FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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Project	**Transition Resource Group for Credit Losses**
Project Stage	**Post-Issuance**
Issue	**Recoveries**

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Memo Purpose

1. Stakeholders have informed the staff that there is diversity in views on whether future expected cash receipts from a financial asset that has been written off or may be written off in the future (expected recoveries) should be included in the calculation of pool-level expected credit losses under Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.

2. This memo summarizes the views and provides the staff's analysis of the issues. The staff will seek input from members of the Transition Resource Group for credit losses (TRG).

Question for TRG Members
1. Does the TRG have feedback on the staff's interpretations and recommendations on the issues in this memo?

Background and Description

3. Paragraph 326-20-30-1 of Subtopic 326-20, Financial Instruments--Credit Losses—Measured at Amortized Cost, defines the allowance for credit losses as a valuation account that is deducted from the amortized cost basis of financial asset(s) to present the net amount expected to be collected on the financial asset.

4. Additionally, paragraph 326-20-35-8 provides the following writeoff guidance:

> **326-20-35-8** Writeoffs of **financial assets**, which may be full or partial writeoffs, shall be deducted from the allowance. The writeoffs shall be recorded in the period in which the financial asset(s) are deemed uncollectible. Recoveries of financial assets and trade receivables previously written off shall be recorded when received.

5. Stakeholders have indicated to the staff through submission of an issues paper to the TRG (the submission) that paragraph 326-20-35-8 pertaining to recoveries "…creates a conflict with the presentation of the net amount expected to be collected on a pool of financial assets, and, therefore, this guidance should be eliminated or appropriately amended." The submission describes how the principle in paragraph 326-20-30-1 implies that recoveries of financial assets should be included in the net amount expected to be collected and therefore by extension be included in the allowance calculation. However, because paragraph 326-20-35-8 specifically states that recoveries on written off assets should be recorded when *received*, stakeholders disagree about whether it is appropriate or, if appropriate, whether it is required that an entity include estimates of expected future recoveries when measuring the expected credit loss for a financial asset or pool of financial assets.

6. The submission highlights the inherent differences between estimating credit losses using a collective versus individual analysis. The submission states:

> Estimates of expected credit losses using a collective versus individual assessment will vary significantly due to the risk diversification effect that is obtained when analyzing expected credit losses on a pool basis versus an individual basis. For example, assume 1,000 loans are originated. An individual analysis of each loan, at origination, would support an expectation of full repayment for each loan. However, when analyzed on a pool basis, collective historical data would support an expectation that some amount of the loans in the pool will not repay. Conversely, at a later date, an individual loan analysis may support a projection of no repayment while a collective analysis of a group of these same types of loans may support a projection of some repayment. In estimating expected credit losses of a pool, it is the collective data that best forecasts how the pool will be expected to perform; that is, the amount of timely payments, prepayments, late payments, probability of default, loss given default and modifications.

7. The submission asserts the difference in a collective versus individual analysis creates "…complications with the application of writeoff guidance." Specifically, the submission states:

> …the assessment of amounts "deemed uncollectible" will differ when a collective (pool) assessment is utilized versus an individual loan level assessment due to the determination of the collectability (or expected cash flows) of loans being significantly different when analyzing a pool of loans versus analyzing loans individually. Arguably, the recovery guidance in CECL was written in the context of individual loan

> level accounting which is in direct contradiction to the pool level measurement principle of CECL. As a result, a measurement inconsistency occurs due to the application of charge-off policies at the instrument level along with an allowance measurement performed on a collective (pool) basis, in accordance with ASC 326-20-30-2. This inconsistency will apply whether the allowance is based on cash flows expected to be collected, as described in ASC 326-20-30-4, or on amounts that are not expected to be collected, as described in ASC 326-20-30-5. Specifically, the current guidance can have the potential to distort an entity's financial position. For example, probable portfolio level cash flows meet the definition of an asset in CON 6 ("…probable future economic benefits…") and not recognizing these probable amounts as assets then distorts an entity's financial position.

