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FASB FLASH REPORT

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FASB Issues Transition Relief for Credit Losses Standard

The FASB issued ASU 2019-05[1] to allow entities to irrevocably elect the fair value option for certain financial assets previously measured at amortized cost upon adoption of the new credit losses standard. The new ASU is available **here**, and the effective dates and transition align with those of ASU 2016-13.

BACKGROUND

In 2016, the FASB issued ASU 2016-13[2] ("credit losses standard"), requiring application of the expected credit losses methodology for the measurement of credit losses on financial assets measured at amortized cost basis. This methodology, generally referred to as CECL, replaces the previous incurred loss methodology. It also modifies 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.

The FASB received feedback that certain entities have elected or plan to elect the fair value option on newly originated or purchased financial assets, although similar financial assets have historically been measured at amortized cost basis. The CECL methodology does not apply to financial instruments for which changes in fair value are recorded in the income statement, therefore it would not be applied to financial assets to which an entity elects the fair value option. Because the fair value option can generally only be elected when the financial asset is first recorded, these entities noted that electing the fair value option would require them to maintain dual measurement methods for those instruments—fair value measurements for new instruments and amortized cost basis, along with application of CECL, for existing similar financial instruments.

1 Financial Instruments—Credit Losses (Topic 326), Targeted Transition Relief

2 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

MAIN PROVISIONS

ASU 2019-05 provides transition relief by providing entities with an alternative to irrevocably elect the fair value option for eligible financial assets measured at amortized cost upon adoption of the credit losses standard. To be eligible for the transition election, the existing financial asset must otherwise be both within the scope of the new credit losses standard and eligible for the applying the fair value option in ASC 825-10.[3] The election must be applied on an instrument-by-instrument basis and is not available for either available-for-sale or held-to-maturity debt securities.

EFFECTIVE DATE AND TRANSITION REQUIREMENTS

For entities that have not yet adopted ASU 2016-13, the effective dates and transition requirements are the same as those in ASU 2016-13.

For entities that have adopted ASU 2016-13, ASU 2019-05 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted once ASU 2016-13 has been adopted. For entities that elect the fair value option, the difference between the carrying amount and the fair value of the financial asset would be recognized through a cumulative-effect adjustment to opening retained earnings as of the date an entity adopted ASU 2016-13. Changes in fair value of that financial asset would subsequently be reported in current earnings.

3 Financial Instruments - Overall

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