CECL TRG Issue Log – November 2018

The Financial Accounting Standards Board (FASB) established the Transition Resource Group (TRG) for Credit Losses to inform the board about issues that arise as entities implement the new credit impairment standard, Accounting Standards Update (ASU) 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. FASB will consider this information and determine what action, if any, to take on each issue. This article contains a summary of all the issues discussed at the three public Current Expected Credit Loss (CECL) TRG meetings held to date.

November 2018 Meeting – Official Agenda Items

Topic	Issue Summary	Resolution
Contractual Term: Extensions and Measurement Inputs Memo No. 15 Contractual Term: Extensions and Measurement Inputs	Should certain extensions be considered when determining the contractual term? Is an entity precluded from considering future economic and other conditions beyond the contractual term when estimating expected credit losses?	As written, the ASU prohibits an entity from extending the contractual term unless there is a reasonable expectation of a troubled debt restructuring (TDR). Several scenarios were discussed and TRG members concluded extensions should not be considered when: • The financial instrument does not have explicit extension options, but the lender has a past practice of renewing or extending loan terms • The financial instrument has a contractual option that gives the lender the right to extend TRG members concluded there are other situations for extension options outside the lender's control that might warrant adjustment to the contractual term. **FASB will issue an exposure draft in mid-December 2018 with a 30-day comment period to clarify these situations**.
Vintage Disclosures for Revolving Loans: Gross Write-Offs and Recoveries Memo No. 14 Cover Memo	As written, the ASU requires disclosure of the amortized cost basis by receivable type or security class, credit-quality indicator and year of origination. An example in the ASU illustrates gross write-offs and recoveries by origination year; however, the ASU does not explicitly require this level of detail. Is this a required disclosure?	This information is seen as important by FASB and investors. Most TRG members had not interpreted the example as a requirement and did not include it in project scope or parallel testing plans. **FASB will issue a separate exposure draft with a 60-day comment period to require this disclosure**. **The proposal will solicit feedback on an extended implementation date**.

Topic	Issue Summary	Resolution
Vintage Disclosures for Revolving Loans: Revolving Loans Memo No. 14 Cover Memo	The ASU generally requires vintage disclosure by origination year for most assets, but exempts certain line-of-credit arrangements. What is the proper presentation of loans initially established as revolving arrangements that later convert to term loans within the vintage disclosure?	TRG members discussed seven presentation alternatives. FASB concluded a combination of views was appropriate. An entity should disclose conversions of line-of-credit arrangements to term loans within the origination year that corresponds to the most recent credit decision. If there is no credit decision, the entity would disclose amounts of line-of-credit arrangements converted to term loans in a separate column on the vintage disclosure table. **FASB will issue an exposure draft in mid-December 2018 to clarify its intention**.
Recoveries: Types Memo No. 17 Recoveries	What types of recoveries could be included when measuring the allowance? There are different interpretations of recoveries: • Cash from the borrower • Amounts recoverable from the sale of underlying collateral at default or foreclosure • Amounts received from a third party from the sale of a nonperforming loan or credit card balance • Increases in the fair value of collateral	After the June TRG meeting, FASB agreed to amendments to remove the phrase “recoveries of financial assets and trade receivables previously written off shall be recorded when received.” In addition, FASB will now add amendments to reverse the limitation that recoveries are only from the borrower. **FASB will issue an exposure draft in mid-December 2018 to clarify its intention**.
Recoveries: Negative Allowance Memo No. 17 Recoveries	Can entities record a negative allowance when applying the collateral-dependent guidance?	At the June TRG meeting, members agreed an entity could record a negative allowance. At the November meeting, members refined this conclusion. For collateral-dependent financial assets, the proposed amendments clarify that an allowance for credit losses that is added to the amortized cost basis of the financial assets should not exceed amounts previously written off. **Included in a recently issued proposed ASU, with comments due December 19, 2018. A final ASU is expected in early 2019.**

November 2018 Meeting – Other TRG Submission

FASB elected not to address these other topics in separate TRG memos because it believed the current guidance is clear and no amendments are needed or the submission is beyond TRG's scope.