8. The submission also highlights that this inconsistency is not a new problem, or said in a different way, this problem was not created by CECL. Specifically, the submission states:

> This inconsistency is not new. The guidance related to the recognition of recoveries in ASC 326-20-35-8, which was substantially carried forward from ASC 310, has created current diversity in practice related to the estimation of expected cash flows on a pool of loans. Currently, many entities will include all expected cash flows in their estimates of expected cash flows while other entities will exclude certain estimates of "recoveries" (or amounts in excess of amounts previously expected related to a charge-off)[1]. As we now have a new expected credit loss model that contemplates all expected cash flows and the recovery language has resulted in various interpretations, we believe it is appropriate to clarify the guidance. This will ensure the measurement principles of CECL are applied appropriately and consistently by all companies.

9. The submission asserts that "…the measurement of expected credit losses for a pool of loans should be based on all expected pool level cash flows that can be reasonably estimated to be consistent with paragraph 326-20-30-5. This would include cash flows expected to be received *prior to the time* an individual loan charge-off is recognized as well as changes in cash flows expected to be received *after that date* as none of those amounts would be deemed uncollectible at the pool level" (emphasis added).

10. The staff notes that although this issue does not appear to be new as noted in the submission, there appears to be general disagreement among stakeholders about how to implement the concept put forth in paragraph 9 above given the perceived conflicts in the literature as described in paragraphs 3 through 8 above.

11. The submission puts forth separate views for addressing recoveries:

    (a) **View A:** The amortized cost basis of a financial asset is the starting point to estimate the allowance for credit losses. Therefore, any cash flows related to loans that have been fully or partially charged off must be excluded from the pool level expected cash flows.

[1] Under current guidance, many industry participants consider the receipt of recoveries in the determination of the allowance for both fully and partially charged off loans based on the view that the guidance on the recognition of recoveries relates to the recognition of cash receipts at the instrument level (instrument-level measurement objective) and is separate from the measurement of the allowance that is assessed collectively.

(b) **View B:** The measurement of the allowance for credit losses for a pool of loans (which includes individual loans that have been charged off or down) should be based on a collective assessment of the cash flows expected to be collected from the pool, regardless of the charge-off status of each loan in the pool.

12. Proponents of View A stated that the amortized cost basis of the pool is equal to the sum of the individual loans that comprise the pool. Thus, any cash flows that exceed the amortized cost of an individual loan within the pool should be excluded when estimating the cash flows expected to be collected from the pool. Proponents of View B noted that all cash flows expected to be collected from a pool of loans should be included regardless of the amortized cost balance of each loan within the pool.

13. Moreover, proponents of View B argued that View B is consistent with paragraph 326-20-30-2, which states "an entity shall measure expected credit losses of financial assets on a collective (pool) basis when similar risk characteristic(s) exist (as described in paragraph 326-20-55-5)." Additionally, View B proponents highlight that paragraph 326-20-35-2 supports that a pool level measurement is required until such time that a loan is required to be evaluated individually and only if a loan is removed from the pool and not moved to another pool would the measurement convert to a loan-level assessment.

14. The submission provided an example to highlight the separate views. The example provided is as follows:

> To illustrate the difference in views, assume that an entity performs an individual assessment of a $1,000 specific loan and concludes that $400 is deemed uncollectible. If the loan was not part of a pool, the entity would charge off $400 resulting in the loan's amortized cost being adjusted to $600. Subsequent to the write-off and in accordance with ASC 326-20-30-1, an entity then determines that the remaining $600 is expected to be collected. If any portion of the $400 charged off was subsequently recovered, it would not be recognized until received in accordance with ASC 326-20-35-8.
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> On the other hand, assume that an entity has a pool of 100 loans each with a $1,000 par value. Also, assume each of ten loans within the pool have been charged down to $600 based on an individual analysis. The entity then performs a collective assessment of the pool and concludes that it expects to collect $70,000 from the pool of loans ($700 per loan on average). The difference between the $700 average collectible amount per loan and the $600 individual loan estimate is specifically due to the difference between performing a pool assessment versus an individual assessment. Importantly, the collection of the $70,000 is not pro rata or specific to an individual loan but a pool level expectation without specific amounts identified for each loan.
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> Under View B, the entity would report the pool of loans at an amortized cost basis of $96,000 ({90 x $1,000} + {10 x $600}) with an allowance for credit losses of $26,000 ($96,000 less $70,000).
>
> Under View A, the average collectability of each loan (i.e., $700) above the individual loan amortized cost (i.e., $600) would be excluded from the estimated cash flows

