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Accounting Journal Entry

Financial Instruments — FASB Makes Tentative Decisions About Purchased Credit-Impaired Assets

April 23, 2015 — At its meeting yesterday, the FASB discussed (1) the definition of a purchased credit-impaired (PCI) asset and (2) assets acquired in a business combination. Specifically, the Board tentatively decided to revise the definition of a PCI asset[1] such that an entity would be required to apply the gross-up approach[2] to an asset for which there has been a "more than insignificant" deterioration in credit quality since origination. In addition, the Board reaffirmed the proposed ASU's[3] requirement under which an entity would use the gross-up approach to account for PCI assets acquired in a business combination.

Editor's Note: The Board chose to revise the definition of a PCI asset partially in response to continued stakeholder feedback suggesting that if an entity were to recognize expected credit losses in its income statement upon purchase of any asset, regardless of the level of credit deterioration in the asset's credit quality since origination, the entity would be "double-counting" expected credit losses on that asset because those losses were already contemplated in the purchase price. Although the Board decided not to require an entity to apply the gross-up approach to all acquired assets, stakeholders are likely to support the change to the definition of a PCI asset because an entity is likely to apply the gross-up approach to more assets than it would have under the proposed ASU's requirements. The Board also indicated at the meeting that the final standard will include implementation guidance to help entities assess whether there has been a "more than insignificant" deterioration in a purchased asset's credit quality since origination.

The Board tentatively decided to require an entity to apply the gross-up approach to assets acquired in a business combination that are determined to be PCI assets because the Board believes that in the measurement of expected credit losses, there is no inherent difference between PCI assets acquired in a business combination and those acquired outside of one. Consequently, an entity would continue to account for non-PCI assets acquired in a business combination in accordance with existing U.S. GAAP. That is, for non-PCI assets acquired in a business combination, an entity would measure the assets at fair value upon acquisition and would be prohibited from recognizing a separate valuation allowance for those assets.

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1 The proposed ASU defines PCI assets as "[a]cquired individual assets (or acquired groups of financial assets with shared risk characteristics at the date of acquisition) that have experienced a significant deterioration in credit quality since origination."

2 Under the gross-up approach, an entity would recognize its initial expectation of credit losses on PCI assets as an allowance for expected credit losses with an adjustment that increases the cost basis of the asset. As a result of applying this approach, the entity avoids immediately recognizing expected credit losses in its income statement upon acquiring the asset. For more information about the gross-up approach, see Deloitte's March 13, 2015, *Heads Up*.

3 FASB Proposed Accounting Standards Update, *Financial Instruments — Credit Losses*.

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