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FASB Proposes Amendments to the Accounting for Purchased Financial Assets

Overview

On June 27, 2023, the FASB issued a [proposed ASU](#)¹ that would amend the guidance in [ASU 2016-13](#)² on the accounting upon acquisition for financial assets acquired in (1) a business combination, (2) an asset acquisition, or (3) the consolidation of a variable interest entity (VIE) that is not a business. Comments on the proposed ASU are due by August 28, 2023.

Background

In June 2016, the FASB issued ASU 2016-13, which requires entities to measure expected credit losses over the life of an asset upon origination or acquisition. ASU 2016-13 is aimed at reducing the complexity in U.S. GAAP of accounting for acquired assets with credit impairment. Specifically, under the ASU, the asset acquirer is required to differentiate between assets purchased with credit deterioration (PCD assets) and assets that are not purchased with credit deterioration (non-PCD assets). PCD assets are defined as assets with “more than insignificant” credit deterioration since origination.

Upon acquisition, a gross-up approach is currently used to account for the PCD assets. As a result, the expected credit losses are added to the asset’s purchase price to arrive at the amortized cost basis and no provision for credit loss expense is recognized upon acquisition. Non-PCD assets are accounted for similarly to originated assets upon acquisition. That is, expected credit losses are recorded through a provision for credit loss expense.

¹ FASB Proposed Accounting Standards Update (ASU), *Financial Instruments — Credit Losses (Topic 326): Purchased Financial Assets*.

² FASB Accounting Standards Update No. 2016-13, *Measurement of Credit Losses on Financial Instruments*.

As part of its postimplementation review process, the FASB received feedback suggesting that ASU 2016-13 creates additional complexities and reduces comparability by requiring entities to use two accounting models to differentiate between PCD assets and non-PCD assets.

In July 2021, the Board added to its technical agenda a project on improving the accounting for acquired financial assets within the scope of ASU 2016-13.

Main Provisions of the Proposed ASU

The proposed ASU would broaden the population of financial assets that are within the scope of the gross-up approach under ASC 326.³ Accordingly, an asset acquirer would apply the gross-up approach to all financial assets acquired in a business combination in accordance with ASC 805⁴ rather than first determining whether an acquired financial asset is a PCD asset or a non-PCD asset. For financial assets acquired as a result of an asset acquisition or through consolidation of a VIE that is not a business, the asset acquirer would apply the gross-up approach to seasoned assets, which are acquired assets unless the asset is deemed akin to an in-substance origination. A seasoned asset is an asset (1) that is acquired more than 90 days after origination and (2) for which the asset acquirer was not involved with the origination.



Connecting the Dots

Although the proposed ASU would expand the application of the gross-up approach, it would not amend the measurement, presentation, or disclosure requirements in ASU 2016-13. In addition, the gross-up approach would not apply to acquired available-for-sale debt securities.

Proposed Effective Date and Transition

Effective Date

The Board will determine the effective date, as well as whether to permit early adoption, after considering stakeholder feedback on the proposed ASU.

Transition

An entity would apply the proposed amendments on a modified retrospective basis, reflected as of the beginning of the fiscal year in which the entity adopted the amendments in ASU 2016-13. If necessary, a cumulative-effect adjustment “would be recorded as of the later of (1) the beginning of that reporting period and (2) the beginning of the earliest period presented” in which the entity adopted the amendments in ASU 2016-13.

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³ FASB Accounting Standards Codification (ASC) Topic 326, *Financial Instruments — Credit Losses*.

⁴ FASB Accounting Standards Codification Topic 805, *Business Combinations*.

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