expected to be collected. As a result, under View A, the entity would also report the pool of loans at an amortized cost basis of $96,000; however, the allowance for credit losses would be $27,000, which is the $96,000 amortized cost less the amount estimated to be collected using View A of $69,000, ({90 x $700} + {10 x $600}).

15. Finally, the submission contained a recommendation for modifying the codification to clarify the treatment of estimating expected recoveries. That recommendation included the following alternatives:

    (a) **Alternative 1: 326-20-35-8** Writeoffs of financial assets, which may be full or partial writeoffs, shall be deducted from the allowance. The writeoffs shall be recorded in the period in which the financial asset(s) are deemed uncollectible. ~~Recoveries of financial assets and trade receivables previously written off shall be recorded when received.~~

    (b) **Alternative 2: 326-20-35-8** Writeoffs of financial assets, which may be full or partial writeoffs, shall be deducted from the allowance. The writeoffs shall be recorded in the period in which the financial asset(s) are deemed uncollectible. If the measurement of expected credit losses for a financial asset is being evaluated on an individual basis, recoveries of financial assets and trade receivables previously written off shall be recorded when received. If the measurement of expected credit losses for financial assets is being measured on a collective (pool) basis, as described in paragraph 326-20-30-2, the entity should include all expected cash flows from the pool of financial instruments. Specifically, when measuring the allowance for credit losses on a pool of financial assets, an entity's expected cash flows applicable to the pool include estimated recoveries of any amounts written off at an individual asset level.

16. In addition to reading the submission and conducting independent research, the staff conducted extensive outreach on this issue across a wide spectrum of entities that included small, medium, and large institutions as well as small and large accounting firms as noted in Memo 7, the cover memo that accompanied the TRG material. In addition, the staff held multiple meetings with individual Board members. While not specifically articulated in the submission, our research and outreach would indicate that there are three separate issues, as follows:

    (a) Issue 1: Can all expected recoveries on financial assets be included in the estimate of expected credit losses when assessing pools of financial assets?

    (b) Issue 2: Can all expected recoveries on financial assets be included in the estimate of expected credit losses when assessing individual financial assets?

(c) Issue 3: Additional Questions:

(i) Question 1: Should expected recoveries be included in the calculation of the allowance or directly write up the asset?

(ii) Question 2: Can the estimate of expected recoveries on financial assets exceed their amortized cost?

Issue 1: Can All Expected Recoveries on Financial Assets Be Included in the Estimate of Expected Credit Losses When Assessing Pools of Financial Assets?

Feedback and Outreach

17. In addition to the views expressed in the submission and noted above in paragraph 11, participants expanded upon their views during the staff's outreach.

18. Opponents of including expected future recoveries also argued that the concept of "expected future recoveries" should not exist. Instead, entities should only write off or partially write off assets when they do not have an expectation of future cash flows from those assets. These stakeholders argued that the guidance in paragraph 326-20-35-8 is clear that any subsequent unexpected cash flows on written off assets should be recorded when received. Despite not including expected recoveries, all expected cash flows on an asset would still be included in the calculation of the allowance.

19. Proponents of including expected future recoveries noted that those cash flows are a part of a financial asset's total expected cash flows, that is, the underlying amount used to calculate the expected credit losses. If expected recoveries are not included, an entity would not be presenting the net amount expected to be collected on the financial asset as required in paragraph 326-20-30-1. Additionally, the implementation guidance in paragraph 326-20-55-6(f) highlights that one of the judgments necessary in calculating current expected credit losses is how an entity chooses to adjust for recoveries, and that this implementation guidance reinforces the intent that the Board broadly expects recoveries to be a part of the credit loss calculation.

