FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: August 20, 2018
Comments Due: September 19, 2018

Codification Improvements to Topic 326, Financial Instruments—Credit Losses

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 326 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2018-270, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until September 19, 2018. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2018-270
- Sending a letter to "Technical Director, File Reference No. 2018-270, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

Codification Improvements to Topic 326, Financial Instruments—Credit Losses

August 20, 2018

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Why Is the FASB Issuing This Proposed 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 that Update, the Board added Topic 326 and made several consequential amendments to the *FASB Accounting Standards Codification*®.

The Board has an ongoing project on its agenda for improving the Codification or correcting its unintended application. Those items generally are not expected to have a significant effect on current accounting practice or to create a significant administrative cost for most entities. The amendments in this proposed Update are of a similar nature to the items typically addressed in the project on Codification improvements. However, the Board decided to issue a separate proposed Update for improvements related to Update 2016-13 to increase stakeholders' awareness of the proposed amendments to scope and transition and effective date requirements and to expedite the improvements.

The amendments in this proposed Update include items brought to the Board's attention by stakeholders. The proposed amendments would align the implementation date for nonpublic entities' annual financial statements with the implementation date for their interim financial statements and would clarify the scope of the guidance in the amendments in Update 2016-13.

Area for Improvement	**Summary of Proposed Amendments**
Issue 1: Transition and Effective Date for Nonpublic Business Entities The amendments in Update 2016-13 are effective for nonpublic business entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. The transition guidance in paragraph 326-10-65-1(c) requires an entity to make a cumulative-effect adjustment to opening	 The proposed amendments would mitigate transition complexity by requiring that for nonpublic business entities the amendments in Update 2016-13 are effective for fiscal years beginning after December 15,

Area for Improvement	Summary of Proposed Amendments
retained earnings as of the beginning of the first reporting period in which the amendments are effective. Stakeholders raised questions about whether it was the Board's intent to require nonpublic business entities to effectively adopt the amendments as of January 1, 2021, because of the cumulative-effect adjustment as of that date, and whether it was the Board's intent to require the same effective date for nonpublic business entities and public business entities that do not meet the definition of a Securities and Exchange Commission (SEC) filer.	2021, including interim periods within those fiscal years.
Issue 2: Operating Lease Receivables The scope of Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost, includes financial assets measured at amortized cost basis, including net investments in leases arising from sales-type and direct financing leases. The scope does not specifically include receivables arising from operating leases. Stakeholders raised questions about whether operating lease receivables would be included within the scope of Subtopic 326-20 because they appear to meet the definition of a financing receivable measured at amortized cost basis.	The proposed amendment would clarify that receivables arising from operating leases are not within the scope of Subtopic 326-20. Instead, impairment of receivables arising from operating leases should be accounted for in accordance with paragraphs 842-30-25-12 through 25-13.

When Would the Amendments Be Effective?

The effective date and transition requirements for the amendments in this proposed Update would be the same as the effective dates and transition requirements in Update 2016-13.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do the amendments in this proposed Update mitigate transition complexity and improve the clarity of the guidance in Update 2016-13? If not, please explain which proposed amendment(s) would not mitigate transition complexity or provide clarification, and why.

Question 2: Should the Board make other changes that are directly or indirectly related to the proposed amendments? Please note that the Board will conduct Codification improvements projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvements project.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

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

Areas for Improvement	**Related Paragraphs**
Issue 1: Transition and Effective Date for Nonpublic Business Entities	3 through 5
Issue 2: Operating Lease Receivables	6 and 7

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–7. 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—Transition and Effective Date for Nonpublic Business Entities

3. The amendments to paragraph 326-10-65-1 relate to the transition and effective date requirements for nonpublic business entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting.

4. The Board's original intent was to require that nonpublic business entities apply the amendments in Update 2016-13 at the end of the same fiscal year as those public business entities that do not meet the definition of an SEC filer, thus providing additional time to implement the amendments in Update 2016-13 for interim periods. However, the Board understands that the amendments related to the transition and effective date in Update 2016-13 would be operably burdensome

for many nonpublic business entities and would not provide nonpublic business entities with additional time to implement the amendments in Update 2016-13, which was the Board's intent. Therefore, to mitigate transition complexity, the amendments in this proposed Update would align the implementation date of annual financial statements for nonpublic business entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, with the implementation date for their interim financial statements.

