bias of using hindsight in discontinuing fair value measurements. In making this determination, the Board also considered that entities that historically have elected the fair value option already have the ability to continue to elect the fair value option on similar financial assets originated or purchased in future periods. As a result,

those entities currently have the ability to elect the fair value option to use a single measurement methodology for similar financial assets. Consequentially, the Board concluded that the requirement to use a dual measurement methodology would result from an entity's future decision rather than from adopting Topic 326. Therefore, the Board questioned whether the scope of the proposed targeted transition relief relating to the adoption of Topic 326 should include the option to discontinue fair value measurements. The Board concluded that the reasons presented by stakeholders for discontinuing the fair value option did not overcome those concerns, and, therefore, the Board decided not to provide entities with the option to discontinue fair value measurements upon the adoption of Topic 326.

Effective Date and Transition

BC23. The Board decided that for an entity that has not yet adopted the amendments in Update 2016-13, the effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements in Update 2016-13.

BC24. The Board decided that for an entity that has 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 of the amendments in this Update is permitted in any interim period, provided that an entity has adopted the amendments in Update 2016-13.

BC25. The amendments in this Update should be applied on a modified retrospective basis through a cumulative-effect adjustment to opening balance of retained earnings balance as of the beginning of the first reporting period in which the amendments in Update 2016-13 were adopted.

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.