Staff Analysis

20. The analysis provided below assumes expected recoveries are estimated for a pool of financial assets and does not address how those assets should be pooled because that discussion is beyond the scope of this issue.

21. In response to the argument that expected future recoveries should not exist because entities should only write off or partially write off assets when they do not have an expectation of future cash flows from those assets, the staff notes that historical practice for writeoffs was retained in Update 2016-13. Paragraph BC73 discusses the reasons for this and states the following:

> BC73. The Board retained the requirements to write off assets if they are deemed uncollectible. The December 2012 Exposure Draft proposed that the assets be written off when there is no reasonable expectation of recovery. The Board received feedback that writing off an asset when there is no reasonable expectation of recovery could be considered to be a significant delay from the point when an asset is deemed uncollectible. *This concern was due in part to regulatory guidance that stated that the designation as an uncollectible asset does not mean that it has no recovery or salvage value. The Board did not intend to delay the point at which assets are written off and, therefore, decided to retain the requirement that assets are written off if they are deemed to be uncollectible.* [Emphasis added.]

22. This practice has largely been dictated by regulatory policy, which has specific rules for the timing and amount of writeoffs of different types of assets.[2] Therefore, while the notion that expected future recoveries should not exist may be conceptually appealing, the fact remains that recoveries do exist and will continue to do so. Moreover, absent regulatory guidance, an entity could determine that a financial asset should be written off under any threshold and the facts and circumstances could change indicating that a recovery exists. Therefore, the staff does not believe that the timing of the writeoff should matter.

23. More broadly, the staff notes that the Board contemplated recoveries as part of its redeliberations on the writeoff guidance now shown in paragraph 326-20-35-8.[3] In those discussions, Board members noted that the timing of an expected writeoff would have no effect on the allowance because the writeoff does not change the expected cash flows from the asset. For this to be true, an estimate of expected recoveries must be included in the estimate of expected credit losses. Board members also explicitly referenced an expectation that many entities may choose to use charge off data net of recoveries in the estimate of expected credit losses.

24. Additionally, there is no indication from the staff's research that the Board intended an entity to begin with individual financial assets and effectively "roll up" the amortized cost that would support a conclusion that appears to be the basis of View A in paragraph 11 above. In fact, the opposite is true and is expressed in paragraphs BC66 and BC69 of the basis for conclusions:

> BC66. The Board understands that many entities measure credit losses on financial assets measured at amortized cost by aggregating assets with similar risk characteristics. Therefore, the Board *anchored its analysis on the expected losses for groups of similar financial assets rather than a particular financial asset held by the entity*. [Emphasis added.]
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> BC69. The Board concluded that financial assets generally are priced assuming an estimated likelihood of credit losses on similar assets, although an entity initially expects to collect all of the contractual cash flows on each individual asset. Similarly, while an entity might not currently expect a loss on an individual asset, it ordinarily

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[2] Regulatory policy is primarily included in the Uniform Retail Credit Classification and Account Management Policy (originally published in the Federal Register on February 10, 1999, and revised June 12, 2000) and related Bulletins. Regulatory policy requires the full charge off at 180 days past due for consumer credit card loans and a charge down to collateral value within 60 days of notification of a bankruptcy filing for certain consumer loans regardless of historical payment performance.

[3] These redeliberations took place at the September 3, 2014 Board meeting.

> would expect some level of losses in a group of assets with similar risk characteristics. Therefore, an estimate of expected credit losses should reflect a *collective assessment* if similar risk characteristics exist for assets measured at amortized cost. Credit losses on those assets should be measured individually if similar risk characteristics do not exist for assets measured at amortized cost. [Emphasis added.]

25. Therefore, the staff believes the Board's intent is clear; expected recoveries on financial assets (that is, those that have not yet been received) should be estimated and included in the calculation of the allowance. This view aligns with the idea of capturing an asset's total expected cash flows in the allowance calculation to present the net amount expected to be collected as expressed in View B. Consequently, the staff believes that an entity should include an estimate of recoveries in its estimate of expected credit losses if that estimate is determined to be reasonable and supportable consistent with the treatment of other inputs to the calculation of expected credit losses.