Topic	Issue Summary	Resolution
Discounting Inputs When Using a Method Other Than Discounted Cash Flow (DCF) Memo No. 14 Cover Memo	Is an entity permitted to discount cash flows to a date other than the reporting date (partial discounting, required under certain regulatory guidance) or discount some—but not all—of the expected cash flows when using a method other than DCF?	TRG members and FASB both agreed that partially discounting cash flows should not be permitted, even if this methodology is used for regulatory reporting. **No further standard setting required**. **TRG meeting minutes will reflect this conclusion**.
Accounting for Changes in FX Rates for Foreign Currency Available-for-Sale (AFS) Debt Securities Memo No. 14 Cover Memo	When should unrealized losses related to changes in FX for foreign currency-denominated AFS debt securities be recognized in earnings?	Unrealized losses related to changes in FX rates from an investment in a foreign currency-denominated AFS debt security reported in other comprehensive income (OCI) are recognized in earnings at the security's maturity, the security's sale, when an entity intends to sell or when the entity is more likely than not required to sell the security before recovery of its amortized cost basis. **No further work planned on this issue**.
Beneficial Interests (BI) Classified as Trading Memo No. 14 Cover Memo	Should an entity maintain an allowance for credit losses for a BI in Accounting Standards Codification (ASC) 325-40's scope that is classified as trading?	An entity is not required to maintain an allowance for credit losses for BIs classified as trading. ASC 326-20 excludes financial assets measured at fair value through net income. Such BIs should be accounted for under ASC 325-40. **No further work planned on this issue**.

June 2018 Meeting – Official Agenda Items

A more comprehensive review of each topic can be found in BKD's article, Additional Clarifications to CECL Model.

Topic	Issue Summary	Resolution
Capitalized Interest Memo No. 8 Capitalized Interest	How should entities consider interest amounts that will be earned when estimating expected credit losses when following a method other than the DCF method?	The allowance for credit losses should be based on amortized cost at the reporting date; unearned future interest resulting from interest deferral features should not be considered. Capitalized interest should **not** be treated the same way as a discount. **At an August 2018 board meeting, FASB concluded no additional standard setting is needed**.

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<tr><th>Topic</th><th>Issue Summary</th><th>Resolution</th></tr>
<tr><td>Accrued Interest

Memo No. 9 Accrued Interest</td><td>As written, ASU 2016-13 includes accrued interest in the definition of amortized cost basis. Currently, IT systems do not track accrued interest on an individual loan basis needed for CECL pooling and vintage disclosure requirements.</td><td>FASB acknowledged the operational challenges in its amortized cost basis definition and will consider a practical expedient that would allow entities to:

• Perform a CECL evaluation for the accrued interest amounts separately from their associated loan balances

• Create an accounting policy election to continue current practices for the presentation of accrued interest, e.g., in “other assets” on the balance sheet

• Create a practical expedient to separately disclose the accrued interest amounts included in amortized cost for the vintage disclosure table by one of these methods:

    • Including the amounts in the vintage year and class of financing receivable amounts
    • Including the amounts in the class of financing receivable amounts only
    • Not including them in any amounts and adding a footnote to the table that states the total amount

Included in a recently issued proposed ASU, with comments due December 19, 2018. A final ASU is expected in early 2019.</td></tr>
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Topic	Issue Summary	Resolution
	How should the reversal of accrued interest be reflected in the statement of operations when a loan is placed on nonaccrual status?	FASB's intent was not to change existing nonaccrual practices. It provided flexibility for regulated and nonregulated entities: • Create an accounting policy election to write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses • Create an accounting policy election not to measure an allowance for credit losses on accrued interest receivable amounts if an entity writes off the uncollected accrued interest **Included in a recently issued proposed ASU, with comments due December 19, 2018. A final ASU is expected in early 2019.**
Transfers Between Classifications Memo No. 10 Transfer of Loans from Held for Sale to Held for Investment and Transfer of Credit Impaired Debt Securities from Available-for-Sale to Held-to-Maturity (HTM)	How should the guidance apply when transferring credit-impaired debt securities classified as AFS to HTM?	At an August meeting, FASB approved an exposure draft that would amend the guidance to require entities to reverse any previous valuation allowance or allowance for credit losses balances when transferring a loan or debt security between the various categories. An entity would then apply the applicable measurement guidance in accordance with the new classification or category. **Included in a recently issued proposed ASU, with comments due December 19, 2018. A final ASU is expected in early 2019.**
	How should the guidance apply when transferring loans classified as held for sale (HFS) to held for investment (HFI)?	Upon transfer of loans from HFS to HFI, an entity would reverse any previously recorded valuation allowance and determine if a credit allowance is required under ASC 326-20. **Standard setting will be required separate from technical corrections noted above**.