Amendments to Subtopic 326-10

5. Amend paragraph 326-10-65-1(a), as follows:

Financial Instruments—Credit Losses—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

326-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments:*

a. The pending content that links to this paragraph shall be effective as follows:
    1. For **public business entities** that meet the definition of a **Securities and Exchange Commission (SEC) filer**, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years
    2. For public business entities that do not meet the definition of an SEC filer, for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years
    3. For all other entities, including not-for-profit entities within the scope of Topic 958 and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, for fiscal years beginning after December 15, <u>2021</u> ~~2020~~, ~~and~~ <u>including</u> interim periods within <u>those</u> fiscal years~~ beginning after December 15, 2021~~.

Issue 2—Operating Lease Receivables

6. The Board provided a model in Subtopic 842-30, Leases—Lessor, in the amendments in Accounting Standards Update No. 2016-02, *Leases (Topic 842),*

to account for operating leases, including an assessment of the collectibility of operating lease payments and how to recognize lease income based on those payments. The Board did not intend to change lessor accounting for operating leases through the issuance of the amendments in Update 2016-13. The amendments to paragraph 326-20-15-3 clarify that a receivable arising from an operating lease that is accounted for by a lessor in accordance with paragraphs 842-30-25-10 through 25-14 is not within the scope of Subtopic 326-20.

Amendments to Subtopic 326-20

7. Amend paragraph 326-20-15-3, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Scope and Scope Exceptions

> Instruments

326-20-15-2 The guidance in this Subtopic applies to the following items:

a. Financial assets measured at amortized cost basis, including the following:
    1. **Financing receivables**
    2. Held-to-maturity **debt securities**
    3. Receivables that result from revenue transactions within the scope of Topic 605 on revenue recognition, Topic 606 on revenue from contracts with customers, and Topic 610 on other income
    4. **Reinsurance recoverables** that result from insurance transactions within the scope of Topic 944 on insurance
    5. Receivables that relate to repurchase agreements and securities lending agreements within the scope of Topic 860
b. Net investments in leases recognized by a lessor in accordance with Topic 842 on leases
c. Off-balance-sheet credit exposures not accounted for as insurance. Off-balance-sheet credit exposure refers to credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815 on derivatives and hedging.

326-20-15-3 The guidance in this Subtopic does not apply to the following items:

a. Financial assets measured at **fair value** through net income
b. Available-for-sale debt securities

c. **Loans** made to participants by defined contribution employee benefit plans
d. Policy loan receivables of an insurance entity
e. Promises to give (pledges receivable) of a not-for-profit entity
f. Loans and receivables between entities under common control.
g. Receivables arising from operating leases accounted for in accordance with paragraphs 842-30-25-10 through 25-14.

The amendments in this proposed Update were approved for publication 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 proposed 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 FASB issued Update 2016-13, 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 these assets. Through this Update, the Board added Topic 326 and made several consequential amendments to the Codification.

BC3. The Board has an ongoing project on its agenda for improving the Codification or correcting its unintended application. Those items generally are not expected to have a significant effect on current accounting practice or to create a significant administrative cost for most entities. The amendments in this proposed Update are of a similar nature to the items typically addressed in the project on Codification improvements. However, the Board decided to issue a separate proposed Update for Codification improvements related to Update 2016-13 to increase stakeholders' awareness of the proposed amendments to scope and transition and effective date requirements and to expedite the improvements.

BC4. The amendments in this proposed Update include items brought to the Board's attention by stakeholders. The proposed amendments would align the implementation date for nonpublic entities' annual financial statements with the implementation date for their interim financial statements, would clarify the scope of the guidance in the amendments in Update 2016-13, and would not change any of the principles in the guidance in the amendments in Update 2016-13. Therefore, the Board does not anticipate that entities would incur significant costs because of the proposed amendments. The amendments should provide the benefit of improving consistent application of GAAP by clarifying pending guidance within GAAP.