26. Finally, the staff notes that some stakeholders have made a distinction between estimating expected recoveries for financial assets not written off and those that are fully or partially written off. In addition to the opposition over including all expected recoveries previously noted, the distinction primarily focuses on the concern that including expected recoveries for fully or partially written off financial assets results in the acceleration of what has been described as *contingent gains*.

27. The Mastery Glossary of the codification defines *contingency* as follows:

> An existing condition, situation, or set of circumstances involving uncertainty as to possible gain (gain contingency) or loss (loss contingency) to an entity that will ultimately be resolved when one or more future events occur or fail to occur.

28. The staff notes that the definition of contingency (whether a gain or a loss) is fundamentally based on the notion of a triggering event that will occur or fail to occur which has been removed under the current expected credit losses model for which the reasoning is best described in paragraph BC48 of the basis for conclusions, which states:

> The Board considered retaining an initial recognition threshold (such as probable) for recording credit losses. The Board concluded, however, that the model for recording credit losses should not be based on a notion of "incurred" losses because it would interfere with the timely *measurement of changes* in expected credit losses and the reporting of credit losses. Similarly, an entity should not automatically conclude that there are no expected credit losses simply because all of the amounts due have been received to date. [Emphasis added.]

29. While the highlighted paragraph is clearly discussing the removal of the loss contingency aspect of calculating credit losses, the staff believes this discussion is equally applicable to the gain contingency aspect of calculating credit losses; therefore, the staff does not believe there is a compelling reason for excluding an estimate of recoveries from the overall estimate of credit losses for fully or partially written off assets because the staff believes it would interfere with the timely *measurement of changes* in expected credit losses. Said another way, an entity should not automatically conclude that there are expected credit losses simply because the amounts expected

to be recovered have yet to be collected. Additionally, the concept of accelerating gains noted above is also applicable to financial assets that have not been written off, and yet the staff is not aware of concerns about excluding these amounts from the calculation. Rather, these amounts are assumed to be part of the expected cash flows of the financial assets under evaluation. Therefore, the staff can find no conceptual basis for distinguishing one from the other.

30. Beyond the conceptual reasonings discussed in paragraphs 27 through 29 above, the staff believes this also would add an element of complexity (that is, segregating recoveries between financial assets written off and those that are not) that is unwarranted. Consequently, the staff thinks this may have more to do with the presentation of the estimate of expected recoveries, which we discuss further below, than the inclusion of the recoveries in the estimate of credit losses.

Issue 2: Can All Expected Recoveries on Financial Assets Be Included in the Estimate of Expected Credit Losses When Assessing Individual Financial Assets?

31. Given that the issue of including expected recoveries is a high-level issue about the CECL model more generally, the staff believes that there should not be differences between pool-level and individual assessment. For the reasons the submission highlighted (shown in paragraph 7 above), individual assessment may yield different results than pool-level assessment, but the overall framework outlined by Topic 326 is the same. Therefore, the staff believes that expected recoveries on financial assets should be included in the calculation of the allowance regardless of the level of assessment for all the same reasons noted above.

Issue 3: Additional Questions

Background and Description

32. Because the staff is providing clarifications on the issues above, during outreach stakeholders noted that there could be potential additional questions for which the staff should provide additional clarity.

Question 1: Should expected recoveries be included in the calculation of the allowance or directly write up the financial asset at an individual asset level?

33. There are stakeholders that have expressed their concerns that including expected recoveries could be a significant change in practice and asked the staff to clarify the accounting treatment of estimates of expected recoveries.