Topic	Issue Summary	Resolution
Recoveries [Memo No. 11 Recoveries]	Can all expected recoveries on financial assets be included in the estimate of expected losses when assessing **pools** of financial assets or when assessing **individual** assets?	TRG members generally agreed recoveries could be included in the estimate of expected credit losses if reasonable and supportable. The recoverable amounts included in the valuation account should not exceed the aggregate of amounts previously written off and expected to be written off by the entity. **Included in a recently issued proposed ASU, with comments due December 19, 2018. A final ASU is expected in early 2019.**
	Should expected recoveries be included in the calculation of the allowance or as a direct write-up of the financial asset at an individual level?	Because the estimation of expected recoveries is an input to the overall calculation of the allowance for credit losses that offsets the expected amount of loss, it relates to the measurement of the underlying asset and, therefore, should be included as part of the valuation account; the individual financial security should not be adjusted. **No further work expected**.
	Can the estimate of expected recoveries exceed their amortized cost?	Entities have historical practices to deal with this situation when it occurs. FASB concluded these practices do not violate the concepts in ASC 326. FASB's intent was to avoid changing practice for write-offs; therefore, this issue is best handled by individual institutions. **At an August 2018 board meeting, FASB agreed to amend the guidance as follows:** • **Require entities to consider expected recoveries when measuring the allowance for credit losses** • **Limit the scope of expected recoveries to only include amounts collected from the borrower** **At the November TRG meeting, the second item was reversed**.
Refinancing and Loan Prepayment [Memo No. 12 Refinancing and Loan Prepayments]	Are entities required to use the loan modification guidance in ASC 310 to determine whether a refinancing constitutes a prepayment for measuring expected credit losses under ASC 326?	Entities should not be required to use the loan modification guidance in ASC 310-20-35-9 through 35-12 to determine what constitutes a prepayment. An entity should not be precluded from using the guidance if the entity determines the guidance provides an appropriate basis for determining prepayments given its specific portfolios and facts and circumstances. **No further work expected**.

June 2018 Meeting – Other TRG Submission

Topic	Issue Summary	Resolution
Fair Value Option (FVO) [Memo No. 7 Cover Memo]	Request for a one-time election to apply the FVO to existing financial instruments on adoption. This would allow entities that choose to elect FVO for instruments going forward from having two different accounting models for portfolios (CECL and fair value).	On November 14, 2018, FASB approved for exposure a one-time election to apply the FVO to existing financial instruments on adoption. An exposure draft is expected in the first quarter of 2019.
Nonpublic Business Entity Transition Resources: FASB Issues CECL Technical Corrections	As written, nonpublic entities with calendar year-ends would have to calculate their allowance for credit losses on January 1, 2021, due to quarterly reporting requirements.	ASU 2018-19, amends the effective date so that a non-PBE would adopt ASU 2016-13 and adjust its opening retained earnings balance as of January 1, 2022.

June 2018 Meeting – Technical Inquiries Addressed Outside Meeting – No Further Work Expected

Topic	Issue Summary	Resolution
Loans and Receivables Between Entities Under Common Control Memo No. 7 Cover Memo	Loans and receivables between entities under common control are not in the scope of ASC 326-20. Does this scope exception apply at the parent or subsidiary level?	It was FASB's intent to provide this scope exception at **all** standalone reporting levels, both parent and subsidiary.
Gains and Losses on Subsequent Disposition of Leased Assets Memo No. 7 Cover Memo	A lessor's net investment in leases is within ASC 326-20's scope. At the end of the lease or upon early termination, these lessors may either sell or re-lease the leased assets for additional cash flows. How should these expected gains be considered in the CECL allowance?	Entities should estimate expected cash flows from the subsequent disposition of leased assets when calculating expected credit losses on a portfolio of net investments in leases if that estimate is reasonable and supportable.

