ASC 326: Credit losses—Abbreviated readiness checklist for nonlenders

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Introduction

When the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, it provided new guidance for the measurement of credit losses on available-for-sale (AFS) debt securities and financial assets that are measured at amortized cost. This guidance is included in the following subtopics of the FASB's Accounting Standards Codification (ASC):

- ASC 326-10, *Financial Instruments—Credit Losses – Overall*
- ASC 326-20, *Financial Instruments—Credit Losses – Measured at Amortized Cost*
- ASC 326-30, *Financial Instruments—Credit Losses – Available-for-Sale Debt Securities*

While this is arguably the most significant fundamental accounting change lenders have ever faced, the scope of this new guidance extends to assets that are routinely held by nonlenders, including cash equivalents, trade and other receivables, contract assets and debt securities. Substantially all assets within the scope of ASC 326-20 will have an allowance for credit losses. Two of the many ways in which ASC 326-20 differs from the preexisting guidance include:

- ASC 326-20 uses an expected loss model (which results in the recognition of an allowance for credit losses for losses that are expected to occur over the remaining life of a financial asset [e.g., trade accounts receivable]), rather than an incurred loss model (which results in the recognition of an allowance for credit losses based only on losses incurred as of the balance-sheet date).
- Under ASC 326-20, the risk of loss needs to be considered even if that risk of loss is remote, which typically results in day-one recognition of an allowance through credit loss expense for substantially all assets within its scope.

To assist nonlenders with their transition to ASC 326, we have prepared an abbreviated readiness checklist, starting on the next page. While this checklist will not alleviate the need to be familiar with the authoritative guidance, nonlenders may find it helpful as they prepare to transition to ASC 326 by the applicable effective date:

- *Public business entities that are Securities and Exchange Commission (SEC) filers, except for entities that are eligible to be smaller reporting companies (as defined by the SEC)*[1]. Fiscal

[1] An SEC filer's status as a smaller reporting company should be based on its most recent past smaller-reporting-company determination as of November 15, 2019 (which would be June 28, 2019 for an SEC filer with a calendar year end [the last business day of its most recent second quarter]).

years beginning after December 15, 2019, including interim periods within those years. As such, a calendar-year-end SEC filer that is not eligible to be a smaller reporting company must apply ASC 326 starting on January 1, 2020.

- *All other entities.* Fiscal years beginning after December 15, 2022, including interim periods within those years. As such, a calendar-year-end *other entity* must apply ASC 326 starting on January 1, 2023.

Early adoption of ASC 326 is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

Chapters 4 and 6 of our publication, A guide to accounting for investments, loans and other receivables (hereinafter referred to as our financial assets guide), provides detailed information and examples pertaining to ASC 326-20 and ASC 326-30, respectively.

Recognition and measurement of credit losses on financial assets measured at amortized cost and off-balance-sheet credit exposures (refer to Chapter 6 of our financial assets guide for additional information)		
Question	**Yes, No or N/A**	**Comments**
Was the population of instruments within the scope of ASC 326-20 appropriately identified (ASC 326-20-15)?		
Was the allowance for instruments within its scope estimated in accordance with the requirements of ASC 326-20, including (in part):		
• Expected recoveries are factored in (ASC 326-20-30-1)?		
• Credit losses on assets with similar risk characteristics are measured on a collective basis (ASC 326-20-30-2, 326-20-35-2 and 326-20-55-5)?		
• Methods selected are appropriately applied (ASC 326-20-30-3 to 30-5A)		
• Estimated expected credit losses over the contractual term of the asset are recognized (ASC 326-20-30-6)?		
• The estimate is based on relevant internal and (or) external information related to past events (e.g., historical loss information for assets with similar risk characteristics) and is adjusted for current conditions and reasonable and supportable forecasts (ASC 326-20-30-7 to 30-9 and 326-20-55-2 to 55-4)?		
• The estimate includes a measure of the expected risk of loss even if that risk is remote (ASC 326-20-30-10 and 326-20-55-48 to 55-50)?		
• Appropriate consideration is given to credit enhancements and collateral (ASC 326-20-30-10 and 30-12, 326-20-35-4 to 35-6 and 326-20-55-41 to 55-47)?		
• Estimation techniques and significant judgments made by management faithfully estimate collectibility in accordance		

Recognition and measurement of credit losses on financial assets measured at amortized cost and off-balance-sheet credit exposures (refer to Chapter 6 of our financial assets guide for additional information)		
Question	**Yes, No or N/A**	**Comments**
with the principles of the standard (ASC 326-20-55-6 to 55-7)?		
• The allowance for purchased financial assets with credit deterioration is appropriately recognized (ASC 326-20-30-13 to 30-15)?		
• The allowance for net investment in leases is appropriately recognized (ASC 326-20-55-8)?		

Recognition of credit losses on AFS debt securities (refer to Chapter 6 of our financial assets guide for additional information)		
Question	**Yes, No or N/A**	**Comments**
Was the process for evaluating impaired securities appropriately updated, given that an entity can no longer avoid recognizing credit losses by considering the length of time that the fair value of a security has been less than its amortized cost basis and should not consider the historical and implied volatility or recoveries or additional declines in the fair value after the balance-sheet date (ASC 326-30-55-1 and paragraph BC82 of ASU 2016-13)?		
Are expected credit losses and write-downs quantified and recognized in accordance with ASC 326-30-35?		

Overall		
Question	**Yes, No or N/A**	**Comments**
Is the company prepared to meet the disclosure requirements of ASC 326-20-50, 326-30-50 and 326-10-65?		
Is transition in accordance with ASC 326-10-65?		
Is the financial statement presentation in accordance with ASC 326-20-45 and 326-30-45?		
Is appropriate documentation of the processes, accounting elections and significant judgments made by management in place?		
Was the design and operating effectiveness of internal controls tested and remediation performed as necessary?		

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