34. While the staff acknowledges that this could change practice for some entities given the noted diversity in practice that exists today, the staff believes the principle is fundamentally the same as that expressed in paragraph 326-20-30-1. That is, the allowance for credit losses is a valuation

account that is deducted from the amortized cost basis of the financial asset(s) to present the net amount expected to be collected on the financial asset. The Board further explained this decision in paragraph BC42 of the basis for conclusions which states:

> The Board concluded that the amendments in this Update are more aligned with FASB Concepts Statement No. 6, *Elements of Financial Statements,* which states that "a separate item that reduces or increases the carrying amount of an asset is sometimes found in financial statements. For example, an estimate of uncollectible amounts reduces receivables to the amount expected to be collected...Those 'valuation accounts' are part of the related assets and are neither assets in their own right nor liabilities" (paragraph 34). The guidance in this Update relates to the measurement (rather than recognition of an asset or liability in its own right) on the basis that Concepts Statement 6 highlights that the valuation accounts are part of the related assets and liabilities.

35. The staff believes that 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 and not directly write up the asset. However, the staff is aware that there are situations in which the recovery could exceed the individual financial asset amortized cost balance and we believe that the Board did not intend to change practice in how entities operationally account for that situation (as discussed below).

Question 2: Can the estimate of expected recoveries on financial assets exceed their amortized cost?

36. Stakeholders have indicated that if an estimate of expected recoveries is included in the estimate of expected credit losses, this may result in assets with expected recoveries that are greater than their amortized cost, especially for unsecured financial assets and financial assets with lower credit quality. Some have highlighted the regulatory guidance highlighted in paragraph 22 as a cause of the issue. However, not all entities are subject to the regulatory guidance and, even without regulatory policy, expected recoveries could exceed an asset's amortized cost basis if economic conditions improved after a writeoff because presumably an entity would establish some threshold for writeoff as part of its process for evaluating when a financial asset is deemed uncollectible. Therefore, when expected recoveries on written off assets are included in the measurement of expected credit losses, the allowance could become negative, or have a debit balance, effectively (from a presentation perspective) writing the assets back up to the amount expected to be collected on the balance sheet when presented on a net basis combined with the amortized cost basis.

37. This debit-balance allowance phenomenon may be exacerbated by the amendments in Update 2016-13, which:

    (a) Broaden the cash flows an entity must consider in developing its estimate of credit losses (that is, reasonable and supportable forecasts)

(b) Require that an entity measure credit losses, and thus recoveries, on a collective (pool) basis when similar risk characteristic(s) are present.

Considering all expected cash flows and not just those that are incurred will increase the expected recoveries that are included in the allowance calculation, increasing the potential that recoveries could exceed an asset's amortized cost. Estimates of collectibility using a collective versus individual assessment could also vary significantly because of the risk diversification effect that is obtained when analyzing expected credit losses on a pool basis versus an individual basis. This difference also could increase the likelihood that recoveries exceed an asset's amortized cost.

38. The staff notes that stakeholders have acknowledged that this phenomenon also could exist under current GAAP, although there has historically been diversity in practice in this area. Many entities include recoveries when determining the allowance for both fully and partially written off loans based on the view that the guidance on the recognition of recoveries when received relates to the recognition of cash receipts at the instrument level (instrument-level measurement objective) and is separate from the measurement of the allowance, which is assessed collectively. This practice today could create a debit-balance in the allowance for credit losses, depending on how an entity pools and writes off financial assets.

Feedback from Outreach

39. In outreach discussions, many preparers reiterated that historical practice for writeoffs often results in assets with potentially significant recovery value, especially for unsecured products that are written down to zero amortized cost. Therefore, given that the Board did not intend to change historical practice on writeoffs, these preparers noted that the only way to properly reflect the expected value of the receivable is to recognize a debit-balance allowance, both on the pool and individual levels. However, some stakeholders are hesitant to recognize a debit-balance allowance, either because they believe it violates the principle in paragraph 326-20-30-1 that the allowance should be deducted from the amortized cost basis or because they are hesitant to, in effect, accelerate the recognition of contingent gains through the allowance.

40. Both preparers and auditors also noted that even if historical practice for writeoffs were changed to allow partial writeoffs and avoid this problem, there would still be significant operational challenges with (a) performing writeoffs at the pool level and (b) changing systems to calculate partial writeoffs. Often entities have numerous loan systems that would have to be adjusted, and some entities do not have direct control of the systems because they are licensed from third parties.