Issue 1—Transition and Effective Date for Nonpublic Business Entities

BC5. Paragraph 326-10-65-1 provides the following transition and effective date requirements for Update 2016-13:

a. For public business entities that meet the definition of an SEC filer, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years
b. For public business entities that do not meet the definition of an SEC filer, for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years
c. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.

BC6. Additionally, under paragraph 326-10-65-1(c), an entity should apply the amendments in Update 2016-13 by means of a cumulative-effect adjustment to the opening retained earnings as of the beginning of the first reporting period in which the amendments are effective.

BC7. Stakeholders asked whether the Board intended to require nonpublic business entities to adopt the amendments in Update 2016-13 as of the beginning of the first reporting period in which the amendments are effective by means of a cumulative-effect adjustment to opening retained earnings. Stakeholders noted that the transition and effective date guidance in Update 2016-13 effectively aligns the implementation date for both public business entities that do not meet the definition of an SEC filer and nonpublic business entities. However, stakeholders noted that nonpublic business entities expected additional implementation time when compared with both public business entities that meet the definition of an SEC filer and those public business entities that do not meet the definition of an SEC filer.

BC8. The Board's original intent was to require that nonpublic business entities apply the amendments in Update 2016-13 at the end of the same fiscal year as those public business entities that do not meet the definition of an SEC filer, thus providing additional time to implement the amendments in Update 2016-13 for interim periods. However, the Board understands that the amendments related to the transition and effective date in Update 2016-13 would be operably burdensome for many nonpublic business entities and would not provide nonpublic business entities with additional time to implement the amendments in Update 2016-13, which was the Board's intent. Therefore, to mitigate transition complexity, the proposed amendments in this Update would align the implementation date of annual financial statements for nonpublic business entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, with the implementation date for their interim financial statements. The Board understands that the requirement to apply the amendments by means of a cumulative-effect adjustment to the opening retained earnings as of the beginning of the first reporting period in which the amendments in Update 2016-13 are effective, which would be January 1, 2021, for calendar year-end nonpublic business entities, does not provide nonpublic business entities with the additional time needed to implement and adopt the amendments of Update 2016-13, which the Board originally intended when deliberating the transition and effective date for nonpublic business entities.

BC9. The amendments in this proposed Update would clarify that for nonpublic business entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965, the amendments of Update 2016-13 are effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. Nonpublic business entities would apply the amendments of Update 2016-13 by means of a cumulative-effect adjustment to the opening retained earnings as of the beginning of the first reporting period in which Update 2016-13 is effective.

Issue 2—Operating Lease Receivables

BC10. Paragraph 326-20-15-2 defines the scope of Subtopic 326-20, which includes financial assets measured at amortized cost basis, net investments in leases recognized by a lessor in accordance with Topic 842, and off-balance-sheet credit exposures not accounted for as insurance. That paragraph only addresses net investments in leases resulting from sales-type or direct financing leases recognized by a lessor and does not address receivables arising from operating leases recognized by a lessor in accordance with Topic 842. Paragraphs 842-30-25-10 through 25-14 provide a model for assessing the collectibility of operating lease payments and how to recognize lease income based on those payments.

BC11. Stakeholders asked whether operating lease receivables are within the scope of Subtopic 326-20 because they appear to meet the definition of a financing receivable, which is specifically referenced in paragraph 326-20-15-2 as a financial asset. Furthermore, if those receivables are within the scope, the stakeholders asked how an entity should apply both the guidance in Subtopic 326-20 and the guidance in Topic 842 about determining the collectibility of lease payments in an operating lease.

BC12. The Board noted that the guidance in Topic 842 provides an operational model for determining the collectibility of lease payments that is well understood by lessors. The Board did not intend to change lessor accounting for operating leases when it issued Update 2016-13. Therefore, the proposed amendment would clarify that receivables resulting from operating leases accounted for by lessors under Topic 842 are not within the scope of Subtopic 326-20.

Effective Date and Transition

BC13. The Board decided that the effective date and transition requirements for the amendments in this proposed Update would be the same as the effective date and transition requirements in Update 2016-13.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would not require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Any stakeholders who believe that improvements to the Taxonomy are required should provide their comments and suggested improvements through Proposed Taxonomy Improvements provided at www.fasb.org.