Topic	Issue Summary	Resolution
Billed Operating Lease Receivables Memo No. 7 Cover Memo **Resource:** Additional Clarifications to CECL Model	Which guidance covers billed operating leases?	ASU 2018-19 clarifies that receivables arising from operating leases are not within the scope of ASU 2016-13. Instead, impairment of receivables arising from operating leases should be accounted for in accordance with Topic 842, *Leases*.

June 2017 Meeting – Official Agenda Items

A more comprehensive review of each 2017 topic can be found in BKD's article, FASB Tackles CECL Questions.

Topic	Issue Summary	Resolution
Discounting Expected Cash Flows Using an Entity's Effective Interest Rate Memo No. 1 Discounting Expected Cash Flows at the Effective Interest Rate	For entities electing a DCF approach for CECL, the use of an unadjusted effective interest rate (EIR) could misstate credit losses for prepayable assets held at a premium or discount since the EIR does not include prepayment assumptions.	FASB will remove the prohibition of using projections of future interest rates when using a DCF method for variable rate instruments. An entity should use the same projections of future interest rates in estimating expected cash flows and in determining the EIR for discounting. **Included in a recently issued proposed ASU, with comments due December 19, 2018. A final ASU is expected in early 2019.**
Scope of Purchased Financial Assets with Credit Deterioration Guidance for Beneficial Interests Memo No. 2 Scope of PCD Assets for Beneficial Interests	How should contractual cash flows be determined when assessing whether a beneficial interest is subject to the purchased credit-deteriorated (PCD) methodology? Should estimated prepayments on beneficial interests be included in calculating contractual cash flows?	Contractual cash flows should be determined by excluding credit losses but including expected prepayments. Contractual cash flows would represent the stream of cash flows the investor would receive if the underlying assets do not experience any credit defaults, but prepay in accordance with the entity's expectations at acquisition. This approach would limit the number of beneficial interests that would be considered a PCD asset.

Topic	Issue Summary	Resolution
Transition Guidance for Purchased Credit Impaired Pools Memo No. 3 Transition Guidance for PCD Assets	Can entities apply the election to maintain pools at the time of adoption only, or both at the time of adoption and on an ongoing basis?	TRG members agreed entities should be given a choice—through an accounting policy election—that the transition relief can apply both at adoption and on an ongoing basis. This interpretation could provide significant cost savings to smaller financial institutions.
Accounting for TDR Memo No. 4 Accounting for Troubled Debt Restructurings	Should entities forecast "reasonably expected" TDRs that extend the contractual term on an individual or portfolio basis in the calculation of expected credit losses?	No consensus was reached. Banking regulators felt strongly a portfolio approach was the only acceptable method, while TRG members felt that approach was too costly and may be extremely challenging for smaller banks to implement. Further work is needed.
Determining the "Estimated Life" of a Credit Card Receivable Memo No. 5 Determining the "Estimated Life" of a Credit Card Receivable	Should expected principal payments be applied to the credit card receivable balance existing at the measurement date until that balance is exhausted, or should those payments be allocated between the measurement date balance and future purchases?	No consensus reached. Banking regulators noted that either approach was acceptable as long as the following conditions were met: • Entities should always segregate balances that are paid in full every month from those that carry an outstanding balance. Failure to do so would incorrectly shorten the expected life of the credit card portfolio. Entities should be consistent in the way they project future payments and their approach for estimating credit losses. If an entity chooses to consider unfunded amounts in determining the estimated life for credit card receivables, it also should allocate payments to principal and interest considering the unfunded balances.

The adoption of this ASU will be complex and likely will require significant hours to implement correctly. BKD can help educate your team, provide implementation tools and assist with analysis and documentation. If you would like assistance complying with the CECL standard, contact your trusted BKD advisor. BKD has prepared a library of **BKD Thoughtware®** on this topic. Visit our website to learn more.

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