Staff Analysis

41. The staff understands many entities have historical practices in this area because this phenomenon occurs today and believes the Board's intent in this area has always been to avoid changing practice

for writeoffs as expressed in the excerpts from the basis for conclusions provided in paragraph 21 above. Moreover, the staff believes that current practices do not violate the concepts in Topic 326 but rather are an operational outcome of the overall model for calculating expected credit losses. However, in keeping with the current expected credit losses model, an entity's forecasts of recoveries should be reasonable and supportable consistent with all other inputs to the calculation and that the overall estimate for credit losses (which includes recoveries as an input) should be supported.

Staff Overall Recommendations

Issues 1 and 2

42. The staff believes the Board's intent is clear with respect to expected recoveries and that expected recoveries should be included in the estimate of expected credit losses for groups of financial assets collectively evaluated or individual financial assets individually evaluated similar to other cash flows. Additionally, the staff believes that a distinction should not be made between financial assets not yet written off and those fully or partially written off.

43. However, because stakeholders have indicated that the intent for how to account for expected recoveries in the estimate of credit losses as currently written in paragraph 326-20-35-8 is unclear, the staff acknowledges clarifying the Board's intent will require amendments to the Codification. The staff believes these changes can be accomplished as part of a Codification improvements project focused on financial instruments in the near term.

Issue 3

44. Regarding Question 1 about how to treat expected recoveries overall (that is, as part of the allowance for credit losses or a direct writeup of assets), the staff believes the guidance and the Board's intent is clear and that expected recoveries should be included as part of the allowance for credit losses and not as a direct writeup of the financial assets under evaluation acknowledging that there are specific instances in which expected recoveries may be presented as a debit balance because the underlying financial assets have been written off and the expected recoveries exceed the amortized costs of the financial assets. The staff recommends no further work on this question.

45. Regarding Question 2 about how an entity should recognize expected recoveries on written off financial assets when the recovery exceeds the amortized cost basis of financial assets thereby resulting in a debit balance for those financial assets, the staff believes many entities have historical practices to deal with this situation because this phenomenon occurs today, and the Board's intent has always been to avoid changing practice for writeoffs. The staff believes these are operational issues that are best handled by individual institutions. However, the staff believes that current

practices do not violate the concepts in Topic 326. The staff recommends no further work on this question.

Appendix A—Relevant Literature

326-20-35-8 Writeoffs of **financial assets**, which may be full or partial writeoffs, shall be deducted from the allowance. The writeoffs shall be recorded in the period in which the financial asset(s) are deemed uncollectible. Recoveries of financial assets and trade receivables previously written off shall be recorded when received.

BC66. The Board understands that many entities measure credit losses on financial assets measured at amortized cost by aggregating assets with similar risk characteristics. Therefore, the Board anchored its analysis on the expected losses for groups of similar financial assets rather than a particular financial asset held by the entity.

BC69. The Board concluded that financial assets generally are priced assuming an estimated likelihood of credit losses on similar assets, although an entity initially expects to collect all of the contractual cash flows on each individual asset. Similarly, while an entity might not currently expect a loss on an individual asset, it ordinarily would expect some level of losses in a group of assets with similar risk characteristics. Therefore, an estimate of expected credit losses should reflect a collective assessment if similar risk characteristics exist for assets measured at amortized cost. Credit losses on those assets should be measured individually if similar risk characteristics do not exist for assets measured at amortized cost.

BC73. The Board retained the requirements to write off assets if they are deemed uncollectible. The December 2012 Exposure Draft proposed that the assets be written off when there is no reasonable expectation of recovery. The Board received feedback that writing off an asset when there is no reasonable expectation of recovery could be considered to be a significant delay from the point when an asset is deemed uncollectible. This concern was due in part to regulatory guidance that stated that the designation as an uncollectible asset does not mean that it has no recovery or salvage value. The Board did not intend to delay the point at which assets are written off and, therefore, decided to retain the requirement that assets are written off if they are deemed to be uncollectible.